SECOR | ASSET MANAGEMENT

SECOR Asset Management

Macroeconomy and Equity Update

September 20, 2021

Macroeconomy: Brief Updates

- **Global Economy: Still Recovering at Above Trend Pace -- Growth Stronger in Q3 than Q2**
  - Asia, particularly India, reversing extreme Q2 weakness
  - Global mobility – a key indicator of economic activity -- still edging up notwithstanding delta concerns
  - Despite strong recovery, global GDP still ~2% below pre-pandemic level
  - Supply-side constraints persistent headwind

- **Inflation: DM Central Banks Continuing to View Price Surges as Transitory**
  - US, UK, EA forecast inflation to be near or below target by yearend ’22 but…
  - Rising prices (particularly for food) causing some EMs (e.g., Brazil & Russia) to raise rates

- **COVID-19: Latest News Mixed/World Seemingly “Learning to Live with Virus”**
  - New global cases up slightly but not impacting global mobility
  - Vaccinations progressing and effective but delta restraining consumer confidence
  - Global lockdowns diminishing headwind with China relaxing its most recent lockdowns

Macroeconomy: Brief Updates– cont'd

- **DM Policy Backdrop: Still Highly Stimulative, Albeit Beginning to Evolve**
  - Fiscal Policy: Public deficits starting to narrow
  - Monetary Policy: Rates expected to stay "low for longer" but central banks cautiously paring QE programs

- **Major Country/Regional Briefs**
  - *US Economy*: Growth rate still far above trend but encountering some headwinds
    - Job market not able to satisfy demand/wages and labor force participation rates bear watching[1]
    - Due to supply constraints not able to meet auto and housing demand[2]
    - Debt ceiling likely to be reached in October[3] / Large spending and tax initiatives nearing passage
  - *Euro Area:* Robust-reopening rebound carrying over to Q3
    - GDP forecast to reach pre-pandemic level by year end
    - ECB expected to slow PEPP purchases for next three months
    - Lagarde: "Rebound increasingly advanced… improving on many fronts…Lady isn't tapering she's recalculating "

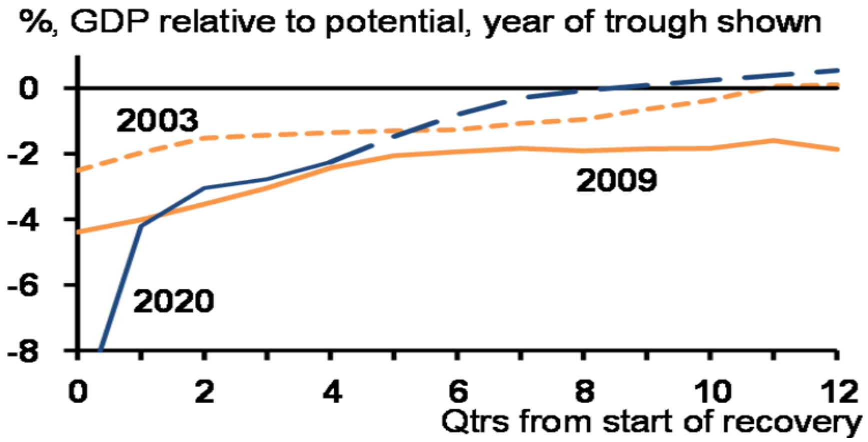
1. Job openings estimated at ~11 million in July, whereas payroll employment growth slowed to 235K in August. Labor force participation rate at 61.7% in August, 0.6% points below pre-pandemic peak- employment down ~ 6 million early 2020..
2. JPM economists estimate that the global pent-up demand for new vehicles is 11.7 million units
3. Failure to raise debt limit by deadline could force government to halt >40% of expected payments, including some payments to households

Macroeconomy Brief Update – cont'd

- UK: Some deceleration from outsized Q2 surge inevitable
  - Continuing above-trend growth expected in Q3, despite weak July
  - Recent tax hike expected to flow through to government spending
- China: Recovering from recent policy-induced cyclical slowing
  - August trade and credit point to near-term rebound
  - Virus seemingly under control -- facilitating re-opening
  - Latest weakness in property market raising new questions
    - Housing activity fell in July and August
    - Evergrande default / restructuring, If it were to occur, expected to be carefully managed

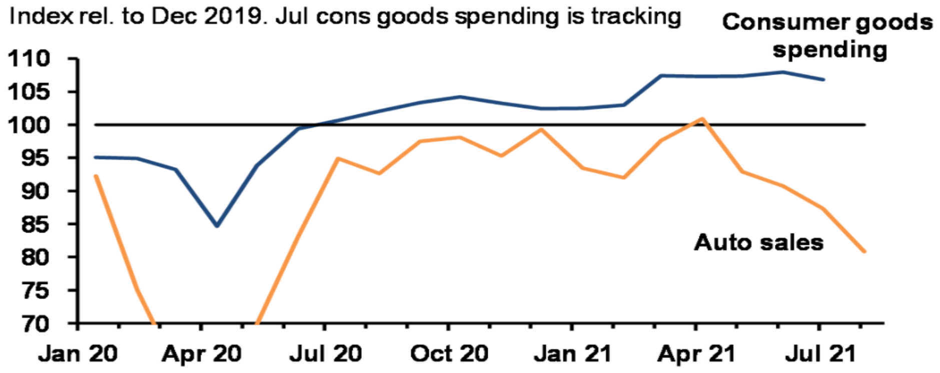
Macroeconomic Backdrop: Strong but Uneven Global Recovery

Global Recovery



- Global economy is experiencing rapid recovery from deep pandemic recession (blue line)
- At mid-year, global GDP was still 2% below pre-pandemic path
- Expected to return to prior path near yearend ‘22

Global Consumer Goods & Autos

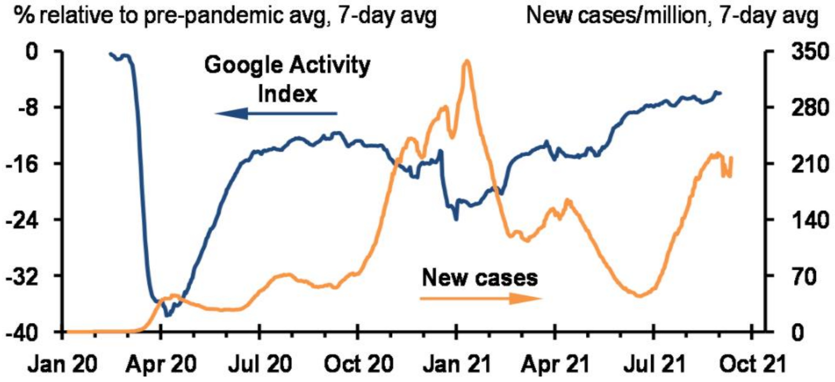


- Uneven recovery from pandemic
- Strong demand lifting consumer goods spending, capex and international trade
- But bottlenecks and virus concerns restraining autos, and many services

Source: JPM

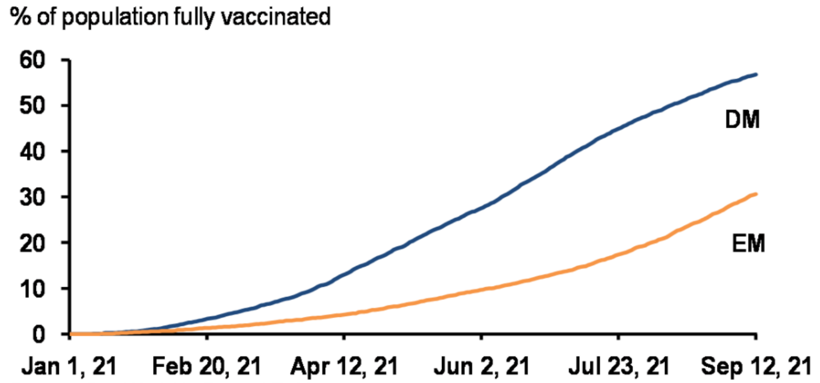
Macroeconomics Backdrop: Global Mobility / Virus / Vaccinations / Efficacy

Global: New COVID-19 Cases and Mobility



- New virus cases starting to edge up once again (gold line) but…
- Global mobility (blue line) seemingly unaffected

Vaccinations



- Vaccinations continuing to increase
- ~55% of DM population and nearly 30% of EM population fully vaccinated[1]
- Latest research confirms vaccines highly effective in preventing severe illness[2]

1. Within European major DMs (80%- 64%) have received 1st dose and in US 62% have received 1st dose
2. Major vaccines (Pfizer, Moderna, Astra Zeneca, J&J) after 150 days shown to be 90% effective in preventing hospitalization

Source: Google, Our World in Data, JPM

Macroeconomy Backdrop: Some Headwinds

Supply Chain Stresses*

- Supply-side of global economy struggling to keep up with demand
- Strong demand creating shortages of some key inputs—particularly semiconductors—and shipping delays which are increasing costs and slowing production in some sections

Global Consumer Confidence

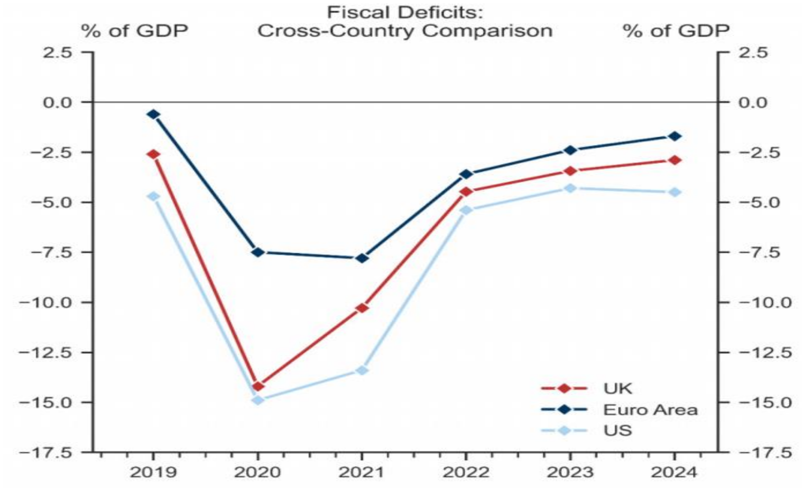
- Consumer confidence has softened somewhat since mid-year due to Delta variant

* APAC = Asia-Pacific

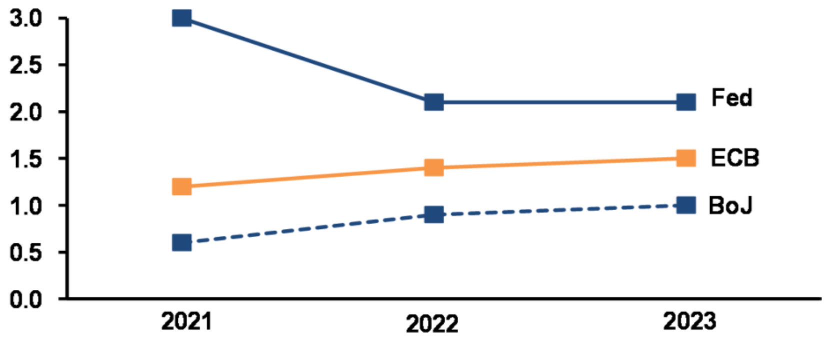
Source: Haver Analytics, GS , JPM

Macroeconomic Backdrop: Fiscal Stimulus Narrowing/Central Bankers Confident

Major DM: Fiscal Deficits



Central Bank Projections: Core Inflation



Source: Fed, ECB, BoJ, J.P. Morgan

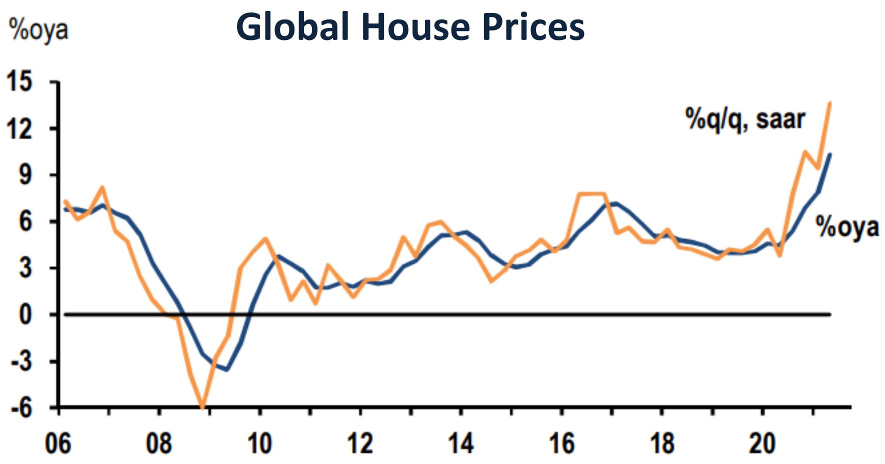
- Fiscal policy will be less stimulative going forward
- Public deficits for major DMs are expected to narrow significantly for over '22- '23 period[1]

- Central bankers remain confident that current inflationary pressures will be transitory

1. US deficit estimate incorporates an assumption of additional fiscal spending of about $3 trillion over 10 years in connection with the infrastructure and social spending packages.

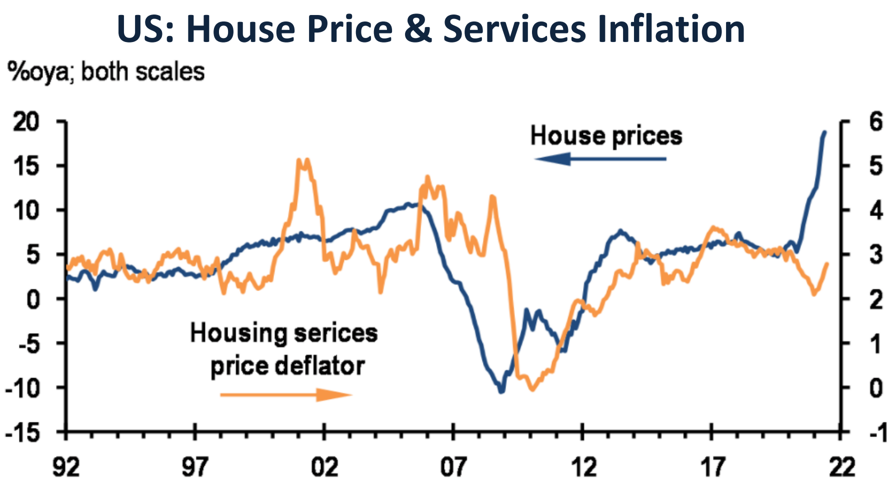
Source: Haver Analytics, OBR,GS

Macroeconomic Backdrop: Global House Prices



Source: JPM

- Global house prices rising sharply[1]
- Demand supported by low rates, fiscal stimulus and mobility restrictions
- Supply constrained by shortages of construction material and labor



- Effect of house prices on inflation indices muted
- CPI indices in most countries measure the cost of housing as the flow of services generated by real estate – e.g., rental equivalent[2]
- Central banks for the most part consider house prices a macroprudential issue. But they could affect tapering decisions

1. Global prices ~9% oya with DM 12.7% oya and EM 6.2% oya.
2. In general, a 10% rise in house prices in the US translates into a2% rise in US housing servicing costs –e.g., deflator service price inflation rose 3.5% in July. Housing services comprise nearly one-third of CPI and ~15% of PCE deflation.

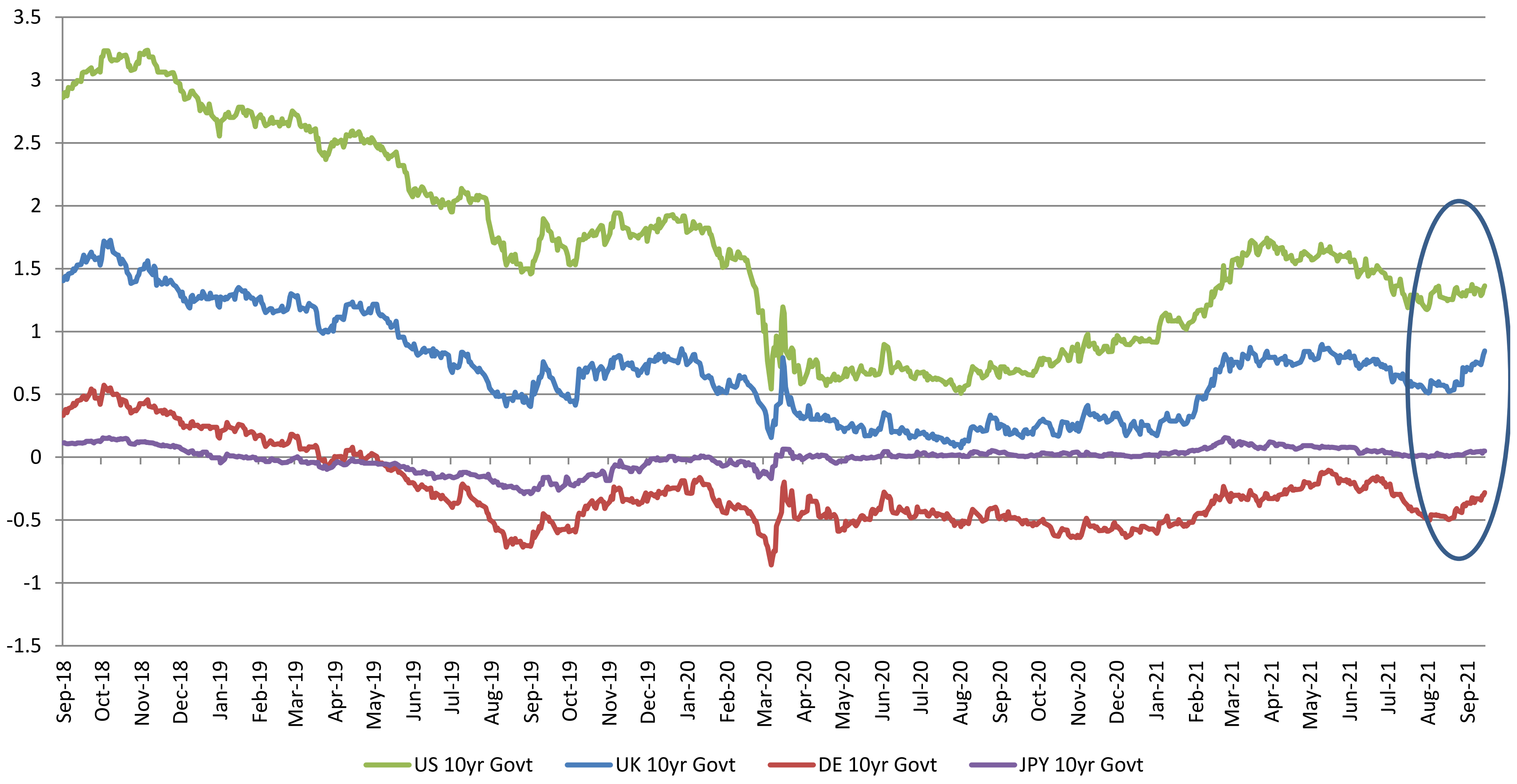
Source: BEA, FHFA, JPM

Market Performance through September 17

(USD)	Since 6/30	YTD	2020	2019	2018
Equities					
MSCI ACWI	1.72%	14.24%	16.26%	26.60%	-9.42%
MSCI EAFE	2.31%	11.34%	7.82%	22.01%	-13.79%
MSCI EM	-6.31%	0.67%	18.31%	18.42%	-14.57%
MSCI US	3.39%	18.52%	20.73%	30.88%	-5.04%
Fixed Income					
BarCap Global Agg Total Return (Hedged)	0.76%	-0.77%	5.58%	8.22%	1.76%
Citi US 10+ Govt Bond Index	3.48%	-4.62%	17.72%	14.89%	-1.89%
BarCap US High Yield Total Return (Unhedged)	1.34%	5.01%	7.05%	14.32%	-2.08%
Oil					
WTI Crude	0.29%	49.91%	-10.14%	5.45%	-2.50%
Brent Crude	3.13%	48.02%	-12.71%	1.60%	-0.49%
Currency					
USD/EUR	1.01%	4.23%	-8.25%	1.86%	7.00%
USD/GBP	0.51%	-0.60%	-3.07%	-3.76%	6.16%
USD/JPY	-0.93%	6.51%	-4.99%	-1.00%	-2.54%
USD/CNH	0.11%	-0.44%	-6.73%	1.38%	5.53%
USD/TRY	-0.46%	16.42%	24.88%	11.93%	40.19%
USD/ARS	2.75%	16.89%	40.55%	58.95%	100.07%

Source: Bloomberg

Sovereign Bond Yields



Source: Bloomberg

Equity Update

September 20, 2021

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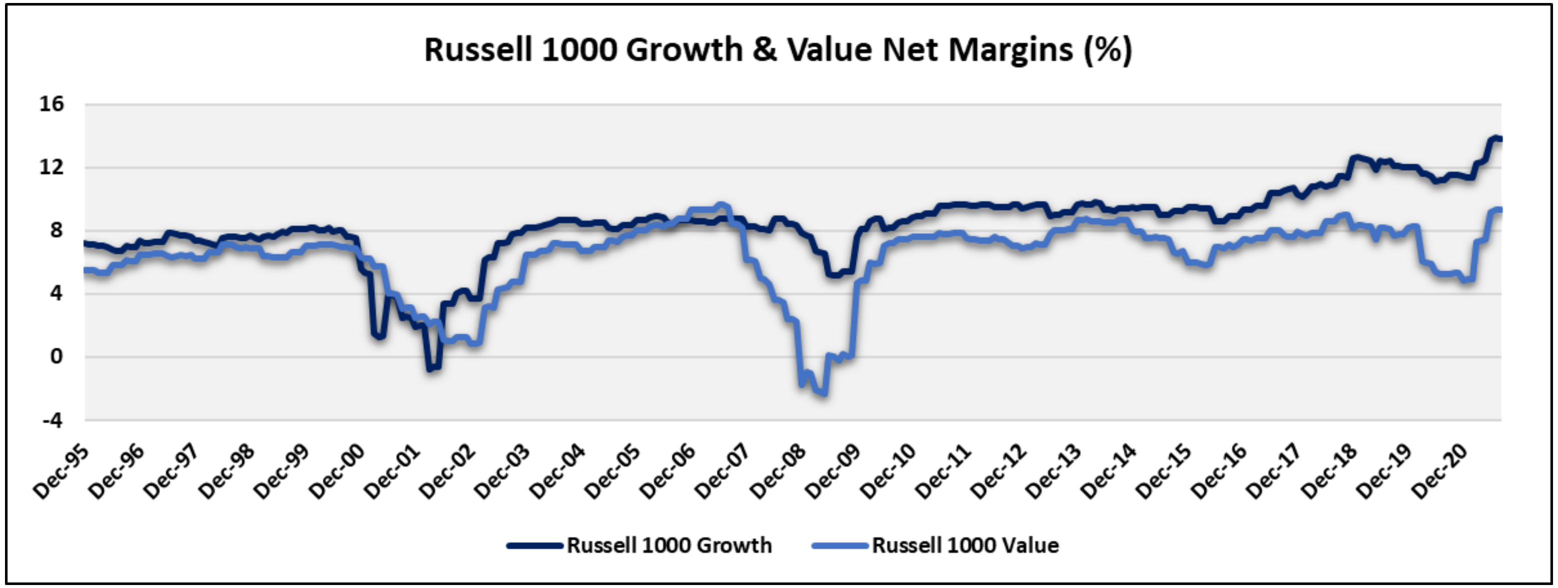
US Growth and Value Net Profit Margins

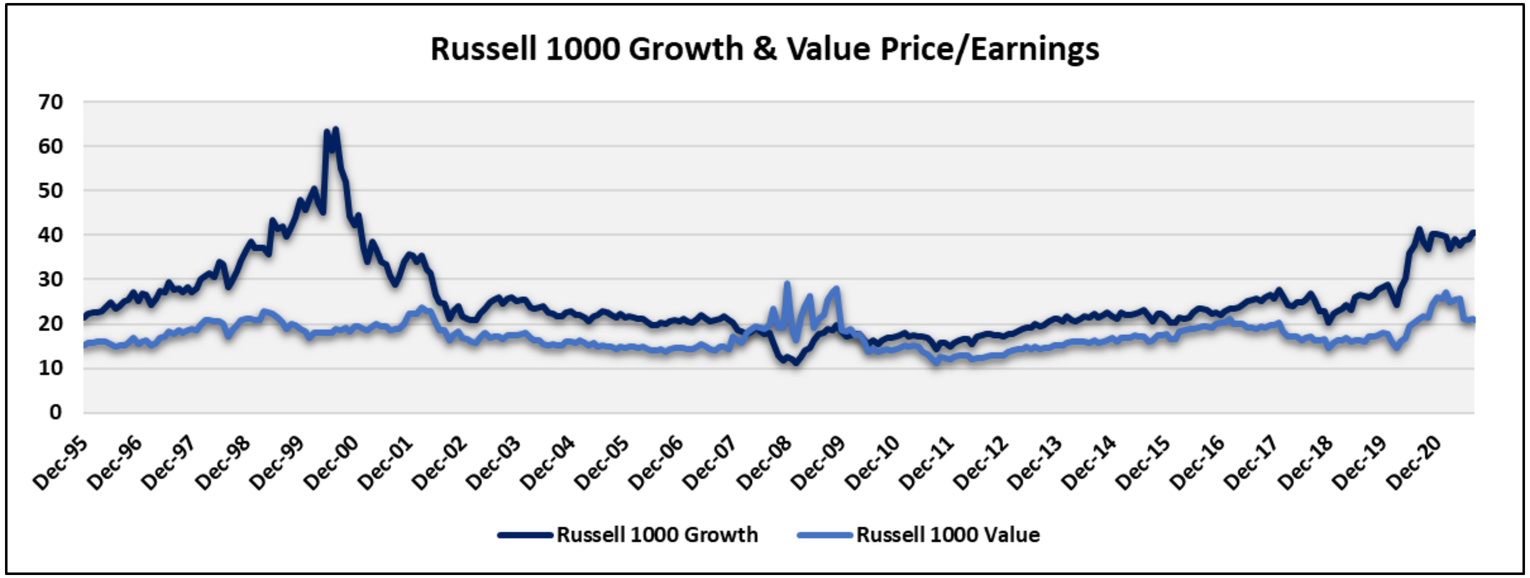
- Value stock profitability has snapped back strongly, surpassing pre-pandemic levels.
  - Value margins have recovered to 9.3%, at a high since pre-GFC and 1.1% higher than at YE2019.
  - Growth margins held up better during the recession, expanding to an all-time high of 13.8%.
  - The good news for Value stocks is that today's margin spread of 4.5% is still more than double the 2.1% average spread since 1995, despite their recovery to near-peak levels. This historically wide spread leaves room for more potential mean-reversion.
  - The bad news is today's near-peak Value margins seemingly leave little room to grow to further narrow the gap; this may require Growth margins contracting, something they have long defied.



Sources: FTSE Russell, Bloomberg, SECOR.

US Growth vs Value P/E Multiples

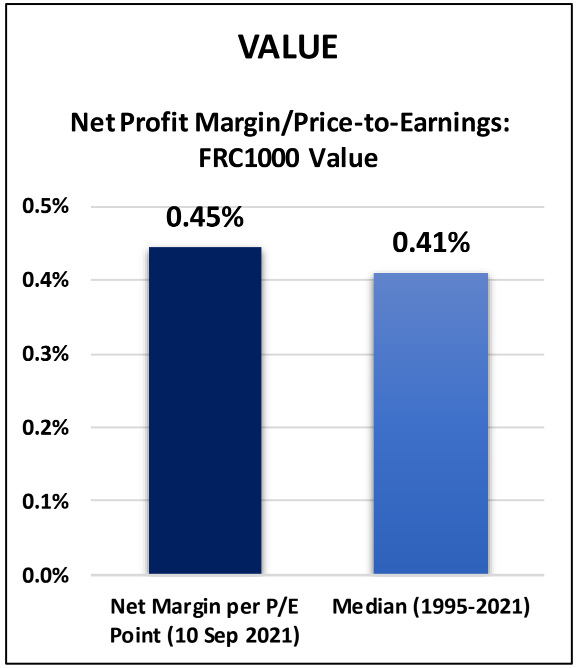
- Despite the Value rally in H1 2021 where it outperformed Growth by 4.7%, Growth stocks have since reasserted their performance dominance, recouping most of their first half deficit by outperforming Value by 4.4% from mid-year through 15 Sep 2021. Dating back to the end of 2019 and the earliest days of the pandemic, Growth stock returns lead Value, 35.1% vs 12.7%.
  - This result has been a further widening in the P/E spread between the styles, even with the recent sharp bounce back in Value earnings. Today's P/E spread of 19.6 is triple the median spread of 6.5 multiple points since 1995.

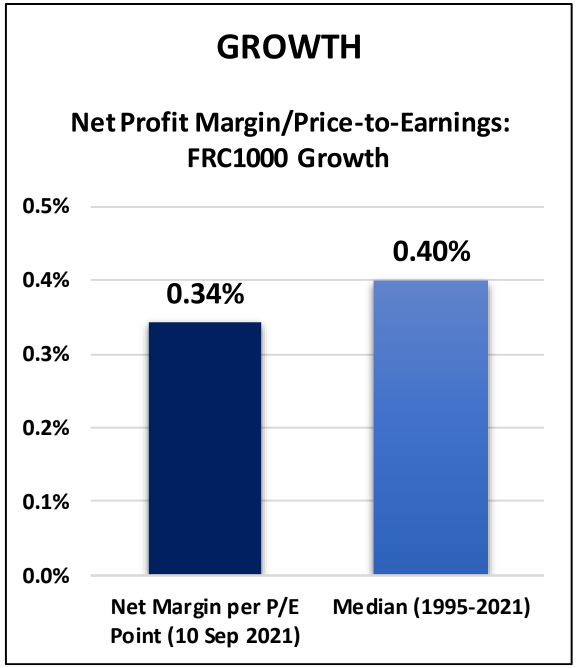


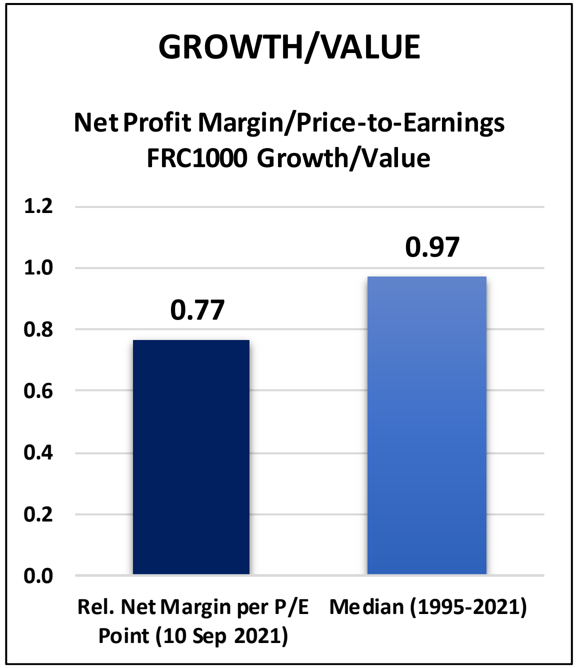
Sources: FTSE Russell, Bloomberg, SECOR.

US Growth vs Value

- As a result of the combination of improved Value earnings with the continued expansion in the P/E multiple for Growth stocks, Value stocks now appear attractive when profitability is scaled by Valuation.





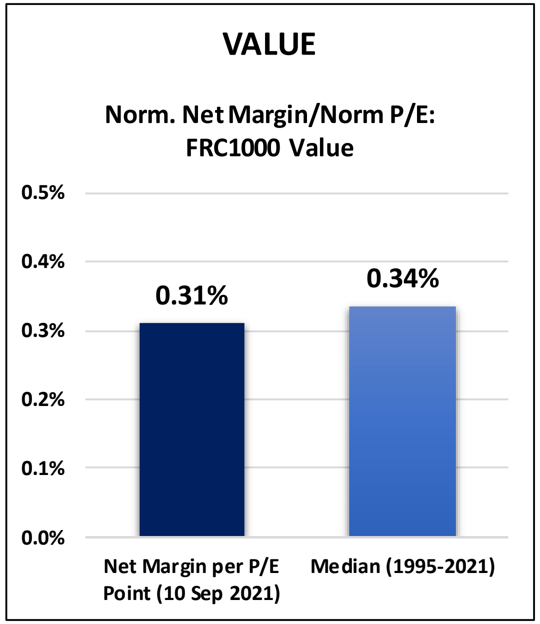


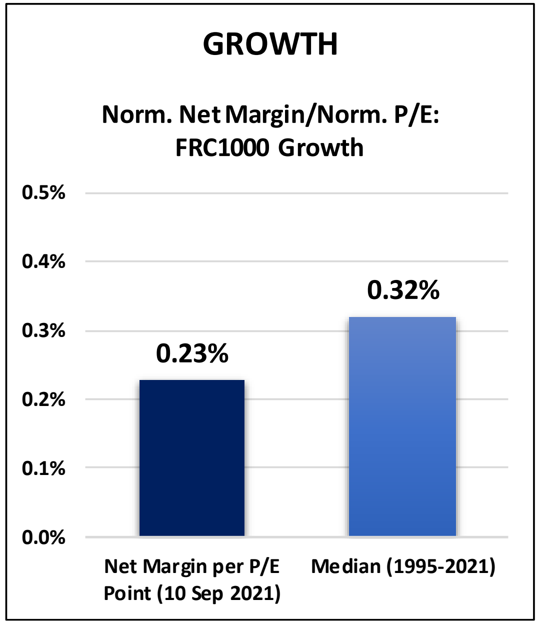
*Growth - Value return spread for convergence to historical median assuming no change in current margins is **-21%.***

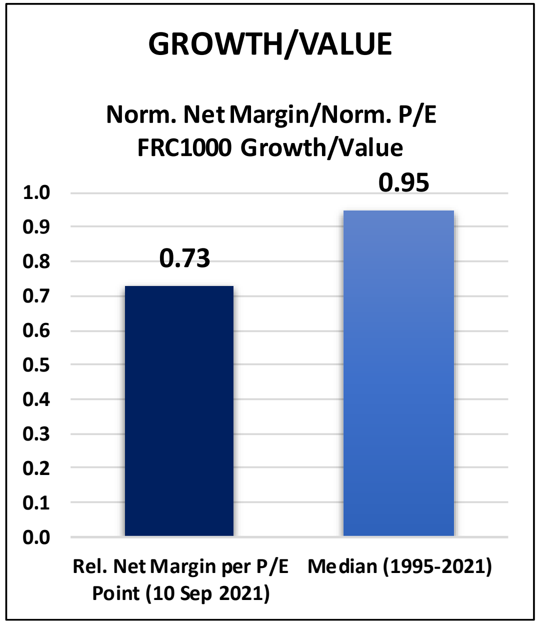
Sources: FTSE Russell, Bloomberg, SECOR.

US Growth vs Value

- Value's attractiveness is not just the result of cyclical-peak Value margins as both styles are now operating at peak or near-peak profitability and the spread in normalized margins remains wide versus history.
  - Normalizing earnings by using a 5-year average for earnings and margins yields a similar result.







*Growth - Value return spread for convergence to historical median assuming no change in current margins is **-23%.***

Sources: FTSE Russell, Bloomberg, SECOR.

Non-US Growth vs Value

- And Value stocks remain attractive outside of the US in this framework.
  - Value underperformance has not been as dramatic outside the US, nor has the divergence in relative profitability been as wide, although EM most resembles the US in this regard with the rise of its Tech giants mirroring the US experience until recently.

Implied Growth-Value Return Spread to Revert to Historical Median Margin per P/E Point

as of 10 September 2021

	TTM Earnings	Normalized Earnings
US	**-21%**	**-23%**
Europe	**-22%**	**-20%**
Japan	**-36%**	**-38%**
EM	**-27%**	**-38%**

Sources: FTSE Russell, Bloomberg, SECOR.

Growth vs Value

- The bull case for Value:
  - Despite near all-time high profitability, portions of the Value universe, most notably Travel and Leisure companies, are still operating well below peak levels of profitability as the Delta variant has disrupted re-opening. There is still ample room for Value margins to expand from current levels.
  - Growth stock valuations have overshot their fundamentals and their profit margins are vulnerable to increased regulation, as we are currently witnessing in China.
  - The era of rate repression begins to unwind as taper talk intensifies. Shorter duration Value stocks rally as rates normalize.

- The bear case for Value:
  - Value margins have peaked and negative effects from the pandemic linger. Long-term changes in behavior disproportionately impact Value companies.
  - Growth stock margins prove sustainable in the long-term, even as increased regulation in the short-term hampers Growth stock profitability. The increased competition from levelling the playing field fosters the rise of the next generation of highly profitable Growth companies.
  - Despite their hints of tapering, Central Banks continue their accommodative practices whenever markets push back, prolonging the low-rate tailwind for longer duration Growth stocks.

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