H1 2021

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We are on the bumpy path to normal

Kevin Quinn, Chief Investment Strategist

H1 delivers a bumper set of returns...

The first half of 2021 saw investors in risk assets richly rewarded (see Figure 1). Equity markets have driven returns for most investors with excellent performance, well ahead of our expectations at the start of the year. The strong gains overshadowed losses from most parts of the bond market, which would otherwise have presented a challenge to low-risk investment funds.

There were six primary drivers behind the gains this year so far:

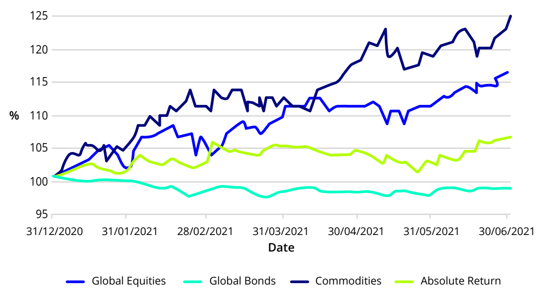
- Continued support from global Central Banks
- A series of announcements of government spending (especially from the new Biden administration)
- The roll-out of vaccinations to a quarter of the world population
- Re-openings of the world economy
- A significant acceleration in economic growth, and
- Exceptional earnings growth in Q1

Commodity markets have also been exceptionally strong so far this year. While perhaps less directly impactful for most of our funds, there are indirect impacts for many of the companies in sectors like energy and transport and obviously commodities are central to the supply challenges and possible price increases that the world faces right now.

Of course it hasn't all been good news. We have seen the devastating impact of Covid-19 in less developed countries such as India, the emergence of the Delta variant and a further rise in infections. For markets, there has been a growing concern that inflation would result as the world economy recovers and perhaps overheat. Indeed the losses suffered by bond investors so far this year had a lot to do with longer-term interest rates moving up in response to both the scale of recovery and anticipated rise in inflation.

Kevin Quinn,
Chief Investment Strategist, Investment Markets

Figure 1: Returns from major asset classes H1 2021



2021 performances (to 30/06/2021)

Global equities	+15.9%
Global bonds	-2.2%
Commodities	+25.0%
Absolute return	+5.4%

Source: Bloomberg 01/07/2021

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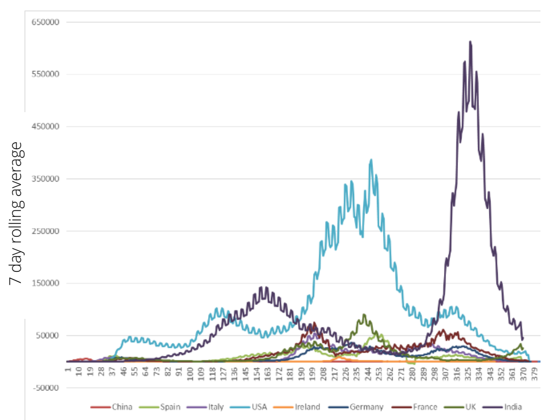
Outlook for H2 ...a series of peaks on the way

As the world heads closer towards normality, we will pass through a series of 'peak' events, as markets start to think about what a more normal post-pandemic world may look like.

Peak Covid-19?

At time of writing over 3.3 billion doses of Covid-19 vaccine had been administered and a quarter of the world's population had been reached[1]. We may have seen the peak in the scale of infections, but the slower pace of vaccination in developing economies leaves space for further variants to emerge. We have already seen how dangerous the Delta variant is proving. Indeed in the final weeks of June, infection levels in developed economies had begun to increase again given its increased infectiousness (see Figure 2). However the economic impact is unlikely to be as substantive as previous waves.

Figure 2; 7 day rolling average infections across major countries



Source: Bloomberg/Bank of Ireland Investment Markets 01/07/2021

With pharmaceutical manufacturers on track to produce 10 billion doses of the various vaccines[2], it seems highly probable that there will be sufficient supply to protect all vulnerable or at-risk groups both in the developed and developing world.

Peak inflation?

Markets' attention has shifted from the pandemic as the top risk, to the consequence of all the policy actions, namely inflation. This has become important as it will be a key determinant of when Central Banks start to increase interest rates.

Most particularly in the US, inflation expectations changed significantly in early 2021 and inflation numbers in the last couple of months have been higher than expected, with a 5% number in June in the US[3]. While there are a lot of reasons to worry that inflation may yet rise further, inflation expectations look like they saw a near term peak in May this year. The medium-term outlook is for inflation to remain elevated this year but to fall back close to where central banks are targeting in the following years.

Peak growth?

Economic growth expectations in the large developed economies have been improving throughout the first half of 2021.

The Organisation for Economic Co-operation & Development at the end of May forecast that growth would reach 5.8% globally for 2021. For the US latest estimates from the Federal Reserve are pointing to 7% growth for the year[4]. In China that figure is 8.5% and for the EU growth is estimated at 4.6%[5]. Obviously much of this reflects the bounce back from the depressed levels of last year. The US and UK in particular have seen significant increases in growth expectations for the full year, reflecting their earlier re-openings. European expectations have contracted slightly reflecting the longer lockdown experience.

As the world normalises, the mini-boom we experience will be looked back upon as the peak of growth.

1 Source: Ourworldindata.org 05/07/2021
2 Source: Global Health Innovation Centre Duke University June 2021
3 Source: Bloomberg 10th June 2021. Consensus estimates were for 4.7%.
4 Source: US Federal Reserve 16 June 2021
5 Source: Bloomberg 05/07/2021

WARNING: These figures are estimates only. They are not a reliable guide to the future performance of your investment

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Outlook for H2 .... a series of peaks on the way (Cont'd)

Peak liquidity?

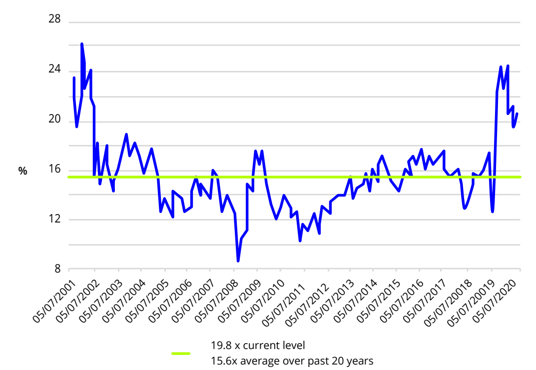
One of the drivers of markets during the worst of the Covid-19 pandemic was the scale of cash that was pumped into the global economy by Central Banks. As one might expect as the recession recedes and economies reopen, Central Banks are slowing the growth in this support. A bit like a patient coming off their medication, the pace of cash being pumped into the economy will reach a more normalised growth level in the coming year. In turn, further economic growth will become more self-sustaining.

Peak earnings & valuations?

Company earnings reported for Q1 2021 were dramatically higher than anticipated across the world, with global earnings per share 23% ahead of analyst expectations[6], and three quarters of companies beating estimates.

Furthermore, expectations for earnings growth for the rest of 2021 remain strong and valuations, while still elevated, have fallen back closer to long term averages. In other words, while share prices have risen, the price investors pay for each Euro of earnings fell, which is a welcome development. We can see this in the Global Forward/Price earnings chart (Figure 3) for global equities. Please see Summary Outlook on next page.

Figure 3: Global Forward Price/Earnings ratio



Source: Bloomberg 05/07/2021

[6] Source: Bloomberg 05/07/2021

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Outlook for H2 .... a series of peaks on the way (Cont'd)

Summary outlook

- Values of assets such as equities and commodities have increased significantly in the first half of 2021 in response to ongoing Central Bank support, fiscal policy stimuli, stronger than anticipated growth in economies that have re-opened and broadly successful roll-out of vaccination programmes in developed economies.
- Assets such as bonds, have been impacted by increased fears of inflation and rising longer term rates in recent months. There remains a period of adjustment here once the economy normalises, so we can expect to see very little from the bond market or cash for some time to come.
- Covid-19 may be resurgent in the form of the Delta variant and while more virulent it may prove less costly in lives lost given the scale of vaccination already completed. With vast supplies of vaccine coming on stream, the virus will hopefully be in full retreat later this year.
- With stronger than expected economic growth, and supply chains strained to meet demand, fears of inflation have become elevated and it does seem likely that we will see more of this in the second half of 2021. However it also seems likely to prove at least somewhat short-lived and we'd expect to it back down to less worrying levels by next year.

For the rest of this year, our view is that risk assets (such as equities) can continue to make gains, although at a slower pace than in H1 2021. The scale of economic recovery will continue to deliver strong earnings growth and as long as Central Banks don't reverse their current policy settings at a far quicker pace than expected, equity markets should continue to deliver positive gains.

The gradual withdrawal of Central Bank bond purchase programmes and eventual removal of some of the pandemic programmes will start to become very real in 2022 and beyond.

Next year and beyond continued market expansion depends on the global economy getting back to strong organic economic growth, with reduced dependency on support measures from authorities.

For more information:

fundcentre.bankofireland.com

boi.com/marketwatchupdates

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Appendix 1: Index returns for past 5 years

	2016	2017	2018	2019	2020
Globalequities	11.09%	8.89%	-5.50%	28.93%	6.65%
Global bonds	2.39%	0.99%	-1.19%	5.35%	4.91%
Cash	0.54%	0.38%	0.33%	0.28%	0.22%
Property	7.90%	8.30%	7.50%	3.20%	-1.80%
Hedge funds (shown as Absolute Return in figure 1)	3.34%	-9.30%	4.30%	6.44%	-5.65%
MSCI Global value	16.70%	3.51%	-5.59%	25.23%	-8.44%
MSCI Global growth	6.34%	12.74%	-1.75%	36.83%	23.26%
S&P 500	15.35%	6.88%	0.37%	34.10%	8.75%
MSCI Europe	3.18%	10.80%	-10.08%	26.82%	-2.77%
MSCI Japan	7.20%	9.21%	-8.78%	22.47%	8.22%
MSCI Emerging markets	18.55%	20.88%	-10.22%	21.39%	5.79%
Bloomberg Crypto index	n/a	558.30%	-80.20%	9.20%	246.01%
Bloomberg Commodity index	14.77%	-11.61%	-8.66%	7.53%	-11.36%

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WARNING: The value of your investment may go down as well as up.

WARNING: If you invest in these funds you may lose some or all of your investment.

WARNING: These funds may be affected by changes in currency exchange rates.

July 2021

Bank of Ireland