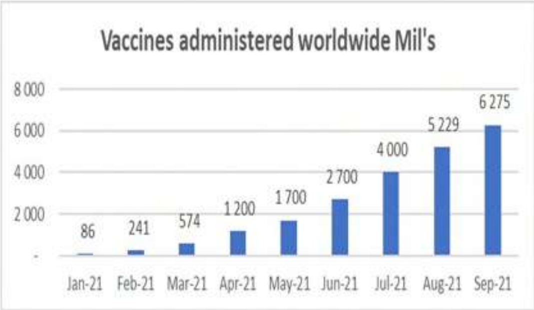
# Douglas Investments
## Investment Environment

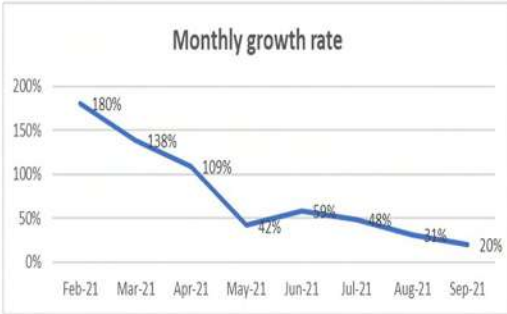
September 2021

### COVID-19 VACCINATION PROGRESS

The number of vaccines administered worldwide continues to grow but at a slower pace. The table on the left shows the absolute number of vaccines administered worldwide; the table on the right shows the growth rate over the prior month – the decline is expected as we start to get closer to “herd immunity”.

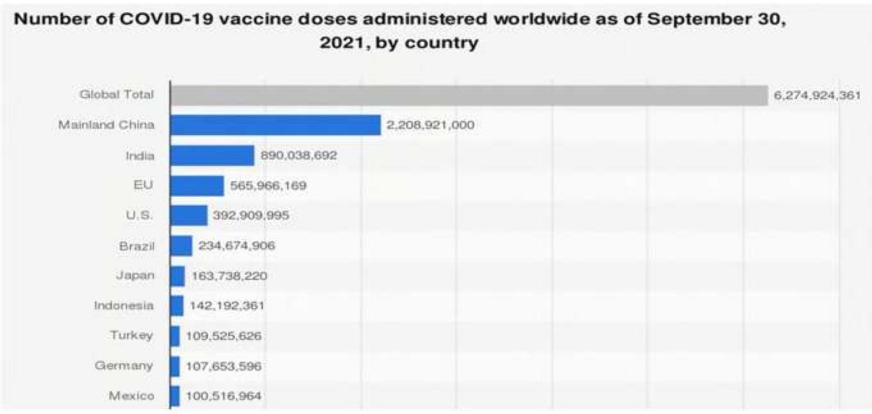



SOURCE: STATISTA




SOURCE: STATISTA

The below graph shows the vaccine doses administered worldwide by country. Emerging markets (China, India, Brazil, etc.) are making significant progress and developed markets continue to do well.



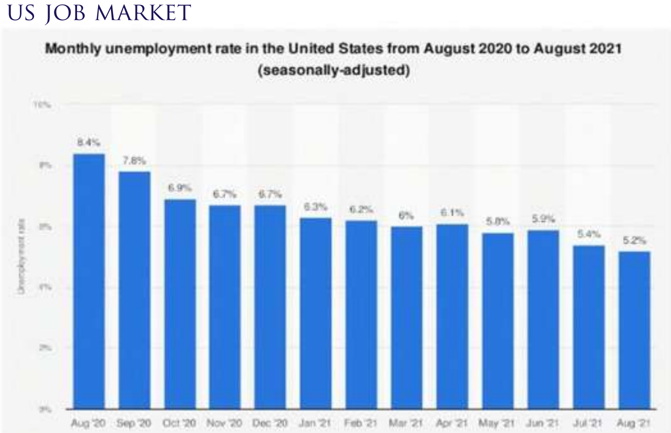

SOURCE: STATISTA

We remain neutral on whether the current progress provides for a “risk on” or “risk off” environment. We recognise the benenfits to date but will aslo monitor efficacy data on a continuous basis as information becomes available.

### FISCAL STIMULUS, INTEREST RATES AND RISK-FREE RATE

The biggest factor driving markets at present remains the future term of US interest rates and the probability of rates rising sooner than anticipated. However, The Fed wants to achieve maximum employment and inflation at 2% or higher for a period of time before considering interest rate increases. It’s worth unpacking how the US job market is developing as well as inflation.

#### US JOB MARKET




The US job market continues to improve but the Fed wants to see a “full recovery” before taking steps to tighten monetary policy by raising interest rates. The August data showed 235,000 jobs were created but the market was expecting 750,000 so the pace of job creation remains in question. The Fed is likely to want to see a more sustained recovery in the job market before acting.

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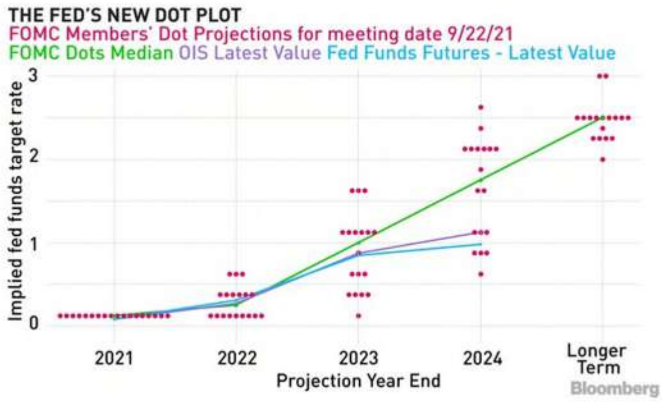
## US INFLATION


Inflation has shown signs of spiking post COVID and is at an elevated level historically. Core inflation, which excludes food and energy – both of which have increased significantly post COVID – has also increased but the Fed remains of the view that the spike is transitory and will likely work its way out of the system once supply chains and supply demand normalizes following the disruptions over the past 18 months. The market, however, believes that higher inflation is here to stay and is forecasting the Fed to act sooner by raising interest rates.

September was a volatile month for equity markets as they continue to digest the economic data and predict the next move by the Fed. We remain of the view that equities continues to be a good asset class to remain invested in. Corporate earnings have met and exceeded market expectations and the Fed is likely to only take steps on interest rates in 2022. The Fed's position can be clearly seen in the "dot plot" which indicates anonymously the stance each of 19 Fed officials who can contribute a dot to the FOMC dot plot. These include seven members of the Board of Governors of the Federal Reserve System and presidents of the 12 regional banks. See the latest dot plot which indicates the expectation of rising interest rates into 2022.




Increasing interest rates will pressure equity prices and we took steps in early September to gradually reduce equity exposure in the portfolios. The USD strengthened during September across all major currencies off the back of a sooner than expected rise in interest rates. The US 10Y treasury yield, as shown below, has increased substantially in September. The US 10Y is viewed as the "risk free" rate around the world and plays an important role in valuing financial assets across multiple asset classes. The increase has caused equity valuations to retrace (as shown in the section below) and bond yields to spike (or prices to drop) impacting the total return for bonds during the month.


*The US10Y yield has risen sharply from 1.29% to 1.52% due to inflationary and interest rate increase*

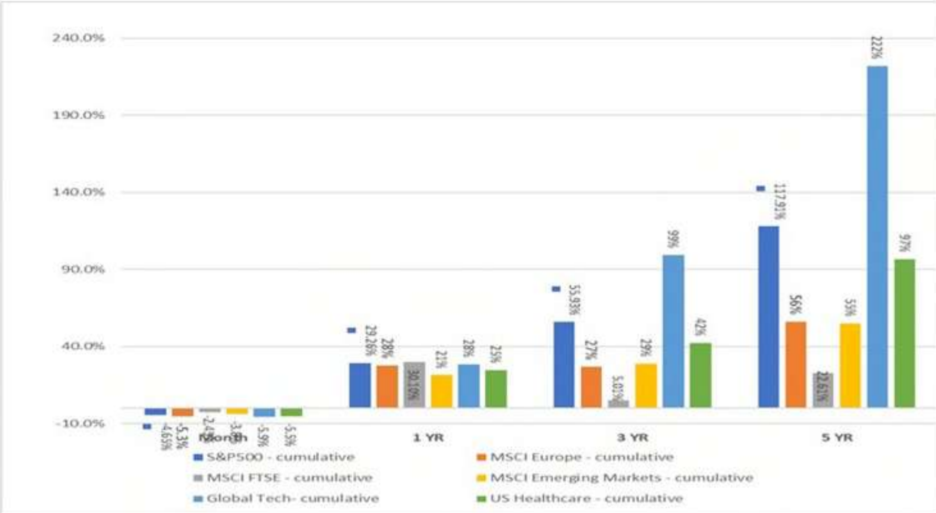
SOURCE: DOUGLAS INVESTMENTS

## EQUITIES

### INDICES PERFORMANCE (ROLLING CUMULATIVE FIVE YEAR RETURNS IN USD):

All market indices were down for the month with Technology (-5.9%) and Healthcare (-5.5%) causing the S&P500 to retrace (-4.9%). Europe (-5.3%), UK (-2.5%) and Emerging Markets (-3.8%) were also down for the month.

The threat of a rise in longer term inflation has re-emerged as has the probability of an earlier than expected interest rate hike. Both of these factors have caused the US10Y to rise significantly in the month putting equity valuations under pressure.




SOURCE: ISHARES

### EARNINGS & VALUATIONS


With Qtr2 earnings season largely complete for the S&P500, the graph alongside shows that ***actual full year growth*** continues to be broad based and ahead of forecasts made in June this year.

Interestingly, 224 companies on their earnings call cited inflation as a factor in forecasting earnings for the remainder of the year.


The graph alongside provides an overview of forecasted net margins for the full year 2021 relative to the forecast in June earlier this year.

The majority of the industries that make up the S&P500 are forecasting a marginal improvement in net margins relative to June this year. It can therefore be implied that whilst inflation is cited as a present issue, it is not viewed as being a significant factor in full year earnings of companies.


This graph was pulled on 17 September and shows the relative price movement to 12-month EPS. With the retracement of price during the last two weeks of September and the improvement in actual and forecasted earnings, the gap of the end point is likely to narrow bring markets more in line with underlying earnings which bodes well for valuations.

## CONCLUSION

Global equity markets have retraced in most cases by >5% in September. This is largely due to global growth moderating and the US Fed forecasted to act quicker with regards to tapering and increasing US interest rates. We took steps in the portfolio to reduce the equity exposure but continue to believe in equities as an asset class for the time being albeit at a lower overall percentage of the portfolio. In addition, steps were taken where appropriate to lighten bond position and increase cash holdings.

In South Africa, political parties are preparing for the municipal elections. Service delivery promises is the main item on their manifestos. It remains to be seen whether these promises will be fulfilled. The ZAR weakened significantly against a strong USD causing ZAR hedge stocks to rally off the back of this movement.