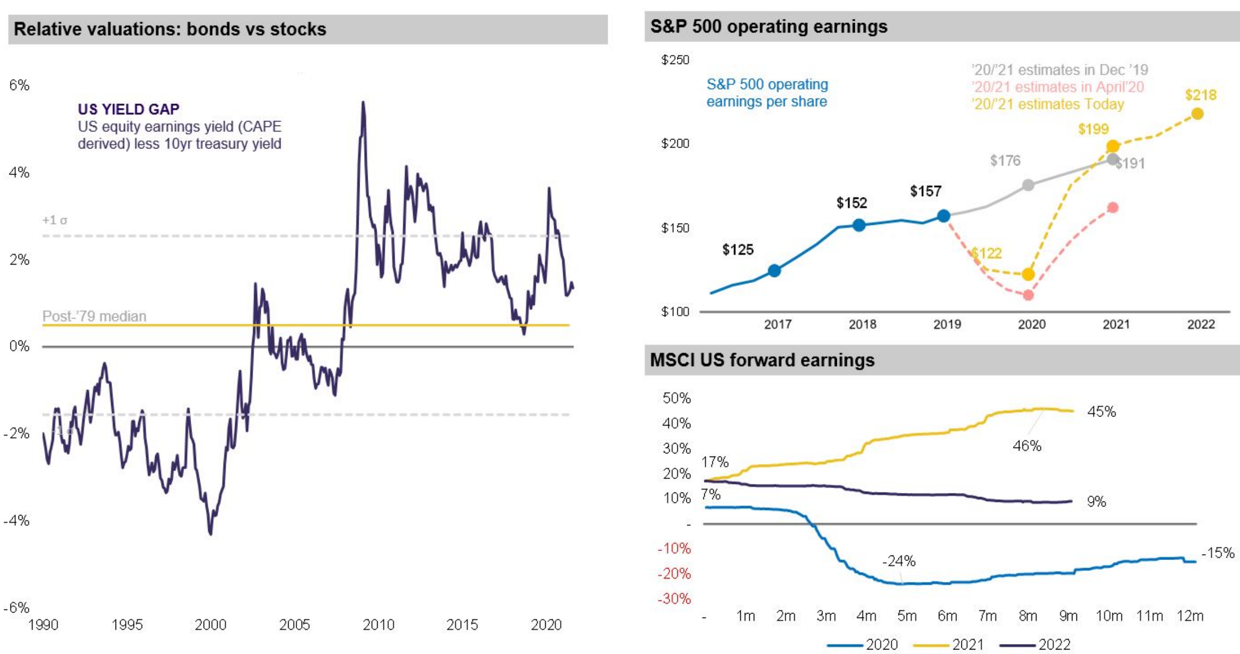
Market Review

September 2021

The case for equities continues be generally favorable from both a relative value and earnings perspective despite high absolute valuation levels across most indexes. Versus bonds, equities are still attractive given the low interest regime of the last decade (**Chart 1**). Earnings estimates have recovered relative to April 2020 with 2021 estimates for the S&P 500® Index already at post COVID-19 levels (**Charts 2, 3**). 2022 earnings growth is expected to show high single digit gains. This combination of healthy forward earnings, even if not at the recovery rates experienced during 2021, and attractive valuation levels versus other asset classes is positive. However, investors are also digesting the potential impacts of higher inflation to growth and profits, as well as the change in Fed policy. These elements have caused a lot of volatility in leadership over the last 12 months between cyclical and growth stocks.

Charts 1, 2, 3: Valuation and Earnings (a positive backdrop for equities)



Source: Rothschild & Co, Bloomberg

Corresponding to the earnings recovery of the past year, economic indicators such as the PMI continue to stay at record-high levels for both the US and most developed economies around the world (**Chart 5**). Early cycle sectors have performed well in light the improving economic picture. Over the past year, Industrials, Energy, Financials and segments of Consumer have all seen a sharp performance recovery. Although of note, is that the rate of growth is expected to moderate (**Chart 4**). Yet if the actual indicators remain in expansionary mode, the environment should remain supportive. Thus far, no alarming dips have been experienced, even with the COVID-19

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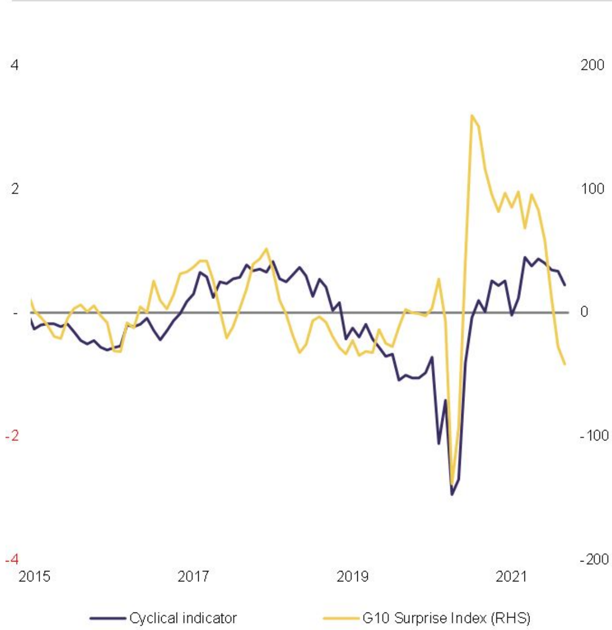
Delta variant disruptions. Supply chain troubles, however, have led to some unmet demand and higher prices. Should they continue or worsen, growth could be more meaningfully compromised. In fact, September saw several US retailers and consumer product companies lower earning guidance due to these bottleneck issues.

Charts 4, 5: Economic Activity (positive but normalizing)

Composite cyclical indicator (z score) and G10 surprise index



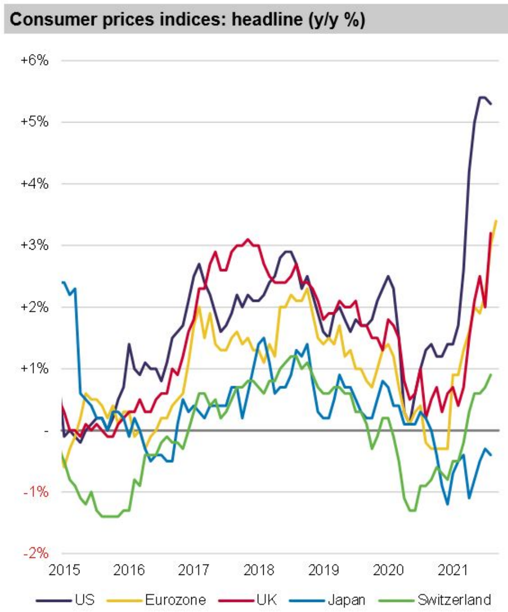
PMI heatmap: manufacturing and services

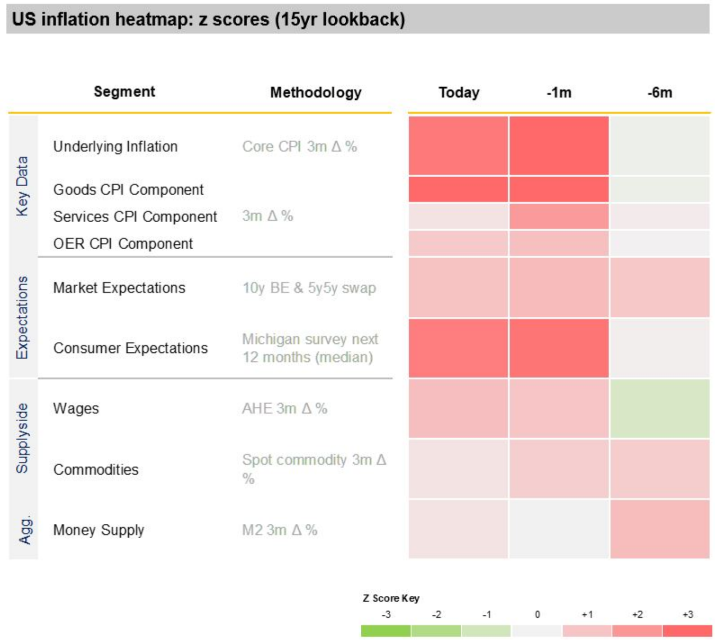
	2020												2021								
	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9
MANUFACTURING																					
US	52	51	49	36	40	50	51	53	53	53	57	57	59	59	59	61	62	62	63	61	61
UK	50	52	48	33	41	50	53	55	54	54	56	58	54	55	59	61	66	64	60	60	56
Eurozone	48	49	45	33	39	47	52	52	54	55	54	55	55	58	63	63	63	63	63	61	59
France	51	50	43	32	41	52	52	50	51	51	50	51	52	56	59	59	59	59	58	58	55
Germany	45	48	45	35	37	45	51	52	56	58	58	58	57	61	67	66	64	65	66	63	59
Australia	50	50	50	44	44	51	54	54	55	54	56	56	57	57	57	60	60	59	57	52	57
Japan	49	48	45	42	38	40	45	47	48	49	49	50	50	51	53	54	53	52	53	53	51
China	51	40	50	49	51	51	53	53	53	54	55	53	52	51	51	52	52	51	50	49	50
SERVICES																					
US	53	49	40	27	38	48	50	55	55	57	58	55	58	60	60	65	70	65	60	55	54
UK	54	53	35	13	29	47	57	59	56	51	48	49	40	50	56	61	63	62	60	55	55
Eurozone	53	53	26	12	31	48	55	51	48	47	42	46	45	46	50	51	55	58	60	59	56
France	51	53	27	10	31	51	57	52	48	47	39	49	47	46	48	50	57	58	57	56	56
Germany	54	53	32	16	33	47	56	53	51	50	46	47	47	46	52	50	53	58	62	61	56
Australia	51	49	39	20	27	53	58	49	51	54	55	57	56	53	56	59	58	57	44	43	45
Japan	51	47	34	22	27	45	45	45	47	48	48	48	46	46	48	50	47	48	47	43	47
China	52	27	43	44	55	58	54	54	55	57	58	56	52	52	54	56	55	50	55	47	

Source: Rothschild & Co, Bloomberg, Citi, Markit

Along with economic indicators, the inflation picture and yield curve have played an important and influential role not just on the direction of equity markets, but also on actual market leadership. Inflation has been running hot in the US (**Chart 6**). Supply chain bottlenecks are largely responsible for the surge in prices for many goods and services. In addition, wages have also moved higher, which could have a more lasting impact on corporate profitability. Fortunately, the latest data points have seen inflation numbers start to slightly ease. The ultimate direction of inflation will be critical as it also sets the tone for Federal policy going forward. Some inflation will be tolerated, especially if it helps growth. Too much inflation will prove damaging to both profit margins, economic growth and the speed with which the Fed will look to both reign in Quantitative Easing and start increasing rates. Therefore, we continue to monitor inflation levels, along with other economic indicators, to see if it should prove to be more than transitory in nature.

Charts 6, 7: Inflation (trending higher and something to watch)

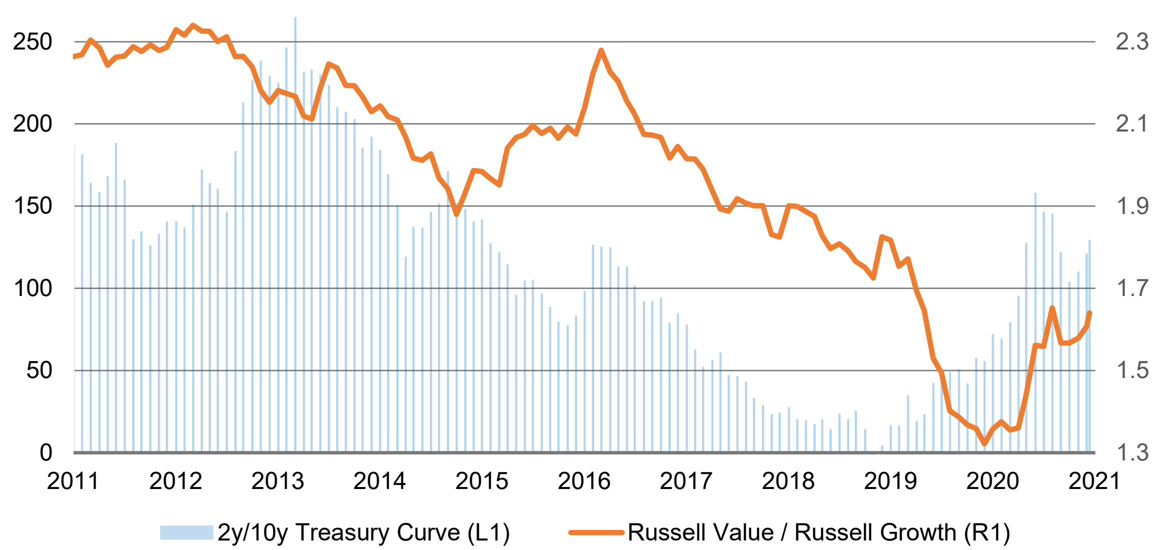




Source: Rothschild & Co, Bloomberg

Despite some near-term divergence in the market cap spectrum with respect to growth and value, there continues to be a lot of volatility around style leadership. As a result, equity investors are watching the yield curve given its tight relationship to market leadership (**Chart 8**).

Chart 8: Treasury Yield vs. Russell 1000 Value / Growth Performance (a steepening curve supports outperformance of value stocks)



Source: Bloomberg

Should yields continue to inch higher into year end and into 2022, “Value” stocks could see a more productive backdrop as long duration growth becomes more expensive. Conversely, should yields retreat and growth slow, long duration growth could continue to outperform. With a level of uncertainty ahead surrounding leadership, we are looking to achieve a level of balance across our equity strategies. We are, therefore, exposed to both attractively priced cyclical companies with idiosyncratic appeal along with secular growers with long-term staying power.

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