Market Strategy Outlook

Q4 outlook: Looking through the volatility

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Summary: Q4 view, looking through the volatility

Overdue pullback. Six risks in focus - to ease

S&P 500 now 6% off its all-time-high in overdue 'pullback'. Corrections happen (-10%) but history favours buying. Six market concerns to ease

- First pullback of the year, versus annual average three
- Corrections do happen. 10 since GFC. History favours buying
- Six market concerns, from tapering to China, that set to ease

Set up for a Q4 'Santa rally'

- Global virus cases -30%. Vaccinations 45%. Firming growth outlook
- Q3 earnings start soon. Expectations low and set-up for beat
- November/December seasonality best of year on year ahead view

What to own as growth fears ease and bond yields move higher

- **Favors reflation assets,** especially with bond yields rising: cyclical equities (financials, commodities, industrials), small cap, and value
- Cautious on fixed income, USD, defensive equities and China
- Commodities moved to neutral on rising China risks

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 2022 re-opening rebound set to continue.
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. 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 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 Fed moves to tighten policy. Structural trends prevent more.
Commodities	Long term supply/demand 'sweet spot' versus 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: equities overdue ‘pullback’

Equities overdue ‘pullback’, with commodities and crypto resilient

- Equities sink under weight of Fed tapering, DC dysfunction, and China growth fears. Commodity supply issues soar, offsetting USD strength. Crypto shrugs of latest China crackdown. Bond prices slump as Fed moves to announce tapering in November

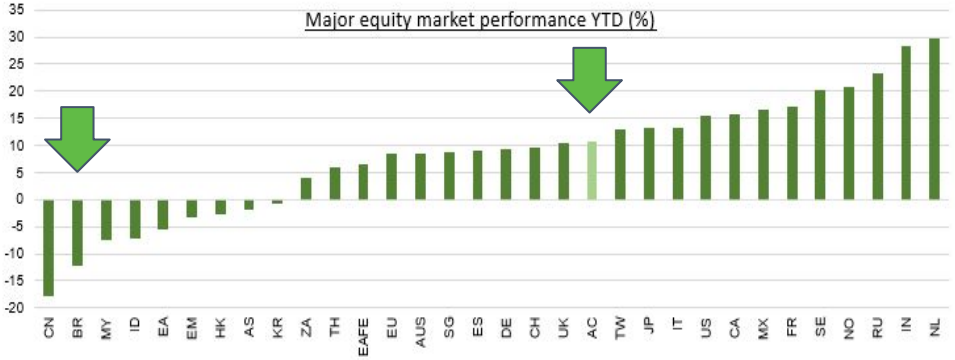
Country and sector performance ‘runners and riders’

- **Country** performance changes include India (rotation from sinking China), Norway/Russia (Oil), and Japan catch-up (new PM hopes)
- Energy regains **sector** leadership, followed by banks (rising bond yields). ‘Bond proxy’ telecoms, household products, utilities all lag

September and third quarter highlights

- **September:** S&P 500 -4.8% in worst month since March 2020 crash. Energy (+9.3%) only sector up. Materials (-7.4%) worst, on China concerns. Cabot (COG) +37%. Las Vegas Sands (LVS) -18%

- **Third quarter:** S&P 500 +0.2%, its sixth straight quarterly gain. Financials (+2.3%) best performer. Industrials (-4.5%) worst, on supply-chain impacts. Moderna (MRNA) +67%. GAP (GPS) -32%



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. 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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Corrections: rare, but they do happen (and worth buying)

The history of -10% corrections

- The S&P 500 has historically seen an average of three -5% **'pullbacks'** every year. This is the first of 2021
- Larger -10% **'corrections'** are rarer, but do happen regularly, with ten since the global financial crisis twelve years ago
- The 'corrections' average a **-17%** fall over nine weeks
- It **pays to buy them**, with markets consistently higher on a 12 month basis
- ....especially if not part of a broader and bigger market crash, such as 1990, 2000-1, or 2008-9 which all saw repeat 'corrections'
- **Worst 'correction' sector performers** (Last 40-years): materials, financials, and IT. They have also led the eventual recovery. The most defensive sectors have been: utilities, staples, healthcare
- The 'covid-crash' was different from others. Faster (33 days) and deeper (-35%) given nature of the virus, and the policy response

Source: Refinitiv, eToro calculations

S&P 500 10% 'Corrections' since the Global Financial Crisis

No.	Correction date	# Days	% Fall	Reasons
1	Sep. 2 - 24, 2020	22	-10.6%	Covid, no new stimulus deal, election
2	Feb. 19 - Mar. 23, 2020	33	-35.4%	Covid, global recession fears
3	Sep. 21 -Dec. 26, 2018	96	-20.2%	Rising rates, China trade war
4	Jan. 26 - Feb. 09, 2018	14	-11.8%	Rising rates, inflation fears
5	Nov. 3, 2015 - Feb. 11, 2016	100	-14.5%	Falling oil, China slowdown
6	May 20 - Aug. 4, 2015	96	-12.5%	Greece default concerns
7	Apr. 2 - Jun. 4, 2012	63	-10.9%	Europe debt crisis
8	Oct. 27 - Nov. 25, 2011	29	-10.4%	Europe debt crisis
9	May 2 - Oct. 4, 2011	155	-21.6%	Europe debt crisis, US debt downgrade
10	Apr. 26 - Jul. 1, 2010	66	-17.1%	Flash crash, growth concerns
	Average	**67**	**-17%**	

Source: Refinitiv

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Risks: the six event risks worrying markets (and why ease)

The six event risks worrying markets, and why we think they fade

1. US **government shutdown** avoided, for now, with spending bill approved until December 3rd. Has had little historic impact

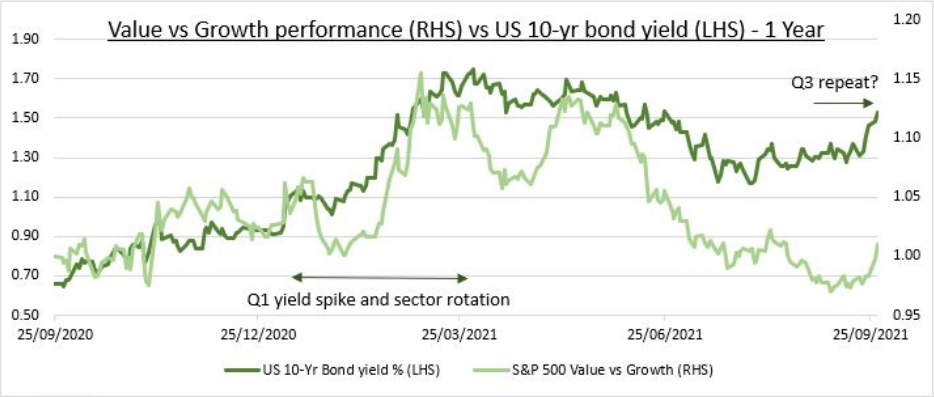
2. Congress to approve lifting $28.5 trillion federal **debt ceiling** by October 18 or see temporary default. No one wants a 2011 repeat

3. Democrats $3.5 trillion (15% of GDP) **fiscal package**, including corporate tax hikes, alongside $600 billion infra plan. Party split to see watered down in order to get passed in 50/50 senate

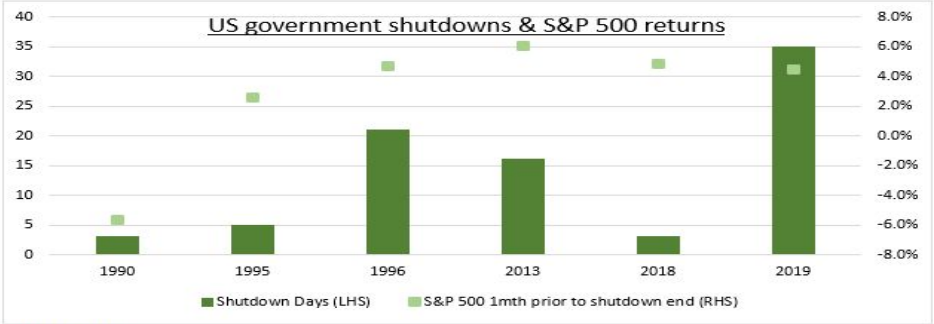
4. Decision re-appointing Fed's **Jerome Powell**. Not re-appointing Powell is a rising risk, but all other candidates have similar views

5. No. 2 economy **China** growth slowing, with Manufacturing PMI at borderline 50. Tech crackdown continues, with gaming, gambling, crypto latest. Evergrande property empire on brink of default on $300 billion debts. Country has a lot of policy flexibility to manage

6. **Federal Reserve** to announce tapering $120 billion/month bond purchases at Nov. 2-3 meeting. To be completed by mid-2022, as prelude to end-year rate rise. Markets tested by Q1 'tantrum'



Source: Refinitiv



Source: Refinitiv

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Q4 Playbook: setup for a 'Santa rally'

Growth to get back on track, whilst low yields help valuations

- Global and US **virus cases** are down 30% from recent highs. First-dose vaccination rates at 45%. Opportunity to further re-open economies. Upcoming Q3 earnings expectations are too low
- Fed to **taper** and bond yields to rise, but to be a fraction of prior recession recoveries where yields were over 4%. Will support valuations well-above long term levels

Heavy load of short term market concerns are 'noise'

- Six market concerns currently - from debt ceiling to Fed tapering and China - are overdone or likely resolved

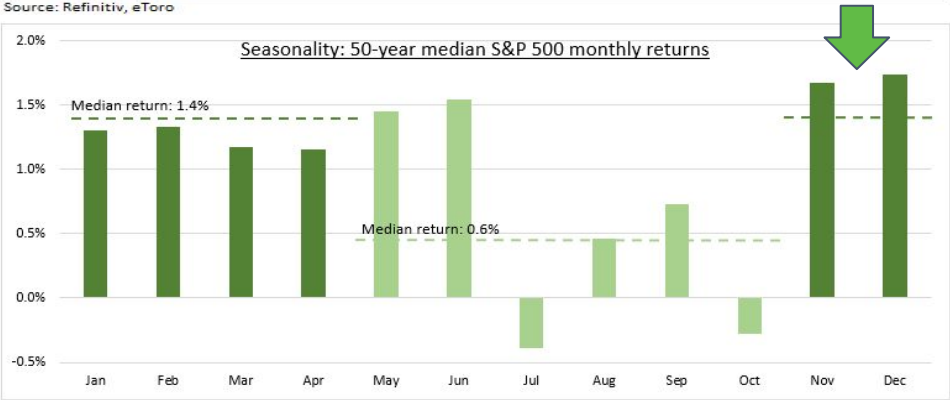
Santa Rally seasonality supportive

- November and December have **best seasonality** of the year as investors traditionally reposition for a positive year-ahead outlook
- Market pullback, lower investor sentiment, but high liquidity and cash levels could make this significant

Key events to watch in Fourth Quarter

Date	Country	Event
Oct. 1	US	US government funding expires. **Partial shutdown**
Oct. 13	US	JP Morgan unofficiallly starts **Q3 earnings**
Oct. 18	US	Estimate of US hitting $28.4 trillion **debt ceiling**
Oct. 23	China	Grace period ends on **Evergrande** offshore bond coupon
Oct. 30-31	Global	G20 meets in Rome
Nov. 1-12	UK	**COP26** UN Climate Conference
Nov. 2-3	US	Federal Reserve meeting. **Taper announcement**
Nov. 7	Japan	Earliest realistic date for General Election
Nov. 11	China	**Singles Day**. World's largest online consumer event
Nov. 26	US	**Black Friday** unofficial start of Christmas shopping
Dec. 14-15	US	Federal Reserve Meeting
Dec.	US	Fed to start tapering its $120bn/month bond purchases
Dec.	Germany	Potential end of German coalition government negotiations

Source: Refinitiv, eToro



Source: Refinitiv, S&P, Etoro calculations

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Earnings: setting up for Q3 beat as market catalyst

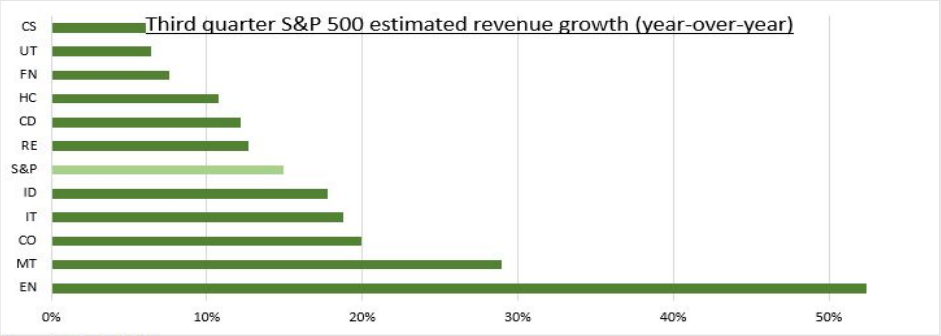
Analysts have become too cautious on third quarter earnings

- Third quarter earnings season 'starts' **October 13**. Analysts have become too cautious
- They are looking for lower absolute earnings than last quarter, even though economy still to grow over 3%
- **Cyclical sectors** (energy, materials, industrials) and tech (IT, communications) forecast to see the strongest growth recoveries

Similarly, are too cautious for 2022 earnings growth

- Similarly, 2022 expectations are only for 8% growth, despite nominal GDP growth of 7%, and many sectors still not recovered from covid-crisis
- We have **above-consensus index earnings** view of $210 (+50% vs 2020) this year and $240 next (+20%)

Source: Factset, Refinitiv



Source: Facstet, Refinitiv

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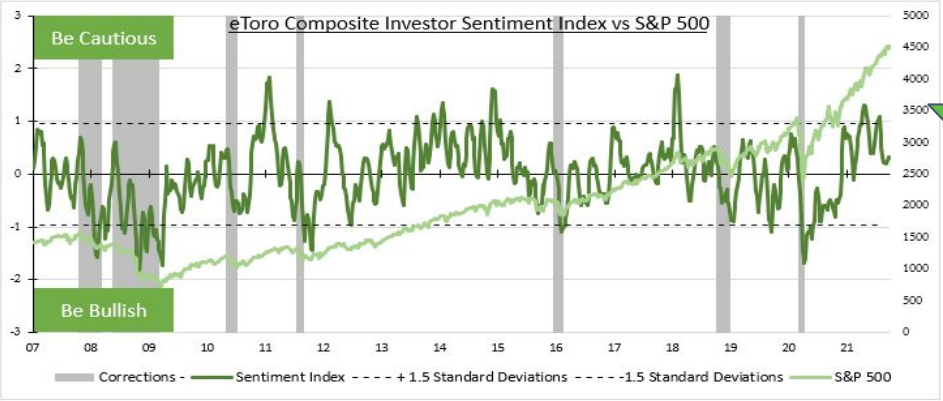
Sentiment: more buybacks and easing sentiment

Poorer sentiment is a positive - more people to buy the market

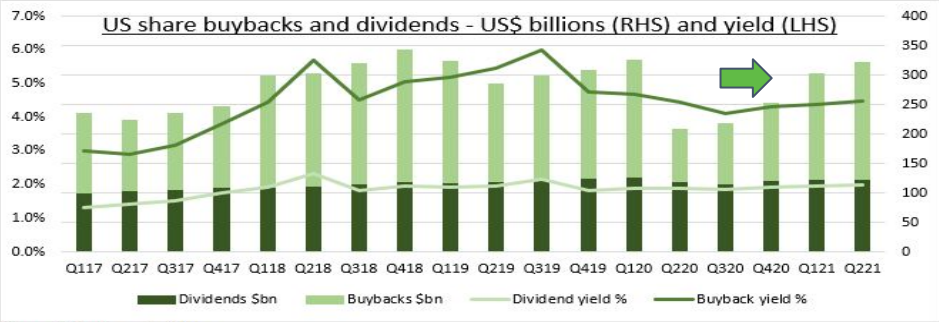
- Our proprietary **investor sentiment indicator has been falling**, and is now nearing long-term average levels
- Fewer retail investors are bullish, strong fund inflows have eased back, and VIX volatility has risen. This is not surprising
- **It is not bad news.** If 'everyone' is bullish there is no marginal buyer to take markets higher. The index lows have been strong buy signals, whilst highs signalled lower, but not negative, returns

Recovering share buybacks a big market support - and now in Europe

- Corporates are the **largest buyers of US equities**, through share buybacks, making them a major market support
- Buybacks rebounded 50% last quarter to $200 billion. Recovering profits and $1.8 trillion cash levels **will push even higher**
- Focused on tech, led by Apple (AAPL) and Alphabet (GOOG). Banks recovering, led by JP Morgan (JPM), as Fed loosened rules. **Europe regulators to follow**. Helping SEB (SK.PA) to ABN Amro (ABN.NV)



Source: Refinitiv, AAII, eToro calculations



Source: S&P, eToro calculations

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Sectors: investing in the EV and streaming music booms

How to invest in the EV boom - Legacy looks attractive

- Global electric vehicle (EV) sales crossed 10 million units last year, but still only 1% world-wide fleet. Targets for **30% annual EV unit growth** to take industry to over 10% of the vehicle fleet by 2030. See @Driverless smart portfolio for diversified exposure

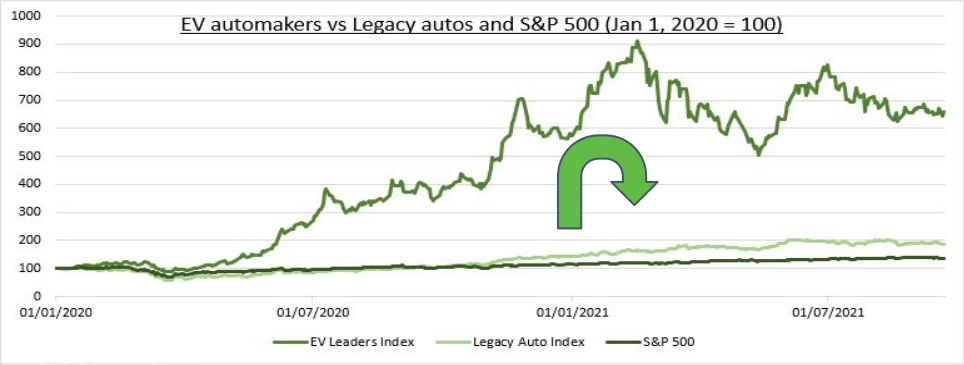
- Legacy automakers, from Toyota (TM) to Volkswagen (VOW3.DE), performance beating EVs YTD, from Tesla (TSLA) to NIO (NIO), on cyclical growth, accelerating EV investments, and low valuations.

- Volkswagen P/E valuation **6x versus Tesla 114x,** with the German automaker funding a four times larger $22 billion investment plan.

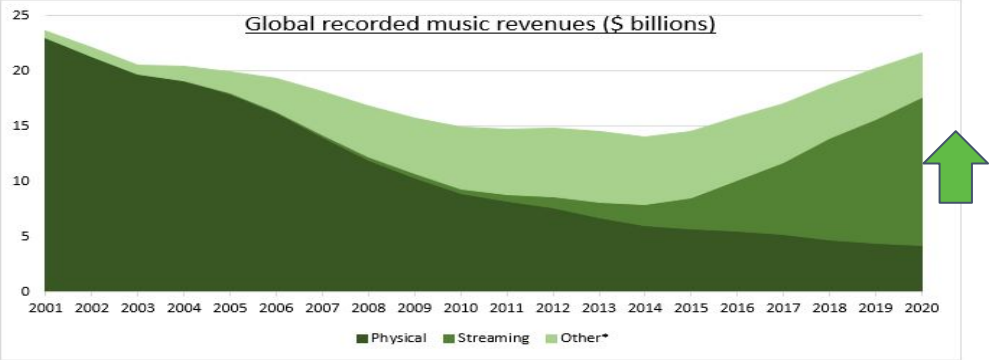
Opportunities in music's rise from ashes - on streaming boom

- $50 billion IPO of no.1 record label Universal Music highlights booming industry, **benefiting everyone** from Vivendi (VIV.PA) to Warner Music (WMG), and even Spotify (SPOT).

- Surging streaming revenues took industry to cusp of regaining $21 billion revenues of 20-years ago. **Streaming now 62% of that**. Revenues grew 7.4%, and streaming by a huge 18.5%, last year.



Source: Refintiv, eToro estimates



Source: IFPI. *Other digital, performance rights, synchronisation

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Commodities: gold still struggling versus oil

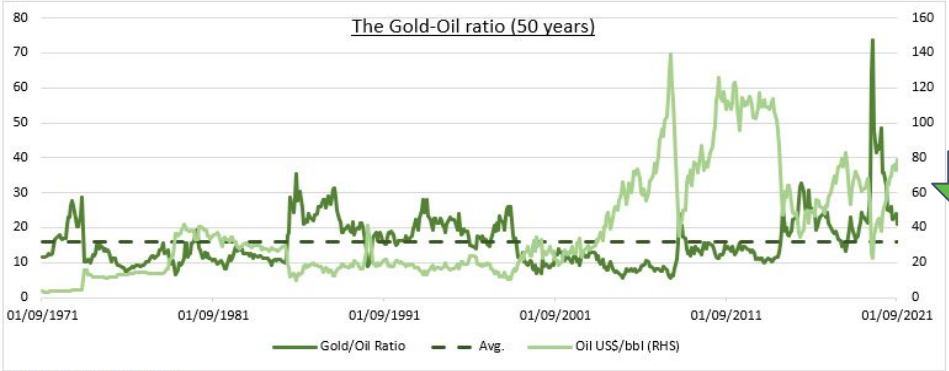
Commodity rally extends on supply deficit

- **Rising supply concerns** across the commodity complex drive latest leg of rally, and makes resilient to 1-year USD high
- The broad-based Bloomberg commodity index rose +4% in September and +6% in Q3

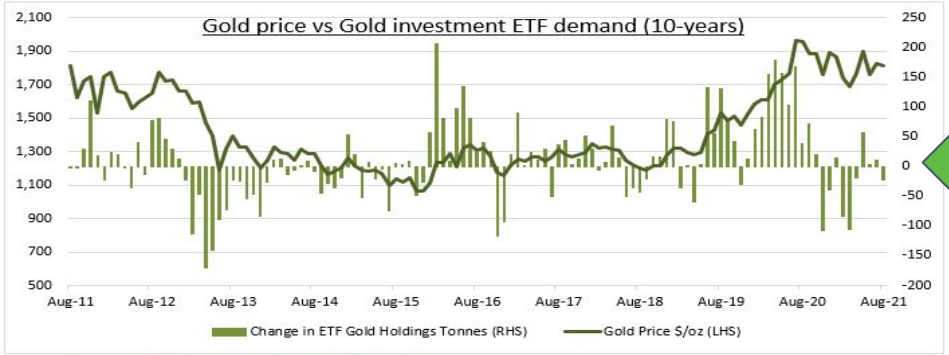
Gold versus Oil ratio has further to fall

- Gold among the worst performing commodities this year. Jewelry and tech demand (60% of total) has rebounded strongly, but investment demand (see chart) remains weak
- Is an interesting indicator on investors **low market crash and inflation surge views**, and may also include some crypto competition
- The long-term gold-Oil ratio (gold price divided by Oil price) remains above its long term average, **signalling further oil gains**

Gold exposure possible, for those wanting, through ETF GDX or @GoldWorldWide smart portfolio, or riskier juniors GDXJ



Source: Refinitiv. *Brent Crude



Source: World Gold Council ETF flows, eToro calculations

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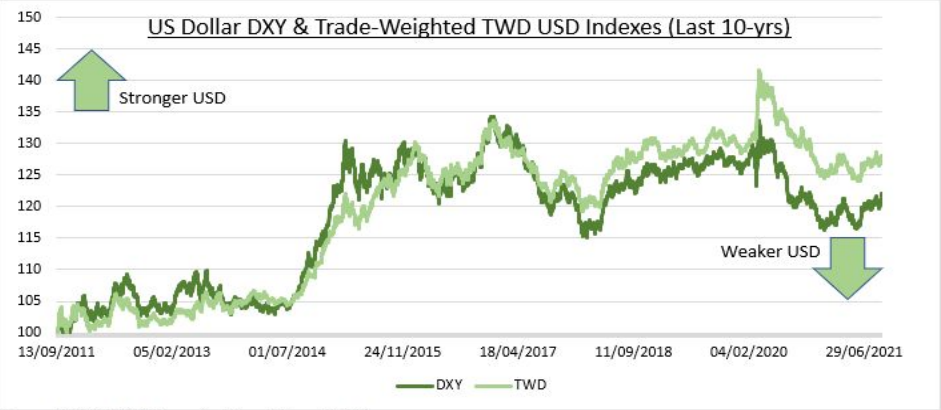
Currencies: USD strengthening on higher bond yields

USD grinding higher. Outperformed all G-10 competing currencies

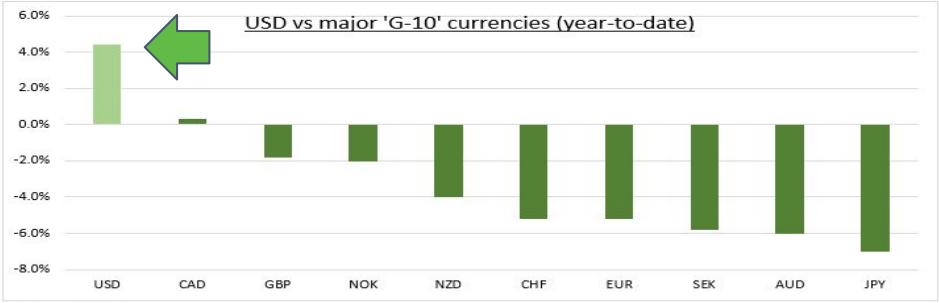
- Perceived **hawkish tilt from US Fed**, with half Governors predicting a interest rate rise by end next year
- **Rising US Treasury Yields** widening the attractiveness of US yields versus Europe and Japan
- Rising **risks of a US debt default**, as October 18 deadline nears, boosting 'safer haven' demand

See medium term USD easing to help 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.



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



Source: Refinitiv

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Crypto: consolidating as CBDC's come into focus

Crypto consolidation

- Crypto consolidating after latest China regulatory crackdown, and market volatility. Bitcoin Q3 +35%. Q4 historically best seasonally
- SEC chair Gensler supports **bitcoin futures ETF.** Fed Chair Powell says does not want to ban bitcoin, in Senate testimony

Central Bank Digital Currency into the spotlight

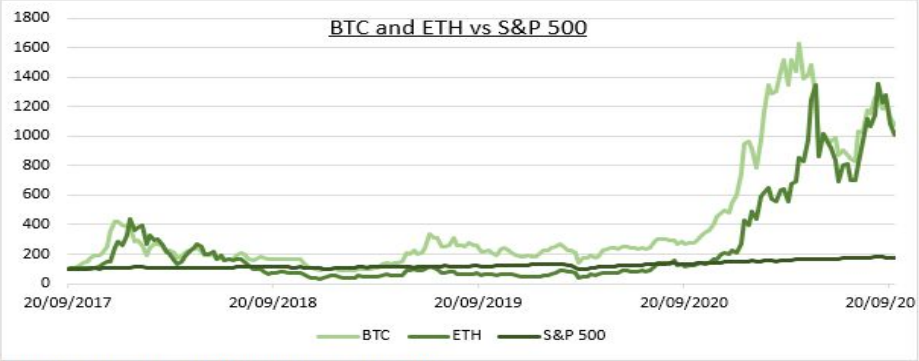
- Bank of International Settlements, Central Bank for Central Bank's, publishes CBDC deep-dive. **Fed to publish research paper 'soon'**
- As stablecoin market cap rises of $130 billion

Adoption trends broadens

- Twitter (TWTR) to integrate **micropayments** Bitcoin Lightening into platform and provide verification features for NFT's.
- Fidelity Institutional Investor digital assets study shows 90% find digital assets appealing but **only 52% are invested** today.

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.

Central Bank Digital Currency (CBDC) Development Tracker

Launched	Pilot	Proof of Concept	Research
Bahamas	China	Japan	USA
	France	Sweden	UK
	Canada	Turkey	Germany
	South Korea	Thailand	Italy
	South Africa		Spain
	UAE		Australia
			India
			Brazil
			Russia

Source: CBDC Tracker

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