Market Strategy Outlook

Don’t overdo virus worries

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November 29, 2021

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Summary: virus fears return; don't overdo them

Virus worries are back - don't overdo them

Equities survived Fed rate hike repricing and we think are ever-more resilient to new virus concerns. Upside to 5,050 S&P 500 target for 2022

- (-) Virus winter 'fourth wave'. Stoking growth concern
- (-) Delays economic reopening and spreads uncertainty
- (+) Resilient to market pricing 3x Fed rate hikes in 2022
- (+) Supply chain inflation worries are past peak levels

Remain focused on upside from resilient growth. US Q4 GDP +8.6%

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

Virus investments: Reopeners, 'big-tech', and @Vaccine-Med

- See out-of-favour 'Reopeners'. @TravelKit. Also 'new' defensives big tech. Don't chase 'Work-from-home' where expectations are high

See 'Catch 22' Year ahead recorded webinars

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 'bond proxy' equities.
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 2022 re-opening rebound set to continue.
Emerging Markets (EM)	China dominates EM. Tech and growth risks now well-priced. 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. Resumed big 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 balanced by stronger overseas growth and a tightening Fed. Benefits EM, Commodities, overseas US sectors.
Fixed Income	Modestly higher US bond yields (lower prices) as Fed moves to tighten policy. Structural trends prevent more.
Commodities	Long term supply/demand 'sweet spot' vs short term demand and property sector concern in no.1 importer China.
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: markets well-supported. 3 drivers

Markets hit by new virus concerns, but resilient to the Fed

- Santa rally came early. **Don't overdo Omicron uncertainty**
  - Markets increasingly resilient to each **virus** wave
  - Market resilience to **Fed** repricing (but ARKK not)
  - Stronger **USD** hurting EM and commodities

What to watch into year end, even with market rate hike concerns

- **Growth** re-accelerating in US to 8.6% in Q4 from weak 2% in Q3
- **Event risk** from Federal funding/shutdown risk (Dec. 3) and need to raise debt ceiling/default risk (Dec. 15).
- November/December **seasonality** is the best of the year
- Supports from new retail investors and record share buybacks

US among the best performing major markets this year

- US equities beaten only by Canada, Sweden, India, and Netherlands. **China** (policy intervention and growth slowdown) and **Brazil** (politics) the worst performers.

Source: Refinitiv. AC=World. AS=Asia. AUS=Australia. BR=Brazil.CA=Canada. CH=Switzerland. CN=China. DE=Germany. EA=Emerging Asia. EAFE=Developed World. EM=Emerging Markets. ES=Spain. EU=Europe. FR=France. HK=Hong Kong. ID=Indonesia. IN=India. IT=Italy. JP=Japan. KR=Korea. MY=Malaysia. MX=Mexico. NL=Netherlands. NO=Norway. RU=Russia. SG=Singapore. SE=Sweden.TH=Thailand. TW=Taiwan. UK=United Kingdom. US=United States. ZA=South Africa.

Source: Refinitiv, S&P, Etoro calculations

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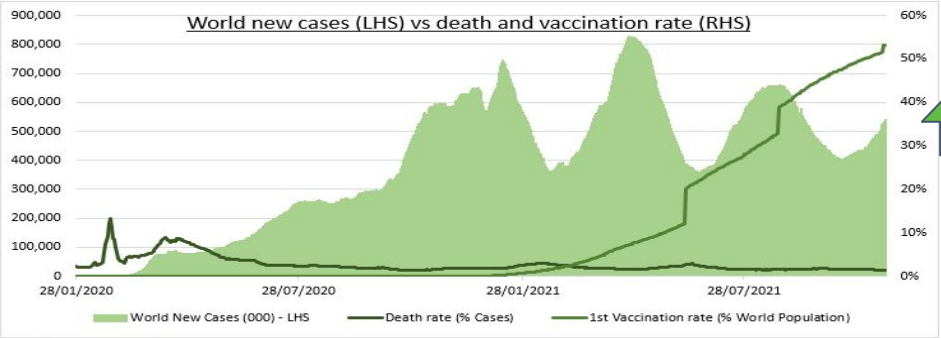
Macro: the virus ‘fourth wave’ in context

Virus ‘fourth wave’ is underway, but economies to be resilient

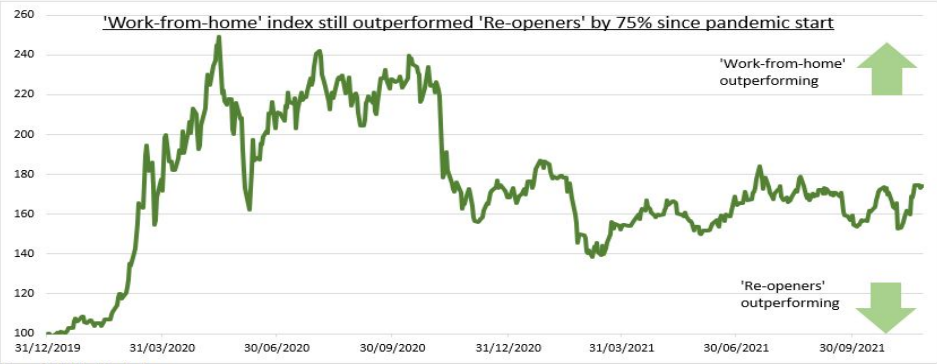
- A ‘fourth wave’ of global virus cases is underway, and new ‘Omicron’ variant sowing fear. This will **dampen but not derail the economic re-acceleration** that was underway, and depress ‘reopening’ stock themes from travel to tourism.
- Economies, consumers, companies **increasingly resilient** to each new wave. Whilst expectations are already low for many reopening segments. ‘Zero-tolerance’ areas like China could be hurt most.

Look for opportunities in ‘Re-openers’ amongst the sell off

- Looking for opportunities in ‘**reopeners**’ basket (airlines, cruises, hotels, gaming, car hire, live entertainment). Has lagged work-from-home (e-commerce, cloud, data centres, gaming, home improvement) by 75%, and **earnings are still 65% below pre-crisis**. See @TravelKit. Risk/reward is attractive.
- **Safer havens** in ‘new defensives’ big-tech and @Vaccine-Med
- Work-from-home (WFH) risk-reward is different. Profits are 40% higher than pre-crisis and valuations above market. Makes vulnerable to any bad news. See **PTON, ZM, ATVI miss reactions.**



Source: John Hopkins CSSE



Source: Refinitiv, eToro indices

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Macro: The 2022 outlook and the Fed ‘stress-test’

Economic outlook: Still-strong-growth and reflation

- Economic scenario of still high growth, a slow interest rate lift-off, and less inflation worry. US and global **GDP growth will naturally slow** but remain well-above long term average levels. This is supported by re-opening economies and very low interest rates.
- These **rates will be rising** with the Fed to hike interest rates twice next year starting in June. But these are still very low rates, and the increase will only be gradual. The pace will depend on inflation.

Inflation pressures to ease as pace of the economic rebound slows, and supply chains adjust.

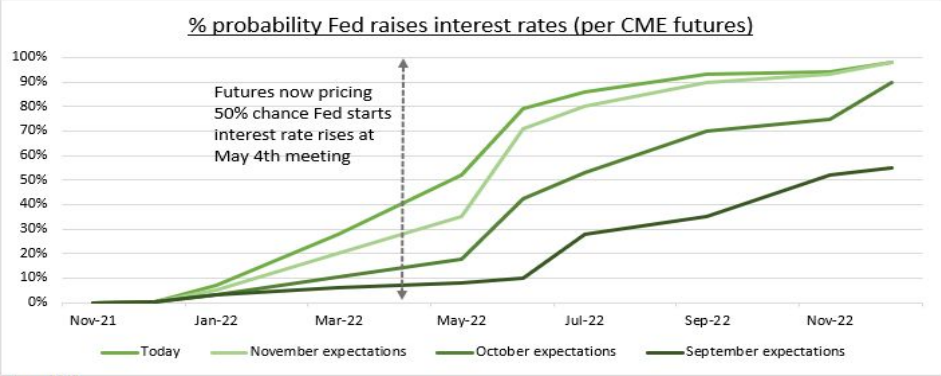
Surviving the Fed ‘stress-test’: Interest expectations have moved a lot

- Equities passed big stress-test so far, with recent sharp **repricing of Fed interest rate hike expectations**. S&P 500 is up 9% this quarter even as investors moved to now price in 3 rate hikes next year. But below surface not all been rosy (or complacent).
- The **hit been on ‘disruptive tech’, w**ith highest valuation and equity funding needs. ARK Innovation (ARKK) -15% from recent high. Similar to the shakeout during the Q1 bond yield ‘tantrum’.

Consensus macro and market comparison: 2022e vs 2021e

Indicator	Metric	2021e	2022e	Change
US Real GDP Growth	%	5.8%	4.0%	↓
US Consumer Price Inflation	%	4.3%	3.2%	↓
US Fed Funds Interest Rate	%	0.13%	0.50%	↑
US 10-Year Bond Yield	%	1.6%	1.9%	↑
S&P 500 Revenue Growth	%	15.6%	7.0%	↓
S&P 500 Earnings Growth	%	44.7%	8.5%	↓
Oil - Brent	US$/bbl	81	74	↓
EUR/USD	Year end	1.16	1.18	↑

Source: Refinitiv investor polls, CME futures, Factset earnings



Source: CME

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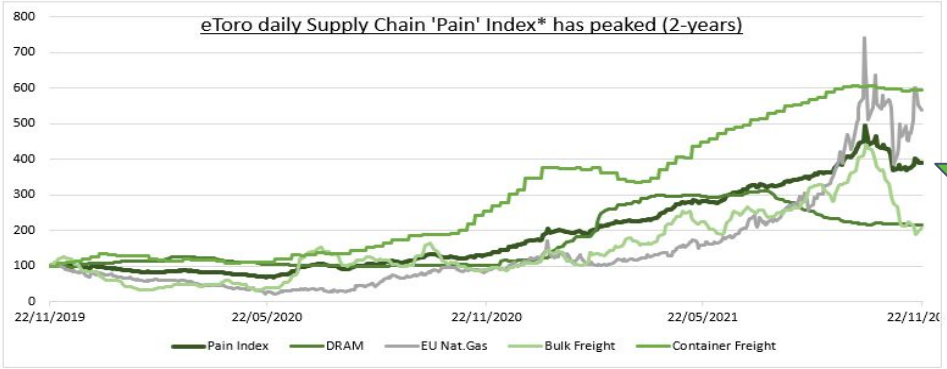
Inflation: Worst-over for supply chains. Forecasts restrained

Supply chains are starting to heal, reducing inflation risks

- We see signs of supply chains **starting to adjust** to unprecedented levels of demand and specific dislocations seen this year.
- Our supply chain **'pain' index is -20% from October highs** on lower computer chip, freight, and energy prices. This likely broadens next year as supply chains adjust, easing inflation worries.
- Should help retail (@ShoppingCart) and auto (@ChinaCar) sectors, and start to ease the tailwinds to container and bulk shipping carriers like Maersk (MAERSKB.COM) and Zim (ZIM).

More broadly, long term inflation expectations are well-behaved

- 5-year market inflation expectations are 2.3%, and **well within the Fed's 2% 'average' inflation target**.
- A significant further rise would pressure the Fed to move faster - but this is already well priced. Continued current levels may see a **positive surprise** of fewer or slower hikes



Source: Refiniitv. * Simple weighted index of daily DRAM price, EU natural gas price, Baltic Exchange dry index, Shanghai container freight index

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Valuations & Earnings: high valuations and high profitability

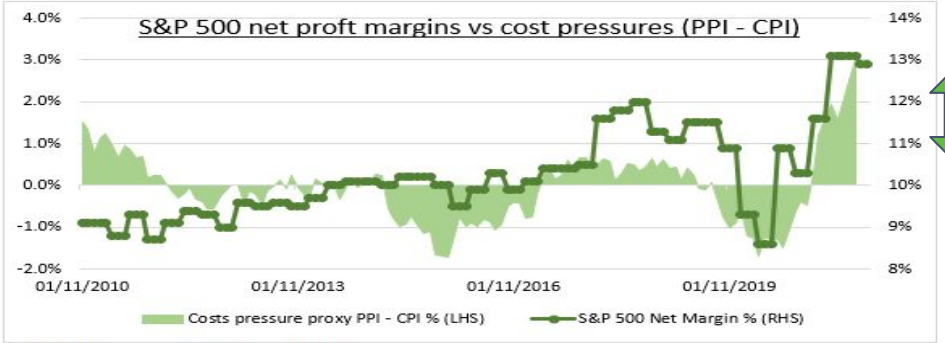
High valuations supported by rising profits, low bond yields, 'big tech'

- Market rebound has kept US equity valuations very high, at around **22x forward P/E ratio**, despite rising earnings
- Falling valuations remains the **biggest market risk**, and why we focus so much on earnings (as the best 'insurance policy')
- Partly **mitigated by** 1) still rising profits, 2) lower-for-longer bond yields, and 3) long term rise of the high profitability tech sector
- Other market segments are significantly cheaper though, such as **international** equities and the **financials** sector

Sustained high corporate profit margins is a key assumption

- S&P 500 net profit **margins remain at an all-time-high 13%,** supported by tech (XLF) and real estate (XLRE). Revenue growth has more than offset rising cost pressures. Similar in Europe, with all-time-high 11% profit margins.
- These **cost-pressures may be beginning to peak**. See our supply chain 'pain' index. We track producer prices minus consumer prices as a margin pressure proct (see chart). Peak margins along with peak pressures.

Source: Refinitiv, eToro calculations



Source: Refinitiv, Factset, eToro calculations

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Sectors: ‘cyclicals’ are the top picks for 2022

Sector outlook for 2022. Best risk/reward in ‘cyclicals’

- Cyclicals, like energy (XLE) and industrials offer the **best risk/reward** of strong earnings growth and low valuations. Financials (XLF), the 2nd cheapest sector, earnings estimates are understated
- ‘Big-tech are the **new defensives**, with resilient growth and fortress balance sheets and reasonable valuations in that context. See @FourHorsemen
- Traditional ‘**bond proxy**’ defensives, like utilities and consumer staples, have limited growth and risks of rising bond yields. Some like healthcare have become very cheap and resilient in a sell off.

Global equity market valuations in context

- **Russia** perennially cheapest world equity market, on high commodities exposure and governance risks. **Brazil** now cheapest after poor 2021 performance and upcoming election risks. **UK** also huguely derated on post Brexit growth outlook.
- **US** now 3rd most expensive major equity market. See valuations supported by low bond yields and large tech weighting.

US Sectors: 2022e Price/Earnings Valuation (x, Horizontal axis) vs Earnings Growth (%, Vertical axis)

Source: Factset. EN=Energy, FN=Financials, MT=Materials, HC=Healthcare, UT=Utilities, CS=Consumer Staples, CO=Communications, SPX=S&P 500, ID=Industrials, RE=Real Estate, IT=Technology, CD=Consumer Discretionary

Source: MSCI, Refinitiv, IBES. AUS=Australia. BR=Brazil.CA=Canada. CH=Switzerland. CN=China. DE=Germany. EAFE=Developed World. EM=Emerging Markets. ES=Spain. FR=France. HK=Hong Kong. ID=Indonesia. IN=India. IT=Italy. JP=Japan. KR=Korea. MY=Malaysia. MX=Mexico. NL=Netherlands. NO=Norway. RU=Russia. SG=Singapore. SE=Sweden.TH=Thailand. TW=Taiwan. UK=United Kingdom. US=United States. ZA=South Africa.

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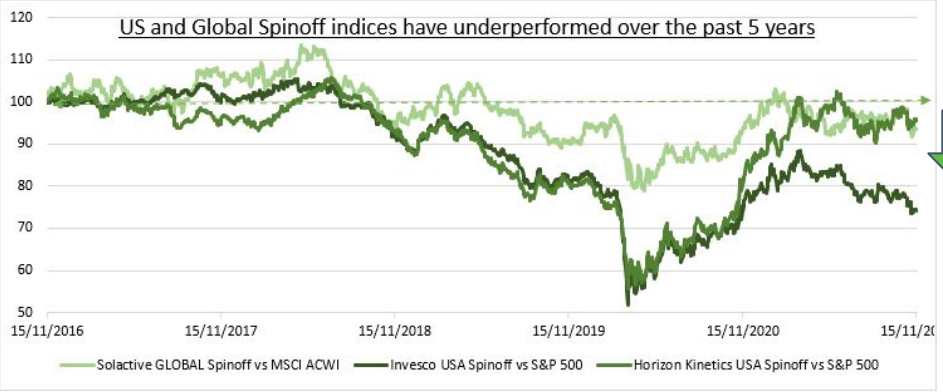
Conglomerates: rise of the ‘new’ conglomerates

Seeing accelerated conglomerate breakups

- Announced breakups by GE (GE), Johnson & Johnson (JNJ) and Japan’s Toshiba highlight for many the ‘**death of the conglomerate**’. We are not so sure.
- **Spin-offs have not performed** well (see chart) which is a surprise to the consensus narrative.
- Berkshire Hathaway (BRK) performance has been unimpressive for the past decade, but it remains the **largest non-tech US stock,** and has a strong longer term record.

But rise of the ‘new’ conglomerates, big tech and private equity

- ‘**Big-tech**’ is looking more-and-more like conglomerates, see alphabet (GOOGL) structure and the new META structure for Facebook.
- Whilst **private equity** may also be ‘new conglomerates’, and with $3 trillion to invest. Different, yes. dead, no.



Source: Refinitiv

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Commodities: Oil mistake and more expensive breakfast

Covid fears hit prices, after US oil plan backfires. See OPEC+ response

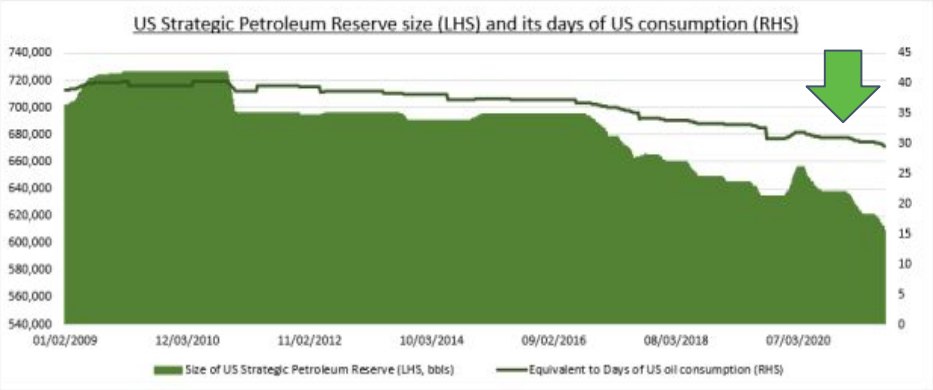
- Omicrom stokes demand fears. **OPEC room to adjust supply.**
- US and others strategic petroleum reserve **oil sales backfired**. Seen as short-term and desperate, with little follow-through given the small SPR's (see chart) and use-case for 'real' emergencies.
- Demand recovering and new oil investment fraction low. This is a recipe for **high-for-longer prices**, helping XLE and OilWorldWide.

Rise in 'Breakfast' commodities a problem for many

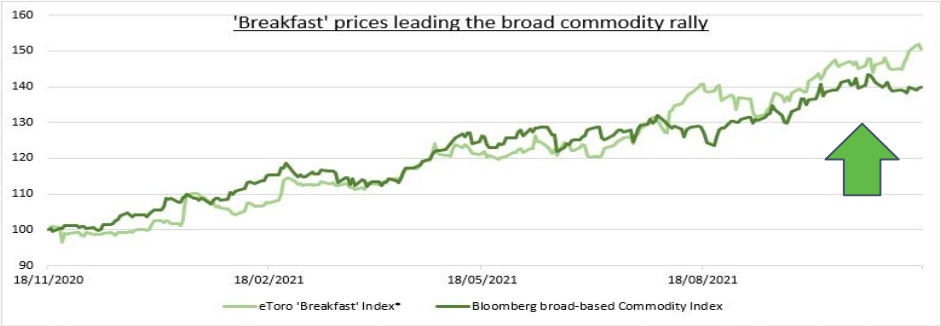
- 55% surge in 'breakfast' cost index outpacing commodity rally and **piling cost pressures on many**. Boosting inflation and interest rates, in emerging markets (EM) especially.
- **Worse may be to come**, with La Nina weather disruption forecast and could hit key LatAm producers. Ag 'producers' from Deere (D) to Mosaic (MOS) benefitting and 'users' like Kraft (KHC) suffering.

Commodities are in a rare 'sweet spot'

- ❑ After 10-year underperformance, in **sweet spot** of rebounding demand, tight supply, and higher investment demand (inflation)



Source: US Energy Information Administration



Source: Refintiv, MSCI, eToro calculations. * Equal weighted index of Cocoa, Coffee, Milk, Oats, Orange Juice, Pork, Sugar, Wheat. Rebased to 100 from 15/11/2020

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Currencies: dollar rally accelerated

Repricing of interest rate and 'safer haven' boosted USD

- **USD** rising as inflation forces market to price three rate hikes next year. **GBP** and **CAD** in similar position.
- Whilst those seen as to only raise interest rate later, such as **EUR**, **CHF,** and **JPY**, remain under relative pressure
- 'Safer-haven' 4th-virus wave boosted **USD** and **JPY** hurt **EUR**

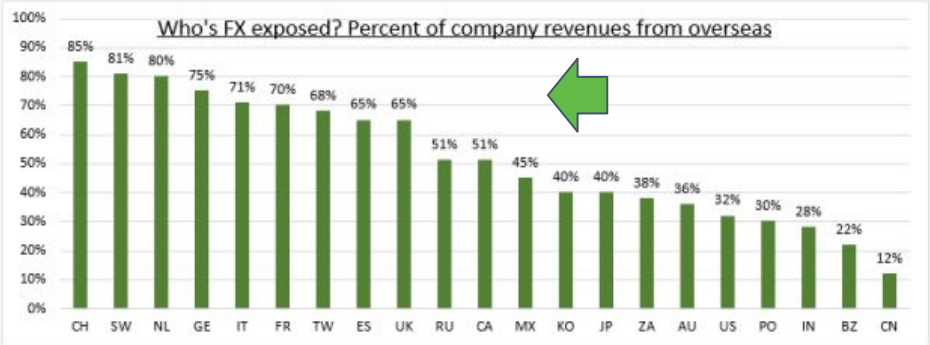
Stronger USD hurts EM, commodities, and tech

- A stronger USD hurts **emerging markets** (EEM), by increasing USD financing and debt pressures
- Also **commodities** (DJP), which are priced in USD and become more expensive 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

Source: Refinitiv



Source: Refinitiv. AU=Australia. BR=Brazil. CA=Canada. CH=Switzerland. CN=China. DE=Germany. ES=Spain. FR=France. IN=India. IT=Italy. JP=Japan. NL=Netherlands. RU=Russia. KR=Korea. MX=Mexico. SW=Sweden. TW=Taiwan. UK=United Kingdom. US=United States. ZA=South Africa.

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Crypto: modest pullback on global risk-off

Crypto pullback exacerbated by global 'risk-off' move

- Concerns ranged from India draft law banning crypto ownership, to Mt. Gox sales, and Biden Infra. Bill widening of tax reporting

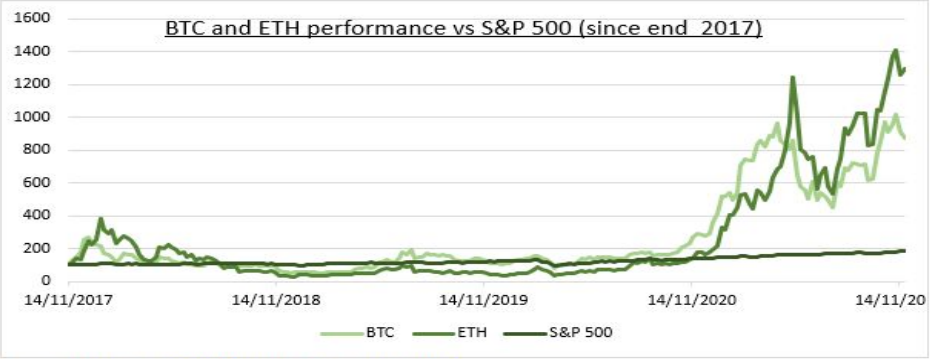
Recent developments - taproot upgrade, inflation credibility, and ETF

- November **'taproot' upgrade** boosted efficiency (lower fees and better smart contract functionality) and privacy.
- BTC as **inflation hedge**. Rallied as inflation expectations rose. Sapping traditional gold demand.
- Launch, and strong fundraising, of **bitcoin futures** ETFs

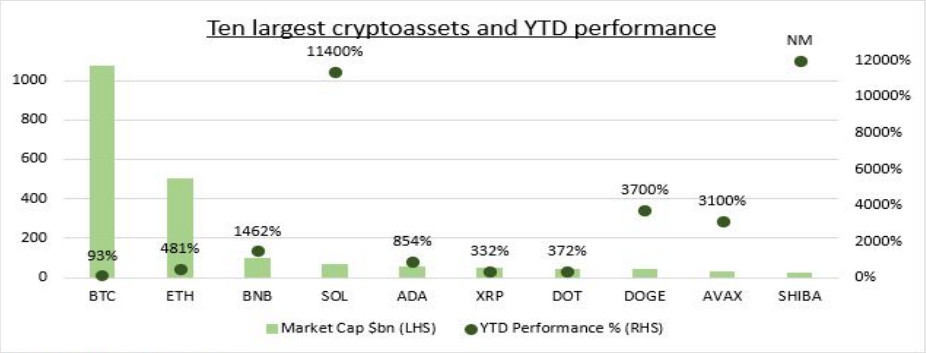
Institutional crypto adoption barely started. To be led by two drivers:

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

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



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



Source: CoinMarketCap, Refinitiv

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