Market Strategy Outlook

Back to School

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Summary: back to school

Markets 'back-to-school' after summer holidays

Remorseless rally continued over summer. S&P 500 now +21% this year, commodities +24%, and bitcoin +75%

- Expect a pick up in volatility, for seasonality or DC risk reasons
- Virus driving pressure on growth outlook, but delaying Fed lift-off
- Gives a clear roadmap to S&P 500 over 5,000 next year, +10%

'Buy-the-dip' instinct is strong given with new investors, low bond yields, and strong fundamentals

Remain focused on upside from growth recovery

US/EU PMI's have stayed strong, earnings are still being revised higher (US +4% last two months), and re-opening trade barely started with 60% world unvaccinated

- **Favors reflation assets:** cyclical equities (financials, commodities, industrials), commodities, crypto, small caps, and value
- Cautious on fixed income, USD, defensive equities and China

The eToro Markets View

Overview	Goldilocks' scenario of strong growth and continued policy support favors reflation assets: cyclical equities, commodities, crypto, small cap, value. Caution fixed income, USD, defensive equities, China.
Traffic lights*	**Equity Market Outlook**
United States	Continued earnings surprise to offset high valuations. Cyclicals to rebound, but large Tech sector well-supported.
Europe & UK	Cheaper valuations and cyclical indices to drive outperformance as 2H re-opening rebound comes into focus.
Emerging Markets (EM)	China dominates EM and lagging now as recovered first. Recovery opportunities in more cyclical EM ex Asia.
Other (JP, AUS, CN)	Canada and Australia benefit from commodity and financials focus. Japan a value-trap laggard as growth struggles.
Traffic lights*	**Equity Sector & Themes Outlook**
Tech (IT, CO, CD)	Structural stories with good growth, high profitability, and clean balance sheets that justify high valuations.
Defensives (HC, CS, UT, RE)	To underperform with low sensitivity to strong growth recovery and large exposure to higher bond yields.
Cyclicals (CD, ID, EN, MT)	Benefit most from GDP rebound and higher yields, with depressed earnings, cheaper valuations, out-of-favor.
Financials (FN)	Biggest beneficiary of higher bond yield view, and by far cheapest sector. Resuming dividends and buybacks.
Themes	Value to lead on GDP recovery exposure, lower valuations, under-ownership. ESG and renewables accelerating.
Traffic lights*	**Other Assets Outlook**
Currencies	USD to ease on stronger international growth and dovish Fed. Benefits EM, Commodities, International US sectors.
Fixed Income	Modestly higher US bond yields (lower prices) as real rates become less negative. Structural trends prevent more.
Commodities	Positive GDP rebound, 'green' demand, weaker USD. Metals best placed. Oil and gold have supply and yield issues.
Crypto	Strong risk-adjusted returns and low correlation with other asset classes driving gradual institutional adoption.
***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.

Source: CD=Consumer Discretionary. CO=Communications. CS=Consumer Staples. EN=Energy. FN=Financials. HC=Healthcare. ID=Industrials. IT=Information Technology. MT=Materials. RE=Real Estate. UT=Utilities.

Past performance is not an indication of future results.

Performance: the remorseless rally

Not even a 5% pullback since November

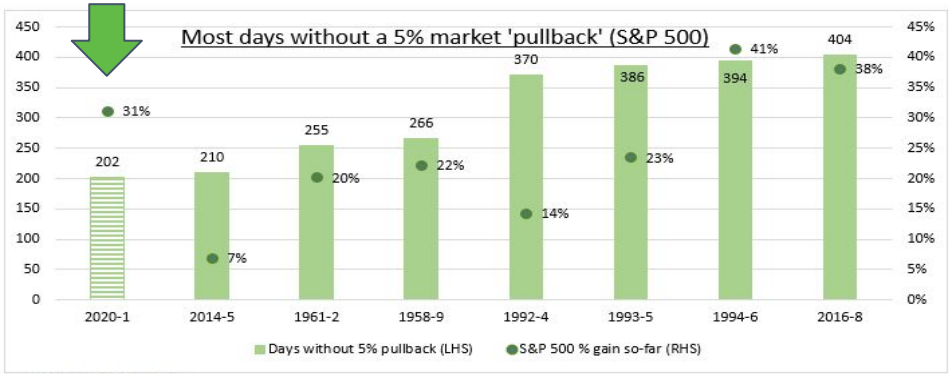
- S&P 500 now amongst the **8 longest winning streaks in history** without even a 5% pullback at over 200 trading days
- Index has only seen 3 years in the last 50 without a pullback. Last was 2017
- A typical year averages 3 pullbacks of 5% or more

'Buy the Dip' drivers strong

1. More buyers: retail, corporates (buybacks), foreigners (home bias)
2. There Is No Alternative (TINA): Bond (1.3%) and cash (0.1%) yields
3. Strong fundamentals: Earnings growth high and still surprising

Sector leader board continues to broaden

- **Media** now the top-performer, followed by Diversified Financials, and **Real Estate**
- Laggards still defensives: **Telecoms**, Household Products, and food & Beverage
- By style **High Beta** and **Buybacks** lead whilst Low volatility (quality) and Value lag



Source: Dow Jones, Refinitiv,

Source: Refinitiv. UT=Autos. BIS=Banks. CAP=Capital Goods. CDU=Consumer Durables. CND=Consumer Discretionary. COM=Communications.CMS=Commercial Services. CNS=Consumer Staples. CSV=Consumer Services. DIV=Diversified Financials. ENE=Energy.FBV=Food & Beverage. FIN=Financials. FRT=Food Retail & Tobacco. HEA=Healthcare HEQ=Healthcare Equipment. HHP=Household Products. IND=Industrials. INS=Insurance. MAT=Materials. MED=Media. PHA=Phamaceuticals. REA=Real Estate. RET=Retail. SEM=Semiconductors. SFW=Software. TCH=Tech Hardware. TEC=Information Technology. TEL=Telecoms. TPT=Transport. US=S&P 500. UTE=Utilities.

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Growth: Virus, lockdowns, and PMI divergence

Economic re-opening process has a very long way to go

- **Global new cases have flattened** at 80/million vs prior 104/ peak. US cases still soaring at 500/m vs prior 740/m peak
- Lockdown 'Stringency Index' measures degree to which restrictions remain by country. 3rd wave has seen it begin to rise again.
- **Remains at 60 vs pre-pandemic zero.** Re-opening trade has a long way to go

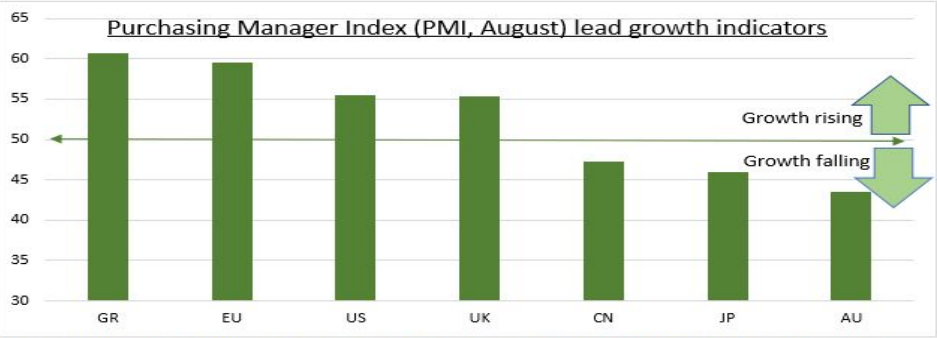
Re-opening trend delayed not derailed by current virus third wave

Driving economic divergence between countries

- **China has the highest lockdown index of major countries, despite lowest case rate.** UK has one of the lowest despite a high case rate. A lot depends on countries willingness to see cases
- Breakout between those highly vaccinated and with some tolerance for cases (US, Europe) versus the relatively unvaccinated and unwilling to see cases (Asia)

Is causing significant volatility in economic data - see recent US jobs report

Source: Oxford COVID-19 Government Response Tracker. * US, China, Japan, Germany, India, UK, France, Italy, Brazil, Canada



Source: Refinitiv, Markit. GR=Germany, EU=Euro Area, US=United States, UK=United Kingdom, CN=China, JP=Japan, AU=Australia

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Fed: tightening expectations shifting back

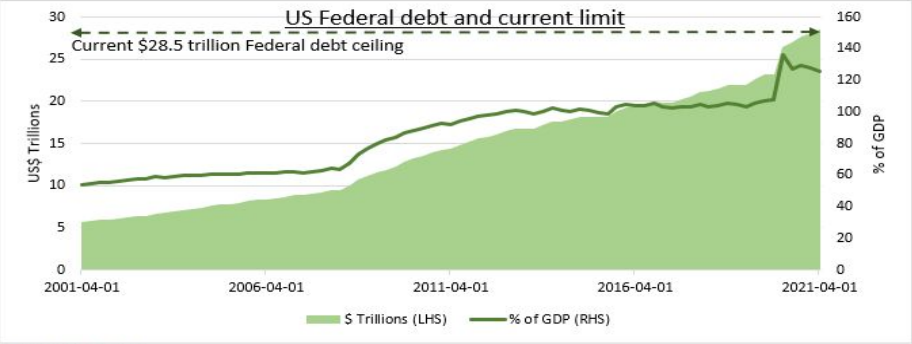
The real September risks are from Washington

1. Congress needs to approve lifting of $28.5 trillion federal **debt ceiling** in October or see government shutdown (as in 2018/19 for 35 days) or temporary default
2. Democrats pushing dramatic $3.5 trillion (15% of GDP) **fiscal package**, including corporate tax hikes, alongside $600 billion infrastructure plan (but party is divided)

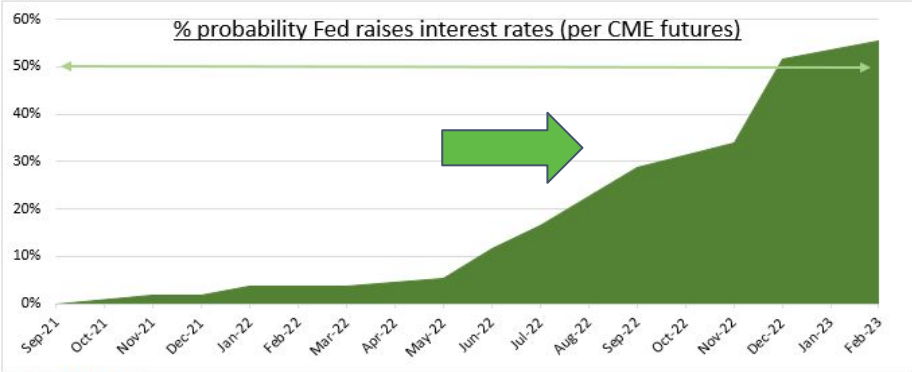
Virus and weak payrolls report pushing Fed tightening back

- Fed tapering decision has slipped from August Jackson Hole, to September Fed meeting and now likely to the November Fed meeting
- Similarly, expectations for the Fed raising rates are being pushed back and is now **barely over 50% probability for the end of next year**

Lower US bond yields and interest rates keep valuations higher-for-longer



Source: FRED, Refinitiv



Source: CME, eToro

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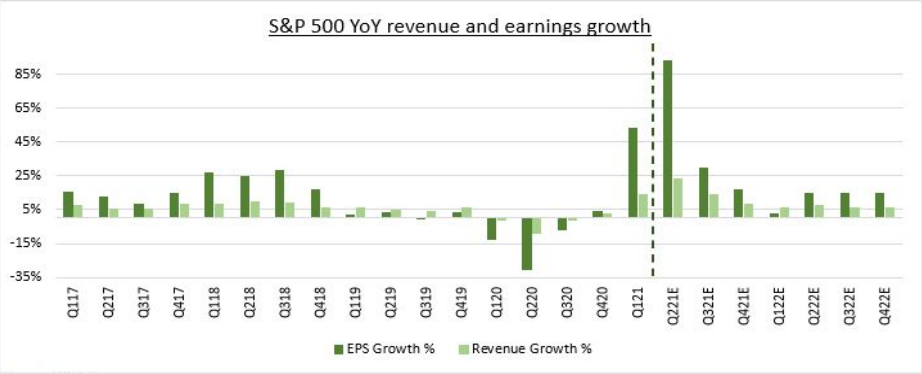
Earnings & Valuations: roadmap to S&P 500 over 5,000

The road to S&P 500 over 5,000 by end of next year

- **Further earnings upgrades** and **lower US 10-year bond yields** combine to boost our 'fair value' S&P 500 valuation
- Give a clear roadmap to the index trading over 5,000.
- Higher-for-longer valuations and our above-consensus index earnings view of $210 (+50% vs 2020) this year and $240 next (+20%)
- Gives a year-end S&P 500 target of 4,700, and 5,050 for next, over 10% from here.
- **This implies a very rare 4th year of 10%+ returns.**

Earnings still rising despite GDP uncertainty

- Analysts have increased S&P 500 consensus earnings for **Q3 +3.8%** so far since July vs an average -3.6% decline. This is the 4th largest increase ever
- Of companies issuing profits guidance for Q3, **54% has been positive**, well above the long term average of 37%
- Increases led by commodities (energy and materials) with consumer discretionary (re-opening stocks) seeing some declines



Source: Refinitiv

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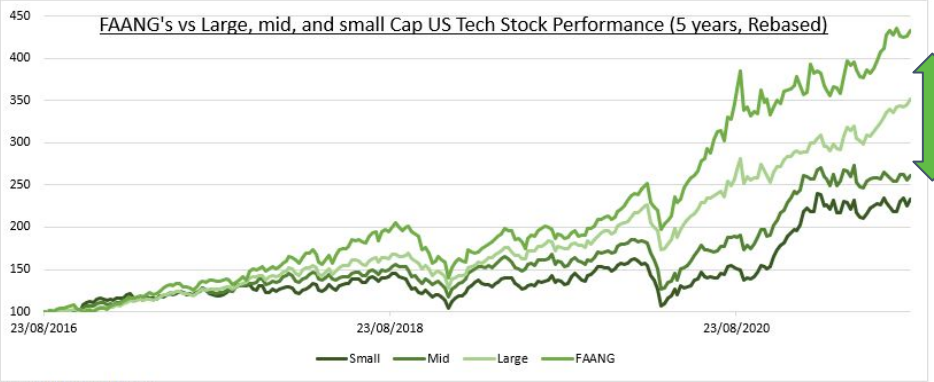
Tech: not all created equal & successful founder changes

Big tech to increasingly dominate high valuation disruptors

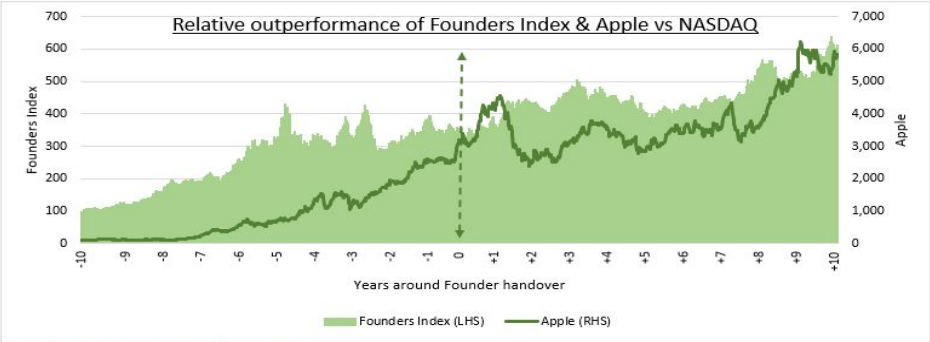
- Large cap tech dramatically outperformed (chart), despite same positive trends from tech adoption to software 'eating world'.
- Disruptive innovators proxied by ARK Innovation (ARKK) lagged FAANGS near 20%, as Tesla (TSLA) to Palantir (PLTR) lagged.
- And may accelerate as business cycle ages and Fed hikes interest rates, we see a **greater premium on big tech and FAANG growth visibility**, cash flows and valuations, and increasing caution paying the innovators growth premium without earnings.
- Big tech are the new defensives

Tech founder transitions in context 10-years after Steve Jobs

- We analyzed tech founders stepping down and the stocks performance the prior 10 years, and following 10.
- Our Index of Adobe, AMD, Intel, Logitech, Microsoft, SAP, Sony, Qualcomm, outperformed by 240% the decade prior to founder stepping down, and by similar 250% the next decade.
- This is reassuring history **for those transitioning today**: Amazon (AMZN), Alphabet (GOOG), Netflix (NFLX), Alibaba (BABA), Pinduoduo (PDD)



Source: Refinitiv, S&P Indices



Source: Refinitiv, eToro calculations. Rebased to 100

Past performance is not an indication of future results.

Themes: startup nations under-represented

Small countries often lead the way, despite being overlooked

- World's smallest countries have some of **most innovative companies** and best investment returns, but are overlooked. There 195 countries, but 5 make up 75% of global equity markets.
- Small and open economies are forced to be innovative and flexible, and benefitted as new economy shifted focus from natural resources **to knowledge**.

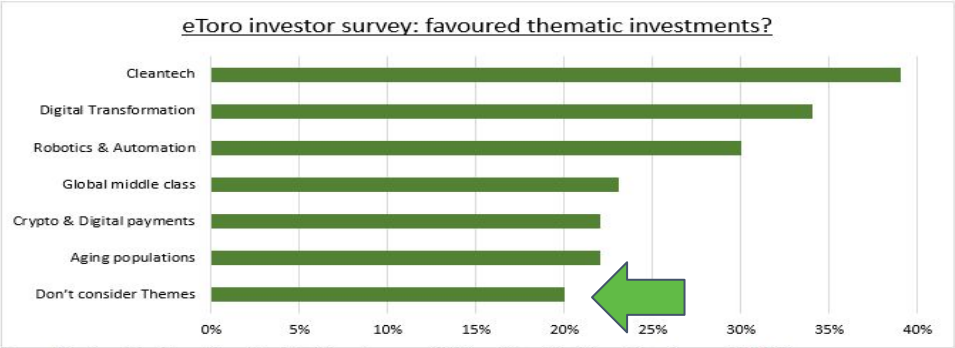
Our StartUp Nation index

- Our Start-up nations index ranks the best five overall for start-up friendliness, economic competitiveness, and ease-of-doing business. Their GDP growth is 70% above developed world average the last 20-years.

Understates their outperformance

- Their markets outperformed (see chart), but understated as **most innovative only list abroad**. Sweden's Spotify (SPOT) and Oatly (OTLY), Singapore's Sea (SE) and Flex (FLEX), Israel's Monday.com (MNDY) and SentinelOne (S.US), Denmark's Just Eat (TKWY.NV) and Zendesk (ZEN), Estonia's Playtech (PTEC.L) and Wise (WISE.L).

Source: Refinitiv, eToro calculations. *Index = simple weight of MSCI Sweden, Denmark, Estonia, Singapore, Israel



Source: Opinium, eToro. From eToro global retail investor survey. 6,000 participants in 12 countries. Surveyed July 2021

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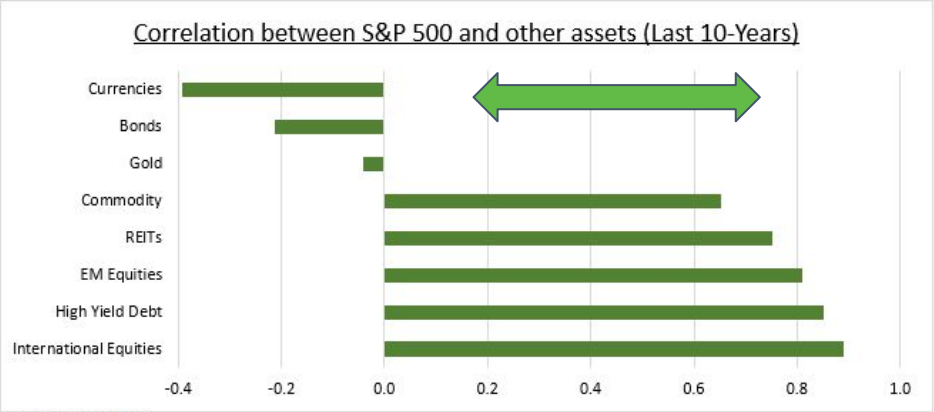
Diversification: time for a check up

Diversification strongly needed, but never more difficult

- US equities have rallied hard, and we see lower returns ahead, putting a focus on diversification.
- But traditional investment alternatives like **cash and bonds are even more expensive**, with average money market yield 0.055 and 10-year bond yield 1.3%.
- Because of this our retail investor survey shows **23% are unsure** of what to do. Additionally, 27% are not rebalancing even annually.

Equity alternatives to help lower risk and increase diversification

1. **Defensive tech** rather than disruptive tech (Copy Portfolio's like @Four-Horsemen)
2. Deep-value segments like **Financials** (with ETF's like XLF) and **international** equities (IEFA)
3. wider equity styles – from **high dividends** (HDV) to **mid-cap** (MDY) and **low volatility** (SPLV). All significantly outperformed the S&P 500 in the 200/1 dot com and 2008/9 global financial crisis



Source: Refintiv, MSCI

Source: Refinitiv

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Commodities: ‘Breakfast’ commodities leading

Breakfast commodities are leading the Ag rally, and to continue

- Our agricultural **'Breakfast' cost index** keeps soaring, +46% the past year, with world food prices at decade highs. Prices have been driven by weather disruptions, even as the wider commodity rally took a breather. Disruptions likely continue, with **La Niña weather forecast** for major producers Brazil and Argentina.

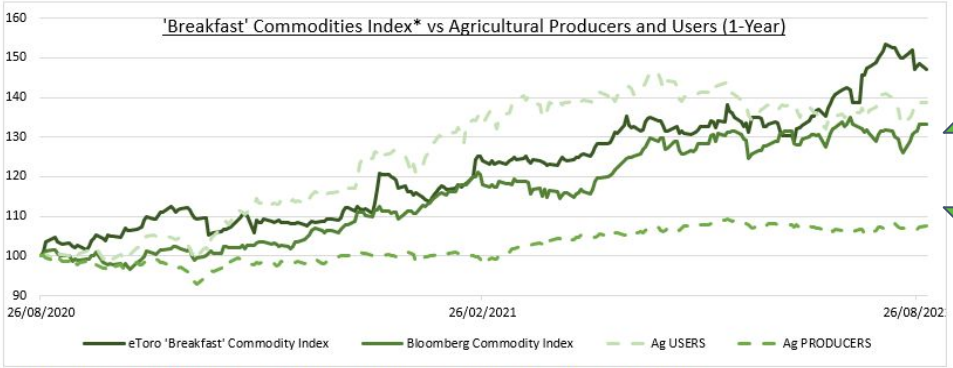
- **Consumer food stocks**, from General Mills (GIS) to Kraft Heinz (KHC), and **emerging markets** (EEM) are bearing brunt of impact. Ag suppliers, from Deere (D) to Mosaic (MOS), have benefitted.

Still see a rare ‘sweet spot’

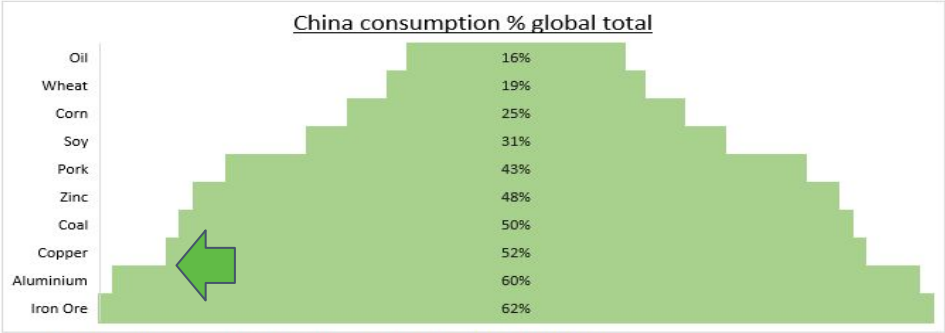
- After 10-year underperformance, in **sweet spot** of rebounding demand, tight supply, and higher investment demand (inflation)
- Retail investor survey shows as the most favoured asset class

China dominates demand for many commodities

- Chinese commodity demand far outstrips its GDP (18% of world)



Source: Refintiv, MSCI, eToro calculations. * Equal weighted index of Cocoa, Coffee, Milk, Oats, Orange Juice, Pork, Sugar, Wheat



Source: Refinitiv, China customs, National bureau of statisitics, USDA, BP. Data as of FY 2020

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Currencies: dovish Fed containing the USD

Setting up for USD weakness

- **Safe haven flows** to ease as delta variant spread flattens and **Fed perceived more dovish** stance undermines.

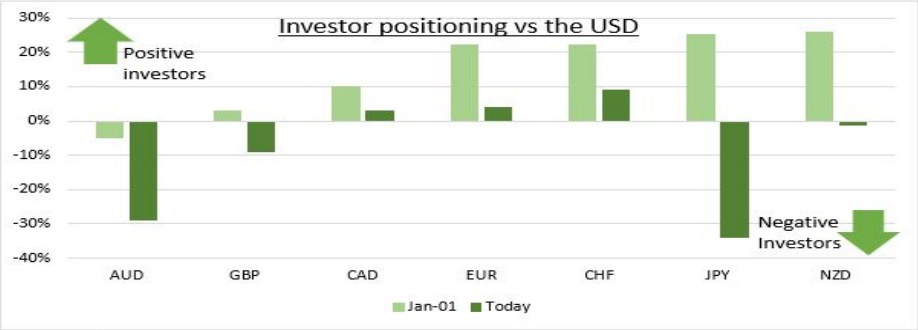
Weaker USD helps EM, commodities, and tech

- A weaker USD would help **emerging markets** (EEM), by easing USD financing and debt pressures.
- Also **commodities** (DJP), which are priced in USD and become cheaper for foreign buyers (as well as related assets like Australia)
- US sectors with large foreign sales, such as **IT** (XLK) with 57% sales from overseas.
- By contrast, stronger local currencies impact the large number of very global and generally lower profit-margin **European** (EZU) companies. Over 50% of UK and European corporate sales come from abroad, and would become less profitable.

Investors turned very negative JPY and AUD

- Strongly bearish JPY and AUD positioning makes these currencies very sensitive to any good news

Source: Refinitiv, FRED, eToro calculations. Rebased to 100



Source: CFTC, Refinitiv

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Crypto: non-fungible tokens driving altcoin rally

Crypto recovery underway. Bitcoin (BTC) back over $50,000

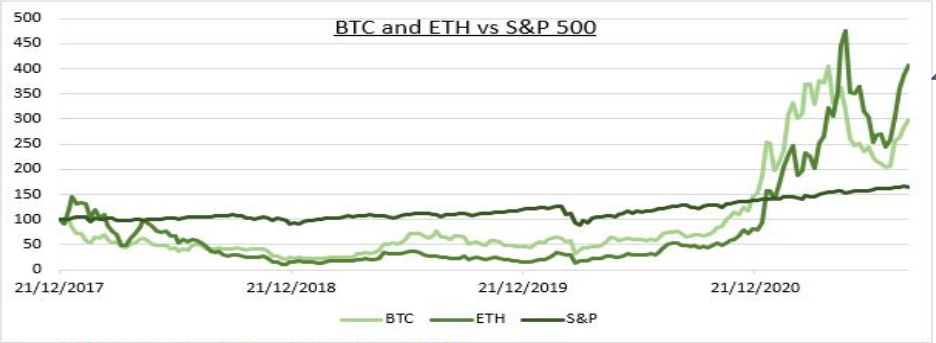
- **Market value of cryptocurrencies rose to $2.3 trillion**
- Recovery from April/May -48% bitcoin sell-off. In-line with average of the fifteen major bitcoin corrections over the last decade

Non-fungible tokens (NFT's) in spotlight

- Interest in non-fungible tokens (NFT's) has surged, with over **$1.5 billion worth of NFT's traded** on the largest marketplace, OpenSea, over the last month.
- This has helped boost Ethereum (ETH), as it has driven ETH 'burning' higher, and could see net supply turn negative.
- And others such as Cardano (ADA), Polkadot (DOT) and Solana

Institutional crypto adoption barely started. To be led by two drivers:

1. By far **highest risk-adjusted returns of any asset**. Adjusting for huge volatility crypto-assets still outpace equities over 5x
2. **Correlation with other assets very low**. Can be added to a diversified portfolio and reduces risk, despite volatility



Source: Refinitiv. Rebased to 100 from ETH launch date in 2017.

Source: Cryptoslam

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