Market Strategy Outlook

‘Fight not flight’ after January pullback

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February 07, 2022
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Summary: ‘fight not flight’ after January pullback

Reasons to look through the January ‘stress-test’

- Fed interest rates risks well-priced. Consensus 5 hikes this year
- Earnings growth remains strong. Q4 5pp ‘beats’
- Valuations 10% cheaper now, and well-supported
- Sharp fall in investor sentiment a big contrarian positive
- It pays to buy corrections outside of recessions. Risk there is low

Focus on diversification, Value, International and Commodities, Crypto

- Outlook of strong 2022e growth (US GDP +3.8%), low but still high inflation (4%). Also US interest rate increases (4-5x) and 10-yr bond yield (c2%).
- Favors reflation assets: cheap cycicals (financials, commodities) and international markets. Plus commodities and crypto
- Cautious on fixed income, USD, and ‘bond proxy’ defensives

We also look at….

- Europe’s luxury ‘all-weather’ sector a rare stand out
- Commodities the only asset class up this year. More to come
- 12-country global retail investor ‘beat’ survey

| Overview | Still strong growth, sticky inflation, and increasingly well-priced rate idea favors reflation assets: cyclical and international equities, commodities, crypto. Caution fixed income, USD, defensive ‘bond proxy’ equities.
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<td>United States</td>
<td>Continued earnings surprise to offset high valuations. Cyclical to rebound, but large Tech sector well-supported.</td>
<td>Tech (IT, CD, CO)</td>
<td>Structural stories with good growth, high profitability, and fortress balance sheets that justify high valuations.</td>
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<td>Europe &amp; UK</td>
<td>Cheaper valuations and cyclical indices to drive outperformance as 2022 re-opening rebound set to continue.</td>
<td>Defensives (HC, C, S, UT, RE)</td>
<td>To underperform with low sensitivity to strong growth recovery and large exposure to higher bond yields.</td>
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<td>Emerging Markets (EM)</td>
<td>China stars re-aligning. Cutting rates, Stability focus, cheap valuations, out-of-favor. Helps EM, materials, luxury.</td>
<td>Cycicals (CD, IL, EN, MT)</td>
<td>Benefit most from GDP rebound and higher yields, with depressed earnings, cheaper valuations, out-of-favor</td>
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<td>Other (JP, RUS, CN)</td>
<td>Canada and Australia benefit from commodity and financials focus. Japan a value-trap lagged as growth struggles.</td>
<td>Financials (FN)</td>
<td>Biggest beneficiary of higher bond yield view, and 2nd cheapest sector. Assumed big dividends and buybacks.</td>
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<td>Themes</td>
<td>Value to lead on GDP recovery exposure, lower valuations, out-underweight, ESG and renewables accelerating.</td>
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<td>Traffic lights*</td>
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<td>Currencies</td>
<td>USD hawkish Fed support well priced. Possible tailwind EM, Commodities, overseas US sectors, headwind for EU.</td>
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<td>Fixed Income</td>
<td>Modestly higher US bond yields (lower prices) as Fed moves to tighten policy. Structural headwinds prevent more.</td>
<td>Commodities</td>
<td>Long term supply/demand sweet spot and China policy action. Plus sticky inflation and stabilizing USD</td>
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<td>Crypto</td>
<td>Strong risk-adjusted returns and low asset correlation drives institutional adoption. Seen 10th average correlation</td>
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*Methodology: Our guide to where we see better risk-adjusted outlook. Not investment advice.
- Positive: Overall positive view, and expected to outperform the asset class on a 12-month view.
- Neutral: Overall neutral view, with elements of strength and weakness on a 12-month view.
- Cautious: Overall cautious view, and expected to underperform the asset class on a 12-month view.


Past performance is not an indication of future results.
Markets recovering from ‘triple whammy’ of Fed, earnings, Russia

- EM and Europe, and Energy and Financials leading global performance divergence. Tech and US leading declines this year
- Remain positive, with clear double-digit upside to our 5,050 S&P 500 index target for end 2022 after January pullback

A weak January does not make the year

- The saying goes that ‘as goes January, so goes the year’. This was popularized by Yale Hirsh, the creator of the Stock Trader Almanac way back in 1972.
- But a down January only equals a down year one-third of the time: 4 of the 13 times in the last fifty years. See the 2009 and 2019 rebounds from weak starts.
- The reality is big sell-offs can happen any time (see chart).

We are still bullish a rare fourth year of strong equity returns.

- Earnings outlook under-appreciated. Valuations supported.
- Focus is cheaper and faster growing cyclicals. Also big tech

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Corrections happen, and should normally be bought

- S&P 500 corrections are rare, with only 25 the past 40 years, clustered around crises (see chart). They average a -16% fall over seven weeks and it pays to buy them, with markets typically higher on a 12-month view.
- The key is avoiding ‘crashes’, which are much fewer (tech bubble, global financial crisis), but deeper and longer lasting. It always pays to be diversified, with a 16pp gap between best (utilities) and worst (tech) sectors.

...unless a recession is coming. Check the US yield-curve

- An inverted US yield curve, with 3-month bond yields above 10-year yields has predicted ten of the last nine US recessions (see chart). This is the best hit rate around.
- The Fed pushes up short term bond yields as it hikes interest rates, but the market often pulls down long term yields as it worries on the economic growth outlook.
- We are well off these levels, with the Fed indicator putting recession risks the next year at a low 15%.
Macro: Fed well-priced, and geopolitics a distraction

Risk/reward shifted and markets have priced in a lot

- Investors near capitulation on Fed (see chart). Futures are pricing five 25 bps interest rate hikes this year, and some banks seven.
- Fed to also start to shrink – not just end expansion – of $9 trn balance sheet later this year (would raise 10-year bond yields)
- Such a tightening combo is unprecedented, but they partly offset. The more of one the less other is needed. Also watch financial conditions indices. More they tighten now the less Fed needs to.

Geopolitics has little lasting market impact..with some exceptions

- Russia-Ukraine tensions stoked geopolitical concerns and added to risk-off tone in global markets. These should not be overdone.
- Geopolitical risk (see chart) is low, relative to 2000's Iraq War and 9/11 attacks. History shows limited long lasting global impacts.
- But it's worse the closer you are. Russia (RSX) worst performing market this year. Shows even world's cheapest market can get cheaper. Could worsen Europe's (EZU) energy crisis, and boost oil (OIL). Russia the world's largest oil producer and wheat exporter.

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Earnings: ‘cyclicals’ and ‘tech’ leading earnings strength

US earnings season positive, led by cyclicals and tech

- US earnings growth: 26% vs last year, 5 points better than forecast.
- European earnings are not as far along, but with even stronger growth. This is also helping global US companies.
- Strongest growth is from the ‘cyclicals’ (commodities and industrials), those most levered to the strong GDP backdrop.
- Tech reminding of its power. With strong growth and highest forecast ‘beats’. Apple (AAPL), Microsoft (MSFT), Alphabet (GOOGL).

Market focused on inflation, competition, and margin pressures

- JP Morgan (JPM), Netflix (NFLX) inflation and competition fear
- Net profit margins seeing some pressure but, at 12%, are well above average. Tech is even growing margins further, to 26%
- Industrials the one sector missing forecasts, led by Boeing (BA)

2022 estimates are too low and rising. A key offset to falling valuations

- Q1 forecasts under pressure, with omicron slowdown. But estimates are being raised later in the year. 8% 2022 earnings growth bar is too low.
Valuation: cheaper valuations reduce the risks

The valuation reality check (see chart)

- The S&P 500 January sell off combined with the continued solid earnings outlook, has cut valuation and therefore market risks.
- The forward price/earnings (P/E) valuation fell 10% to under 20x, and 25% from its 2020 high, as Fed turns hawkish.
- P/E’s are still above the five (18.5x) and ten-year (16.7x) averages, as they should be. Company profitability is near records and bond yields low.
- Our ‘fair value’ P/E ratio (see chart) supports this; using current bond yields, company profitability, and long-term GDP growth.

Focus on cheaper markets and sectors

- We focus on cheaper sectors and overseas markets, for re-rating upside and protection from valuation pressures.
- Global equities on a 30% valuation discount to the US after over a decade of underperformance. We like UK, Europe and China.
- We are positive on many the sectors most exposed to the strong economy (so-called ‘cyclicals’) that have the cheapest valuations. Energy and financials are cheapest and 2nd cheapest in market

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Sectors: European luxury an ‘all-weather’ sector

A rare European sector success story

- Luxury stocks been strong outperformers (see chart). Both ‘narrow’ luxury like fashion, leather goods, beauty, or ‘broad’ plays including cars, spirits, sportswear.
- They enjoy strong brands, big profit margins, non-cyclical growth drivers of exclusivity and status. Supports high valuations.
- These trends will endure. This rare European-dominated sector benefits from a stabilizing China, weak EUR, and embrace of online channels and younger consumers.

France dominates with LVMH (MC.PA), Hermes (RMS.PA), Dior (CDI.PA), Kering (KER.PA). Also Switzerland’s Richemont (CFR.ZU), and Italy’s Moncler (MONC.MI), Ferragamo (SFER.MI). Broad luxury includes prestige cars, Tesla (TSLA), Ferrari (RACE), or spirits makers Diageo (DGE.L), Pernod (RI.PA).

Dramatic sector divergence this year. Energy off-the-charts

- US Energy rose 19% in January and was the only sector up, Consumer Discretionary fell the most, -10%.
- Biggest losers included Moderna, Netflix, Etsy, as well as Semis. Oil were the winners - Haliburton, Occidental, Hess, Exxon.
eToro’s Retail Investor Beat: Investors sitting tight

eToro’s global retail investor Beat survey. 8,500 investors in 12 countries, answering 26 questions

- Retail investor numbers growing, and amounts invested at record
- 54% of DIY investors are ‘not confident’ the outlook for the global economy. Inflation is by far top concern. 47% believe it is the biggest threat to their investments (up from 41% last quarter)
- Investors are resilient, with majority (56%) making no portfolio changes, and similar numbers (net 23%) planning to invest more

Other highlights: thematic investing boom and high crypto adoption

- Thematic investing growth focus with 80% of retail investors considering it. Cleantech theme is the most popular
- Crypto asset adoption grows (26% own). Now 3rd most owned after equities and bonds, and well ahead of commodities and FX

The future is young and female, and they are different

- Survey results highlight the rise of both 1) young and 2) female investors, and the multi-faceted 3) crypto asset investor
Commodities: only asset class up (and best start ever)

Best commodities start to the year ever. Strong demand / tight supply

- Energy leads best commodity asset class (+10%) start to year ever
- World's largest commodity importer - China - cuts interest rates

**Palladium (PALL) on Russia tension. Platinum (PPLT) a substitute**

- Short term boost from higher catalytic converter loading to meet tightening environmental rules, and rise of hybrid EV's
- Autos 85% of demand. Russia 40% of supply.
- Long term obsolescence as pure EV adoption accelerates

History argues for a stronger commodity rally

- We see ‘high-for-longer’ oil (OIL and XLE for equities) prices, even at a politically sensitive $90/bbl.

Commodities are in a rare ‘sweet spot’

- After 10-year underperformance, in sweet spot of rebounding demand, tight supply, and higher investment demand (inflation)
Currencies: a more stable USD dollar helps many

More restrained USD shows much priced-in

- DXY USD index down 0.5% YTD despite more hawkish Fed, higher bond yields, and global risk-off. Shows much already priced-in
- A more stable USD is positive for many

A stable/weaker USD helps EM, commodities, and tech

- A weaker USD helps emerging markets (EEM), by easing USD financing and debt pressures.
- Also commodities (DJP), which are priced in USD and become cheaper for buyers (as well as related assets like Australia).
- US sectors, like IT (XLK), with 57% of sales from overseas.

Equity market exposure to local currency moves vary dramatically

- Stronger local currencies would hurt global and lower margin European (EZU) companies. Over 50% UK and European corporate sales are from abroad. Switzerland, Sweden, Netherlands most.
- Largest economies: US, China, Japan among the least impacted.

Past performance is not an indication of future results.

Source: Refinitiv, MSCI, eToro calculations. Subject to error.
Crypto: anatomy of the new crypto investor

Crypto stabilizes along with global equity markets
- Crypto assets hurt by global risk-off move as Fed turns hawkish
- eToro adds Ankr, Bancor, dYdX and 0x to crypto line up
- New MetaverseLife portfolio including MANA, SAND, ENJ

Anatomy of the crypto investor
- Retail investors lead ownership of crypto, with institutions lagging. Crypto has grown into 3rd most-owned asset class, in our global survey results. This happened in under a decade.
- Crypto owners own a lot (26% of portfolios), led by young.
- Wide owning reasons provide solid foundation. Is room for more. Greater knowledge, regulation, less volatility to drive adoption.

Institutional crypto adoption barely started. To be led by two drivers:
1. By far highest risk-adjusted returns of any asset.
2. Correlation with other assets very low.

See related smart portfolios: @CryptoPortfolio, @DeFiPortfolio. Many considering ‘equity-proxies’ like SI, RIOT, MARA, and MSTR

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