TOP DOWN CHARTS

Chart driven macro insights for investors

Quarterly Strategy Pack – Q1 2021

1. **Introduction:** Background and reason for being.
2. **Research Process & Philosophy:** How I approach markets.
3. **Core Views:** Big picture macro/market outlook and asset allocation views.
4. **Interesting Ideas:** Some specific short and medium term directional views.
5. **Positioning:** Summary of views across asset classes.

1. Introduction

TOP DOWN CHARTS

Topdown Charts Limited is a New Zealand registered and headquartered company, founded on the 5th of September 2016. Topdown Charts is a 100% independent pure investment research firm.

The focus of the research is global economics and asset allocation. **The aim is to serve as a trusted and valued resource for portfolio managers and investment advisors.** This is achieved by delivering high quality insights, innovative and original research, and personalized service - with the perspective of a multi-asset portfolio manager front of mind.

Callum Thomas
Head of Research

Callum is founder and head of research at Topdown Charts. Prior to starting the business he worked in investment strategy at AMP Capital, AXA Global Investors, and the New Zealand Stock Exchange. Having spent his career in Australia and New Zealand he has by necessity developed a strong global focus, and sound capability in chart-driven top-down analysis for asset allocation.

Callum holds a Masters in Banking, Masters in Finance, and Bachelor's degree in Finance all earned at Massey University.

2. Research Process and Framework

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Research Process

Valuation

Valuation as a common anchor in the thesis
- Identify and develop valuation indicators
- Monitor for extremes (where the best opportunities are found)
- Explore the relative value case (no asset exists in a vacuum)

Cycle

Cycles are a constant across time and markets
- Identify the core cyclical/monetary drivers for the asset class
- Develop and monitor indicators and key data points
- Clarify how asset prices evolve across the cycle

Tactics

Round out the idea with tactical guidance
- Tactical indicators aid in idea generation + implementation
- Apply disciplined and sensible technical analysis techniques
- Look for extremes in sentiment, flows, and positioning

Key Beliefs

- Risk = owning an asset which is overvalued, overowned, overbought and out of time.
- Risk also = underexposed to assets which are undervalued, unloved, oversold, and turning around.
- See things as they are: minimize forecasting, be data-driven yet be unapologetically forward looking.
- Must define/frame key risks and drivers for a given asset class.
- Must know what indicators/charts to watch and monitor (and strive for constant innovation/improvement).
- Aim = put the odds in your favour.

2. Key Objectives and Scope of Research

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Really there are 3 key objectives that we aim to deliver: **risk management input** (investors tend to disproportionately punish permanent loss of capital vs rewarding exceptional performance), **idea generation** (but exceptional performance is still critical!), and help our clients **gain perspective** (which not only helps them in managing money, but also communicating with their clients and stakeholders).

Risk Management	Idea Generation	Gain Perspective
• Rule 1 of investing: don't lose money. • What do we need to be paying attention to?	• Engage multiple factors to find the best ideas. • Create unfair advantage for our clients through superior research.	• Stay focused on the signal, not the noise. • Inform our clients with cutting-edge studies.

Investment Universe

Equities
- ❑ Regions/Countries
- ❑ Sectors/Industries
- ❑ Styles/Factors

Alternatives
- ❑ Commodities
- ❑ Currencies
- ❑ REITs, MLPs

Fixed Income
- ❑ Government bonds
- ❑ Corporate credit
- ❑ Inflation linked

3. Core Views

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Big Picture Macro/Market/AA Outlook:

1. Themes That Echo: massive monetary stimulus, (more) fiscal stimulus, green shoots, backlogs

2. “Where is Inflation?” better question = *when* is inflation? Clear upside risk to inflation near term

3. Risks Remain: second/third waves, vaccine efficacy + efficiency, policy and (geo)politics

4. Mega Theme (The Big Ideas for 2021): the set of ideas that are likely to do well in the year(s) ahead

5. Growth vs Defence: overweight growth vs defence, pay attention to the sign posts for next steps

6. Global Equities: fade passive - it’s time to get more nuanced in the allocations

7. Commodities & USD: new beginnings or old ranges, that is the question, the answer is probably both

3. Core Views: Themes That Echo…

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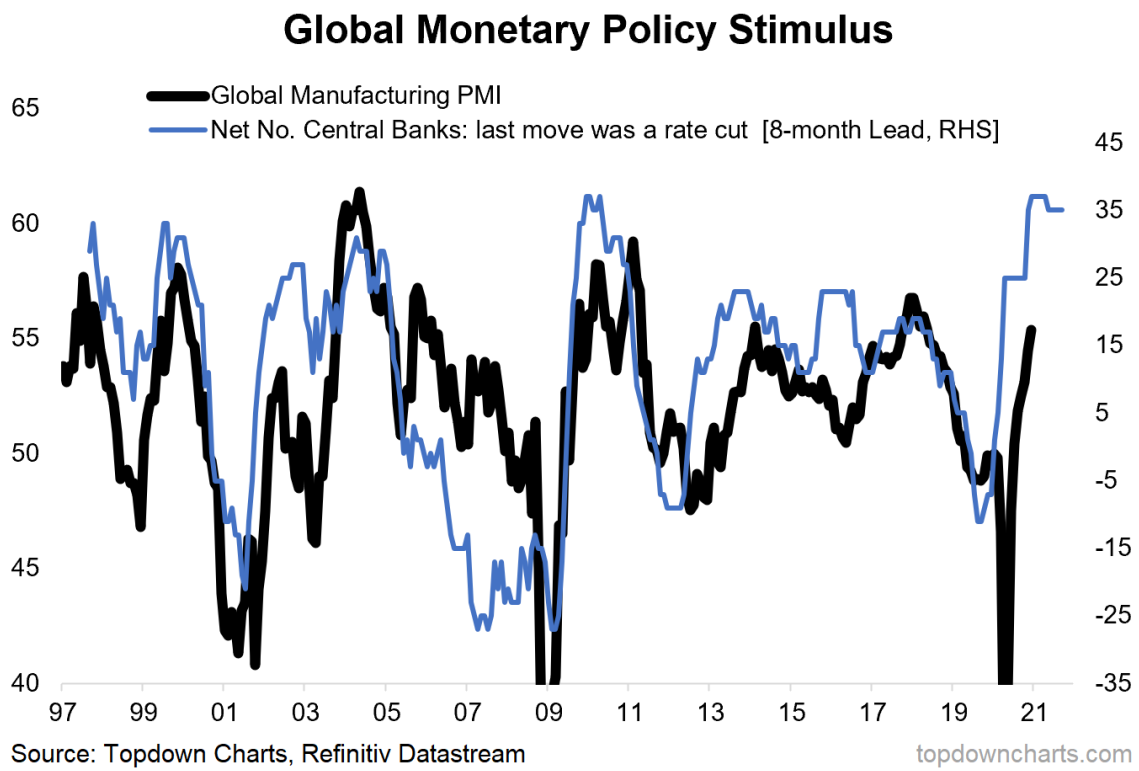
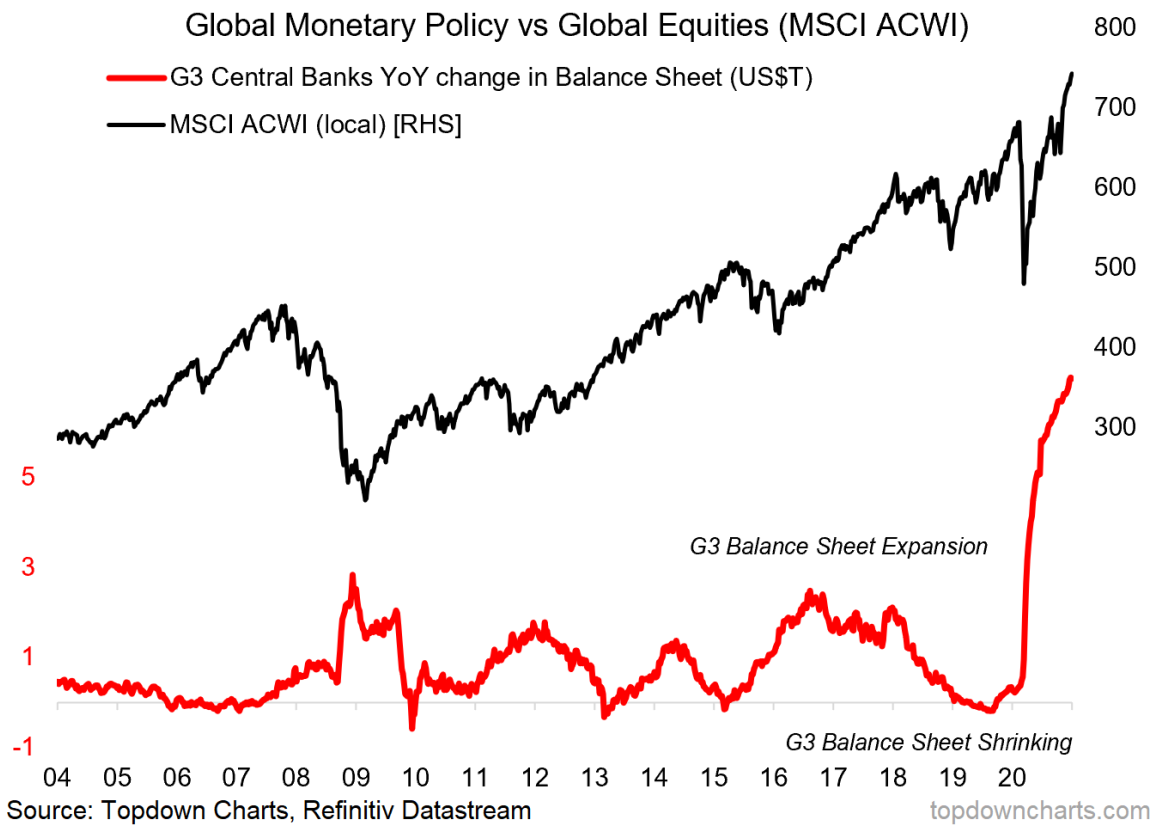
Massive Monetary Stimulus: a key theme that echoes even from 2019 - the policy pivot turned to policy panic in 2020 with historic globally coordinated conventional and unconventional monetary policy stimulus now baked in. I don't expect much incremental easing on the monetary front (nor tightening any time soon), indeed, I suspect if anything it's over to fiscal to do the heavy lifting…





3. Core Views: Themes That Echo…

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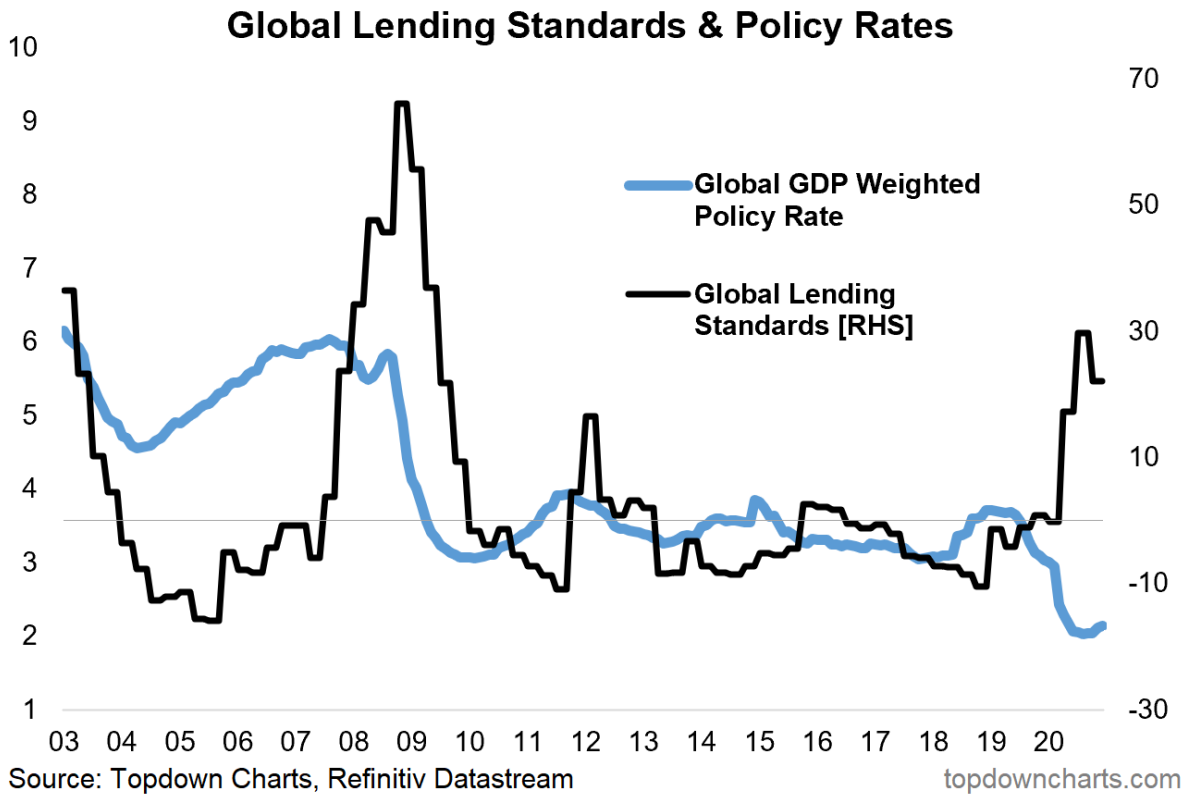
Monetary Policy Limits - Passing the Torch to Fiscal: Monetary policy has its merits, and can be implemented rapidly, but as former Fed Chair (and incoming Treasury Secretary) Janet Yellen has extensively noted: fiscal policy can play an important role in dealing with severe economic downturns. And indeed, fiscal policy looks set to play an increasingly important role in "recovery and transformation", as governments take the opportunity to get longer lasting initiatives in place.



Fiscal stimulus planned/announced	US$ Amount
USA: already approved for 2021	US$900B
USA: possible further stimulus package	~US$750B
Europe: raise debt for recovery spending	US$900B
Europe: economic transformation 2021-27	US$1.3T
Japan: fiscal stimulus + transformation 2021	US$700B
Global: IMF Fiscal Monitor as at Oct 2020 total spending/foregone revenue announced	US$5.9T
Global: Liquidity measures e.g. guarantees	US$5.8T

Source: Topdown Charts, IMF, Reuters, CNBC, Google News

3. Core Views: When Is Inflation?

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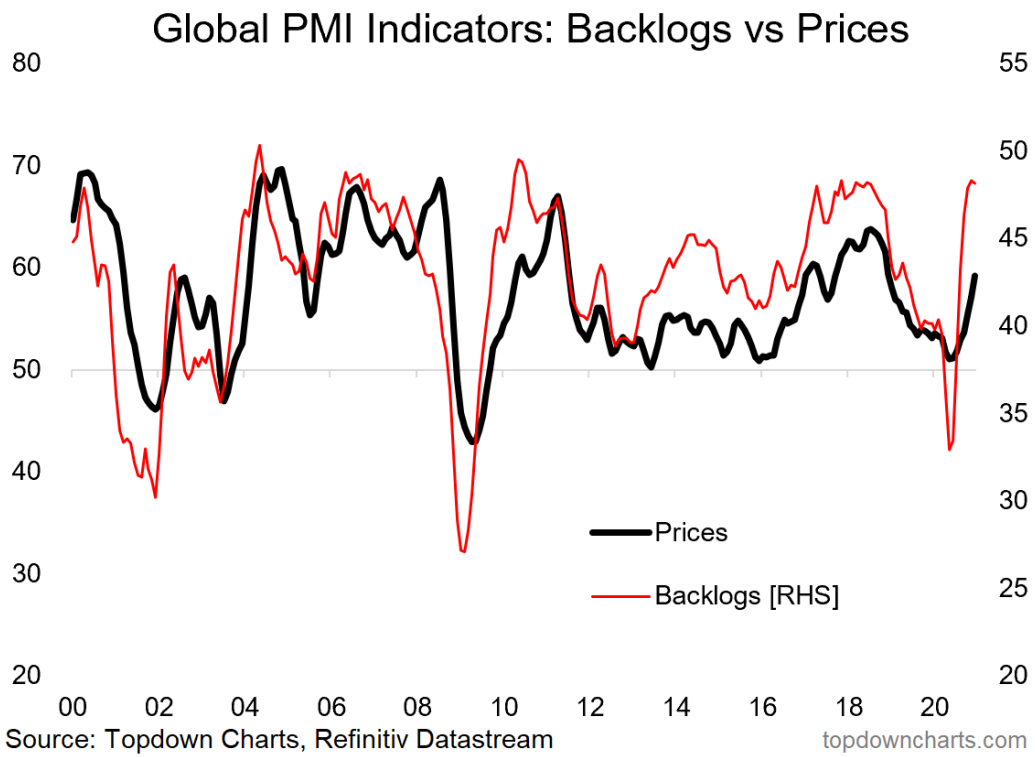
Green Shoots + Stimulus + Backlogs = Inflation: As noted there is substantial monetary and fiscal policy stimulus in the system already (and on the way), we are also seeing clear economic green shoots, and commodities have seen broad strength and we still have the issue of backlogs. Thus inflation risks are clearly tilted to the upside, and likely start to show up in Q2 (n.b. base effects).



3. Core Views: Risk Radar

Political Geopol Economic Upside

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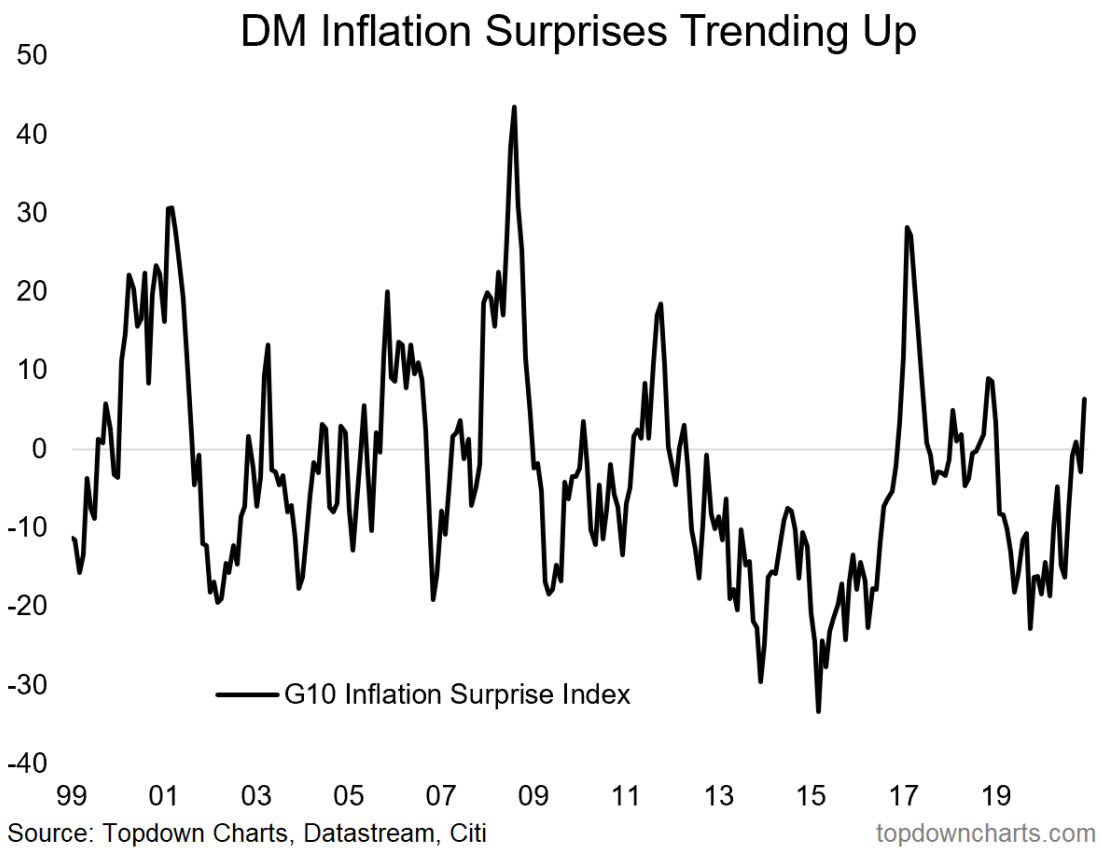
Downside risks in the short-term are dominated by the virus, but further out a number of important and credible risks start to come into focus. Equally though, there are still upside risks to be mindful of.



Risk List

- USA: Big Tech regulatory risk (bipartisan)
- USA: Corporate tax hikes

- Virus resurgences and lock-back-downs
- Virus mutation/vaccine efficacy issues
- Civil unrest (economic/food/virus stress)
- Geopolitics: Iran/M.East, North Korea
- Geopolitics: China vs USA "Cold War 2.0"

- Longer/Deeper economic shock (vs exp.)
- Debt default cascade (secondary crisis)
- Inflation comes faster/higher vs expected
- Global: monetary policy early exit/mistake

- Faster global vaccination than expected
- Faster recovery than expected
- More stimulus than expected (e.g. infra.)
- Stimulus triggers asset bubble/overshoot

3. Core Views: Mega Theme (the big ideas)

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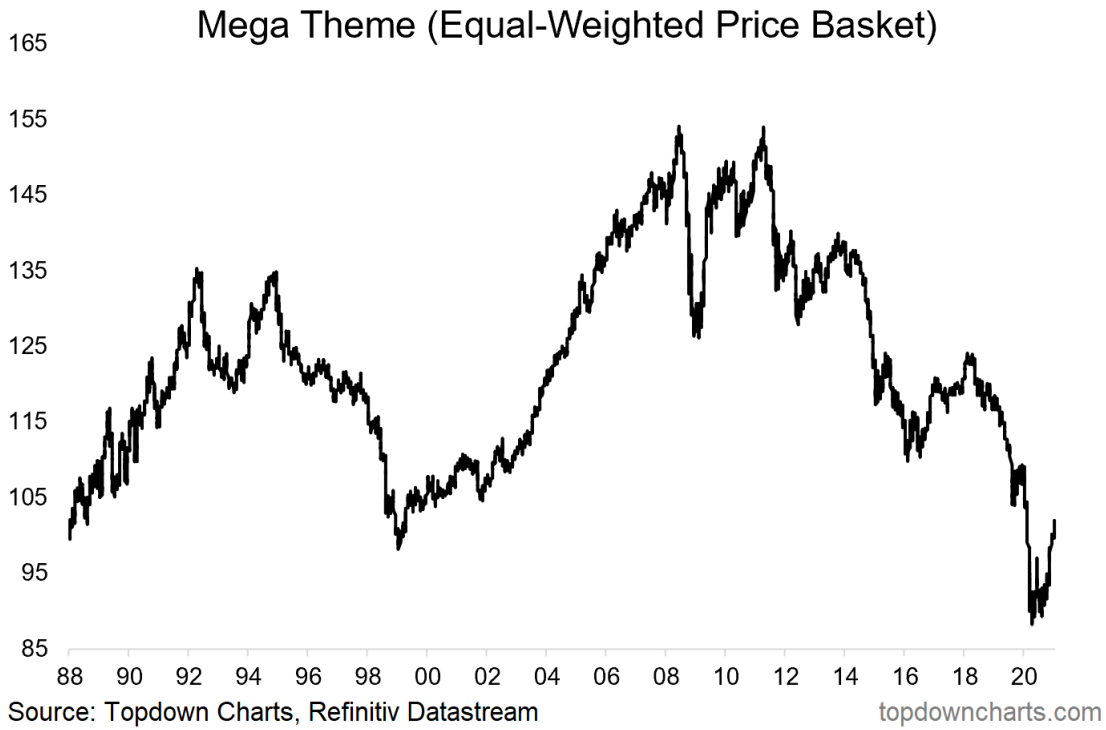
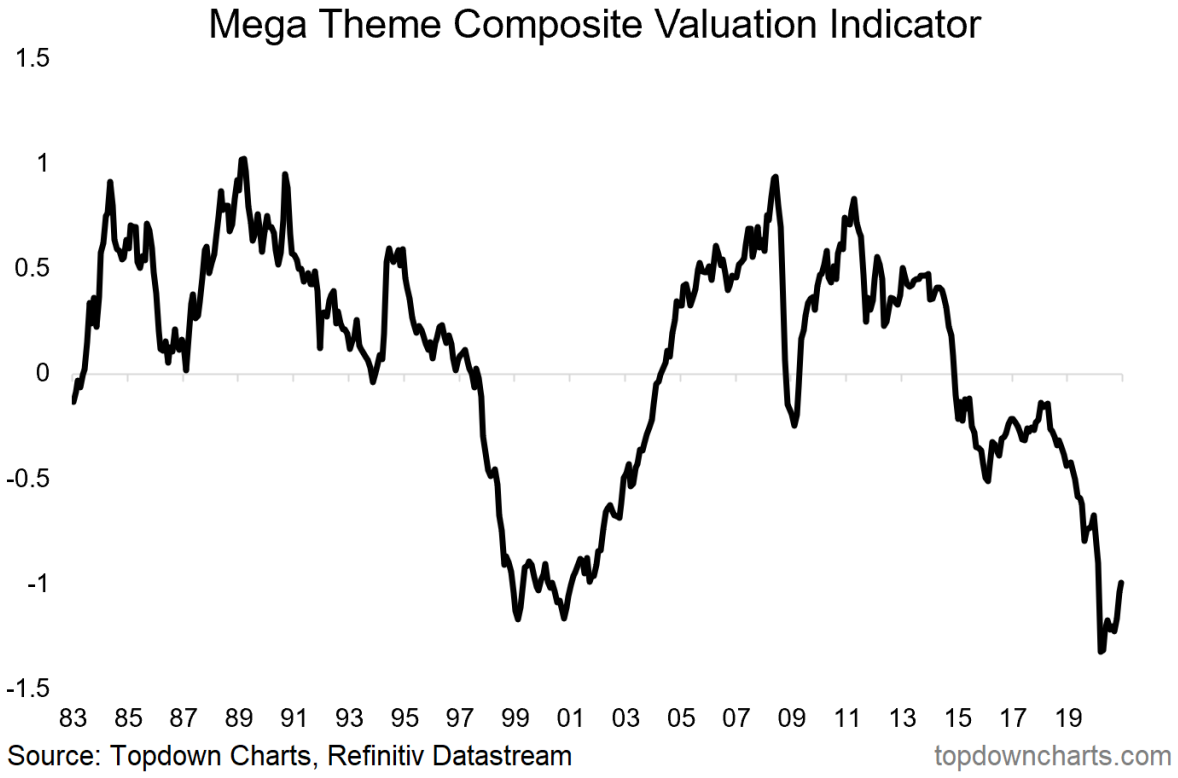
With global stimulus still playing through the system, and a fairly optimistic outlook for the global macro picture, a reflation/risk-on type of environment should help the "mega theme" I outlined late last year – which basically lumps all my big ideas into one theme (given many of them likely benefit from normalization and recovery, and many of them have strong valuation arguments).



"Mega Theme" consists LONG: global ex-US vs US, EM vs DM, EM ex-Asia vs Asia, Value vs Growth Small vs Large, Commodities, EM FX, [and SHORT/inverse: US dollar index, gold, US treasuries]



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3. Core Views: (bullish) Growth vs Defense

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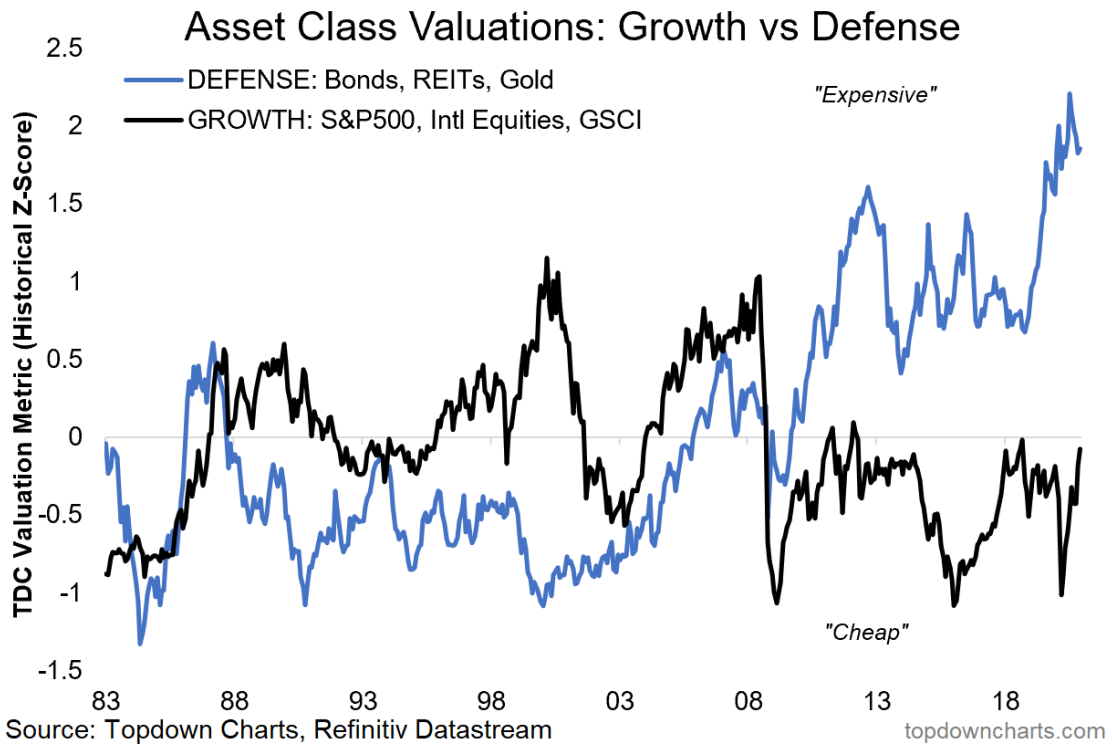
Aside from the big ideas, at the highest level I remain bullish growth vs defensive assets. It is true that valuations have rebounded sharply for growth assets, but defensive assets remain extreme expensive. Importantly, policy remains easy, earnings/cycle is turning up, and the technicals look good. There's no clear case to get defensive from a big picture medium-term standpoint yet, but obviously we'll keep monitoring the key sign posts for clues as the cycle progresses.



	Max Growth	Max Defense
Valuations	Cheap	Expensive
Monetary Policy	Easy/Easing	Tight/Tightening
Earnings/Econ (1)	So bad it's good	So good it's bad
Earnings/Econ (2)	Turning up	Turning down
Sentiment	Excess pessimism	Excess optimism
Positioning	Light/Excess Cash	Heavy/Min. Cash
Technicals (1)	Oversold	Overbought
Technicals (2)	Breakout	Breakdown
Technicals (3)	Uptrend	Downtrend

3. Core Views: UW government bonds

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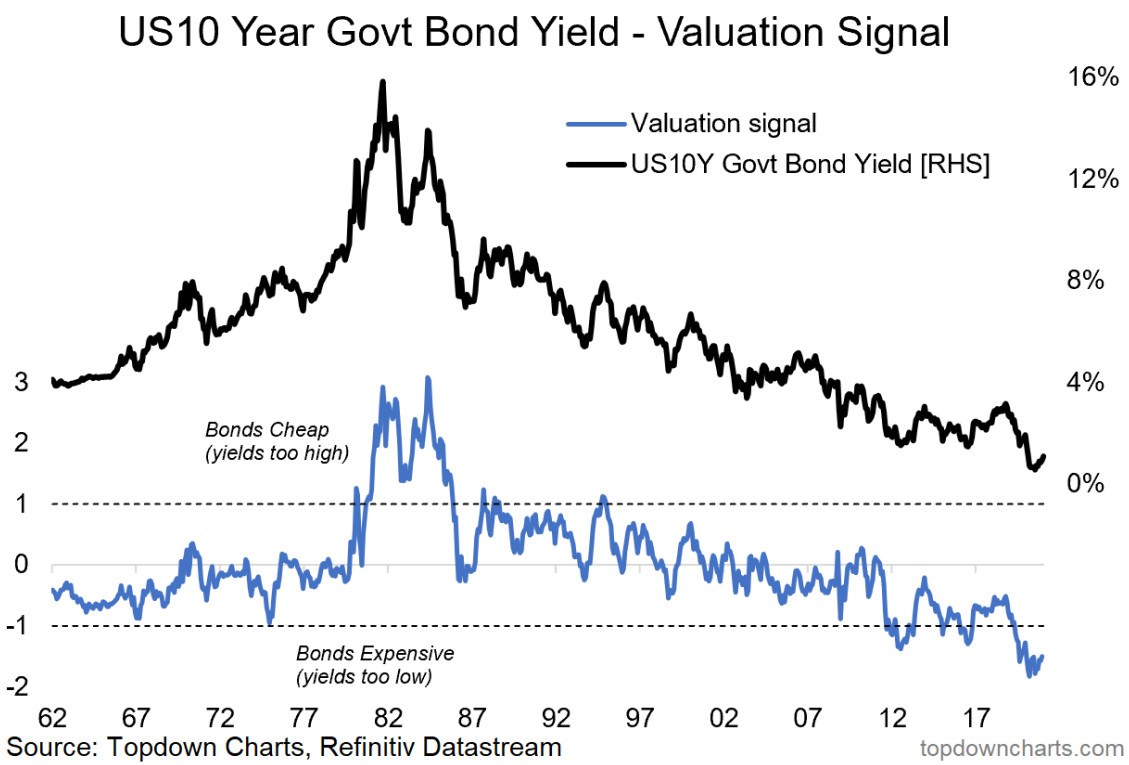
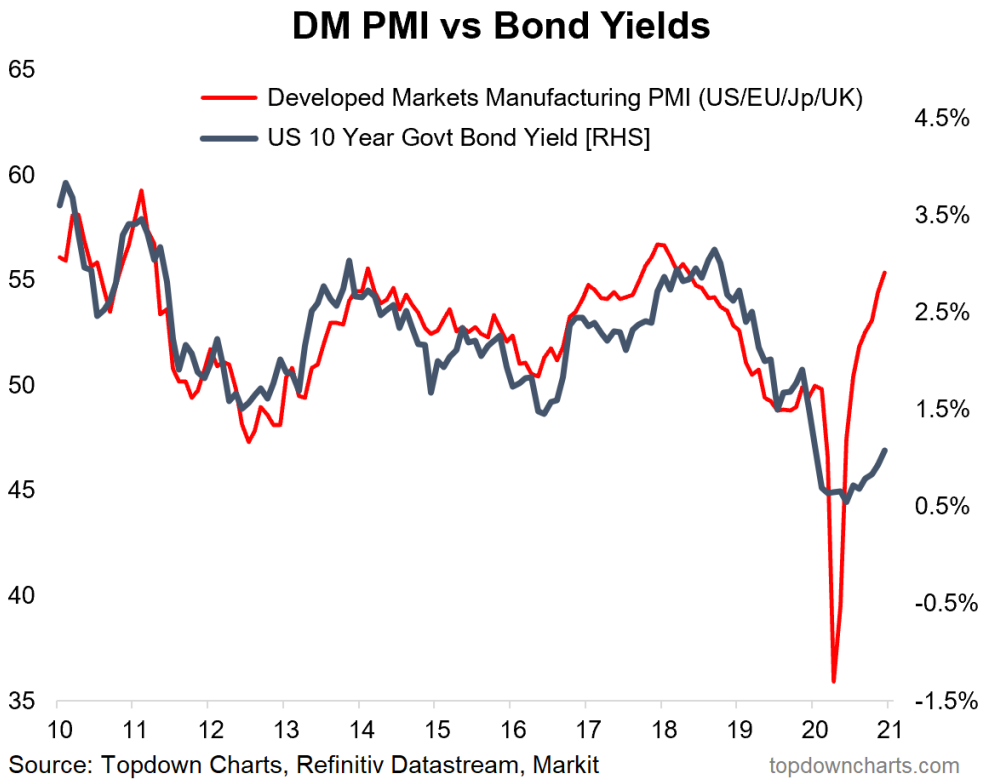
In terms of treasuries, valuations remain extreme expensive, sentiment has clearly started to turn, and multiple macro/market indicators point to higher yields (e.g. the PMI). Add to that the final US election results which have the Democrats with a clean sweep: this puts a more aggressive fiscal policy program on the agenda, and that's likely bullish growth/inflation >> bearish bonds.





3. Core Views: remain OW Global (ex-US) Equities

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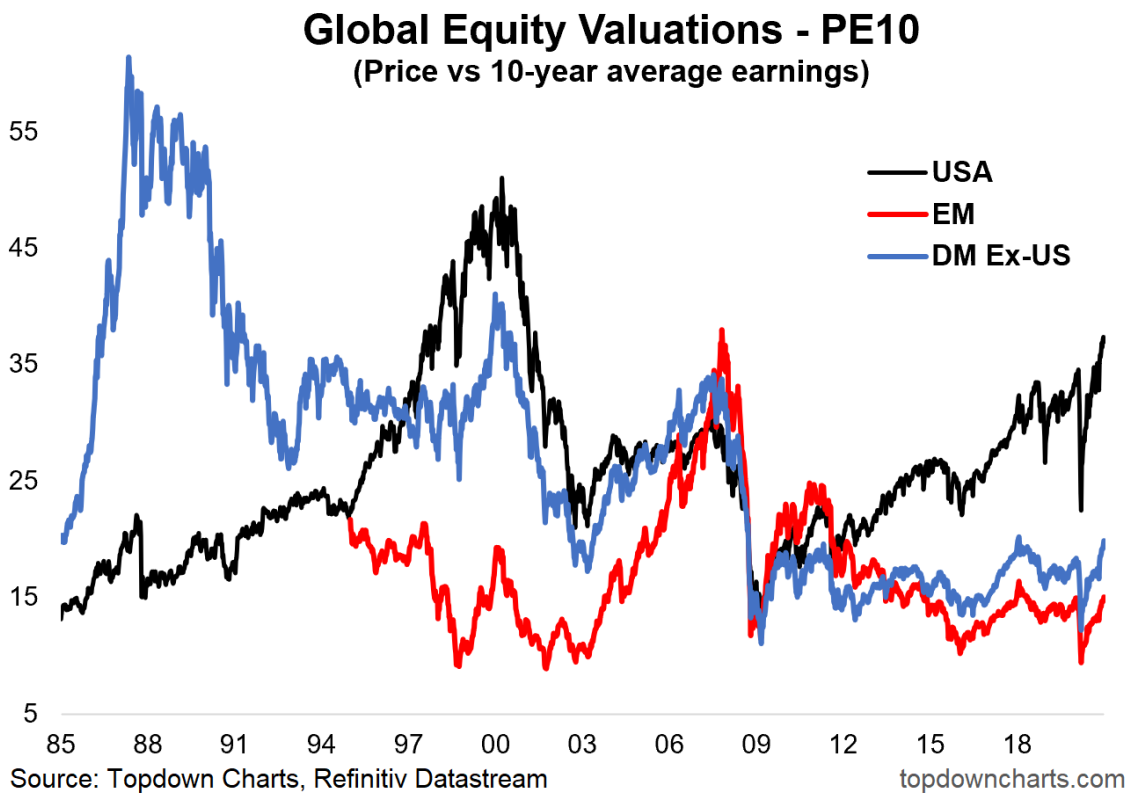
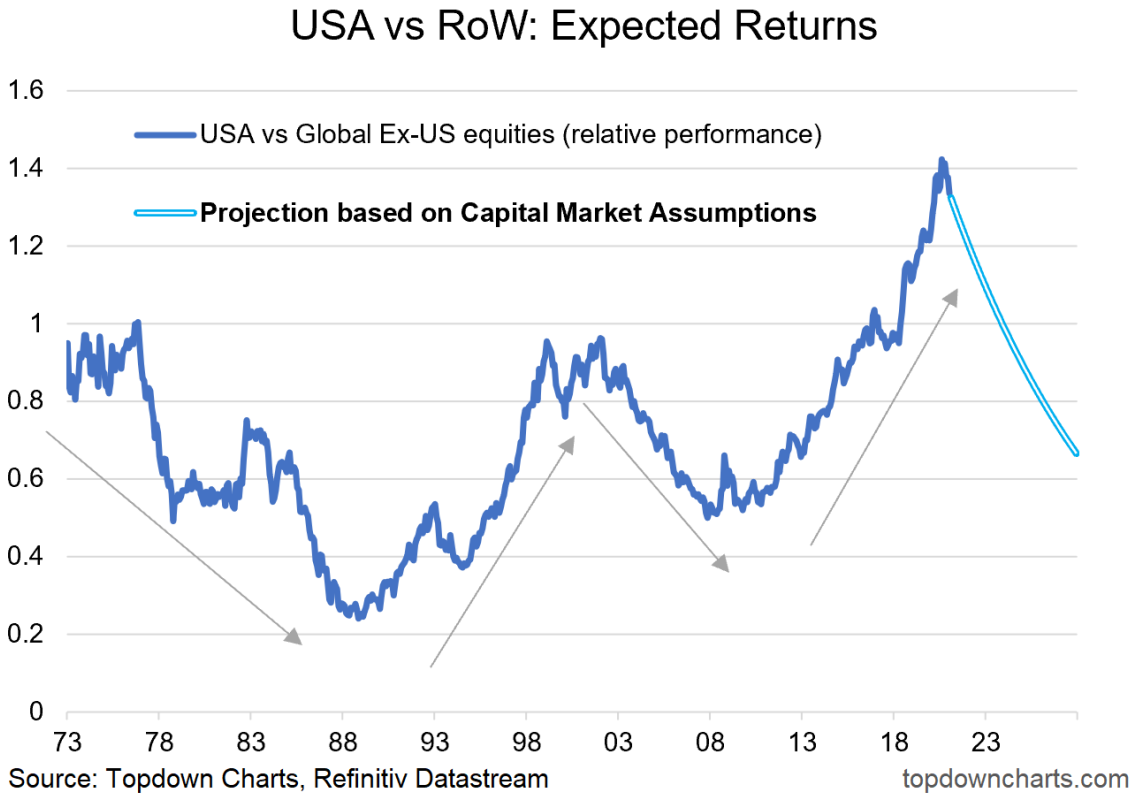
Remain overweight global equities given solid ERP, monetary tailwinds, economic/earnings green shoots… but given the divergence in valuations, prefer global ex-US relative to US. The chart shows the 10-15 year cycles of relative performance, with the projection period based simply on capital market assumptions (which will address in section 5). Policy & politics remain highly relevant also.





3. Core Views: remain OW Global (ex-US) Equities

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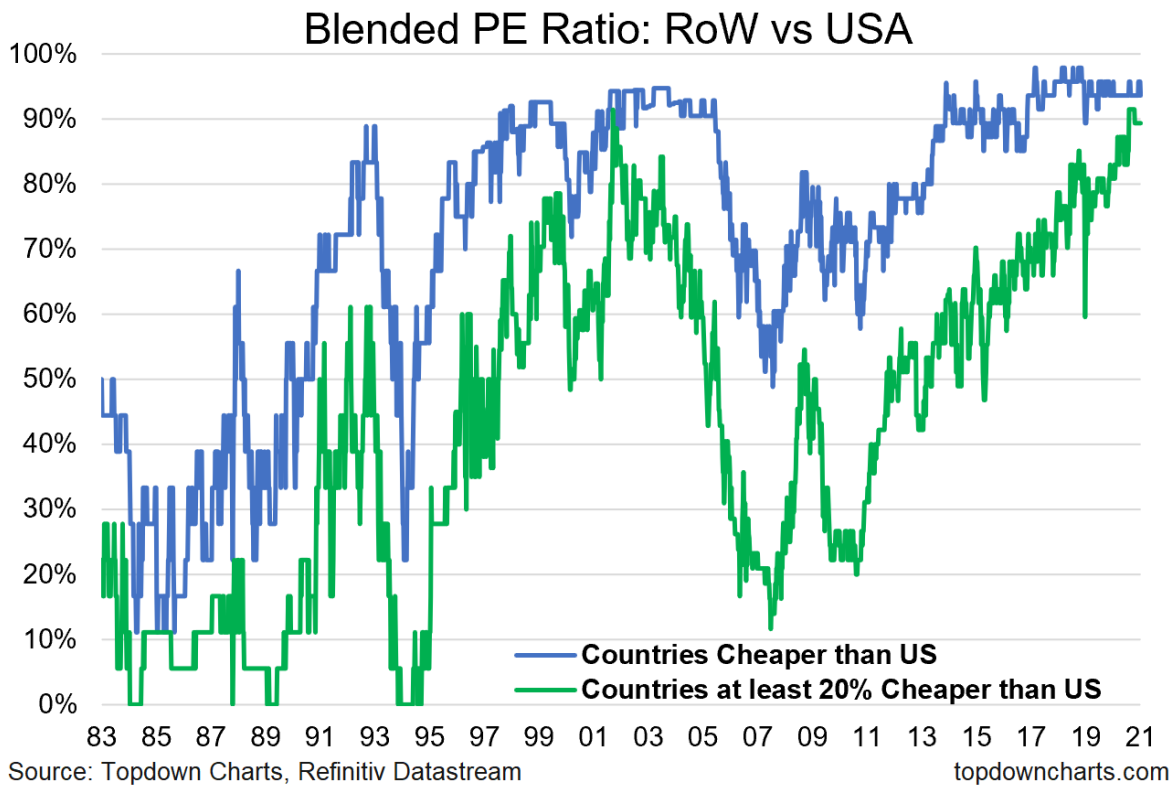
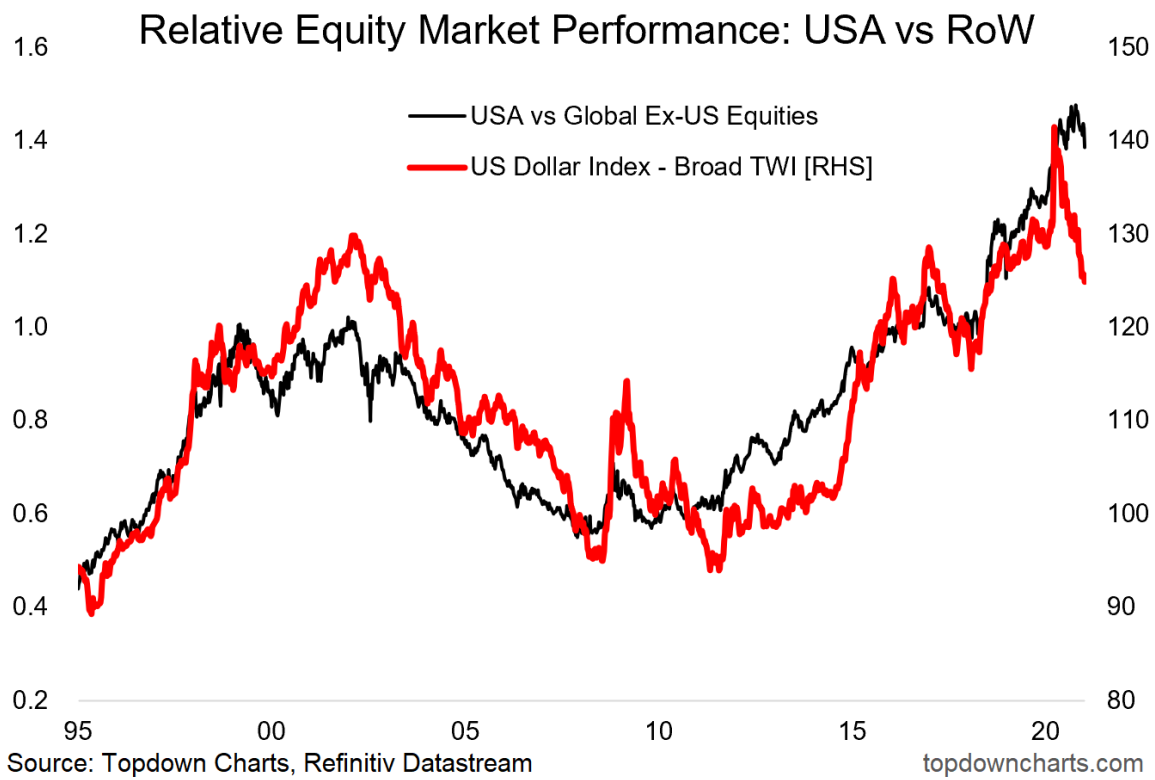
It's also worth highlighting the breadth of valuations: 90% of countries are trading at least 20% cheaper vs the US on a blended PE ratio basis, so it's very much a widespread issue (hence the top-down/high-level view). One key puzzle piece is the US dollar, and as noted in the next slide, my bearish view there helps the case/is consistent with this.





3. Core Views: bearish US Dollar

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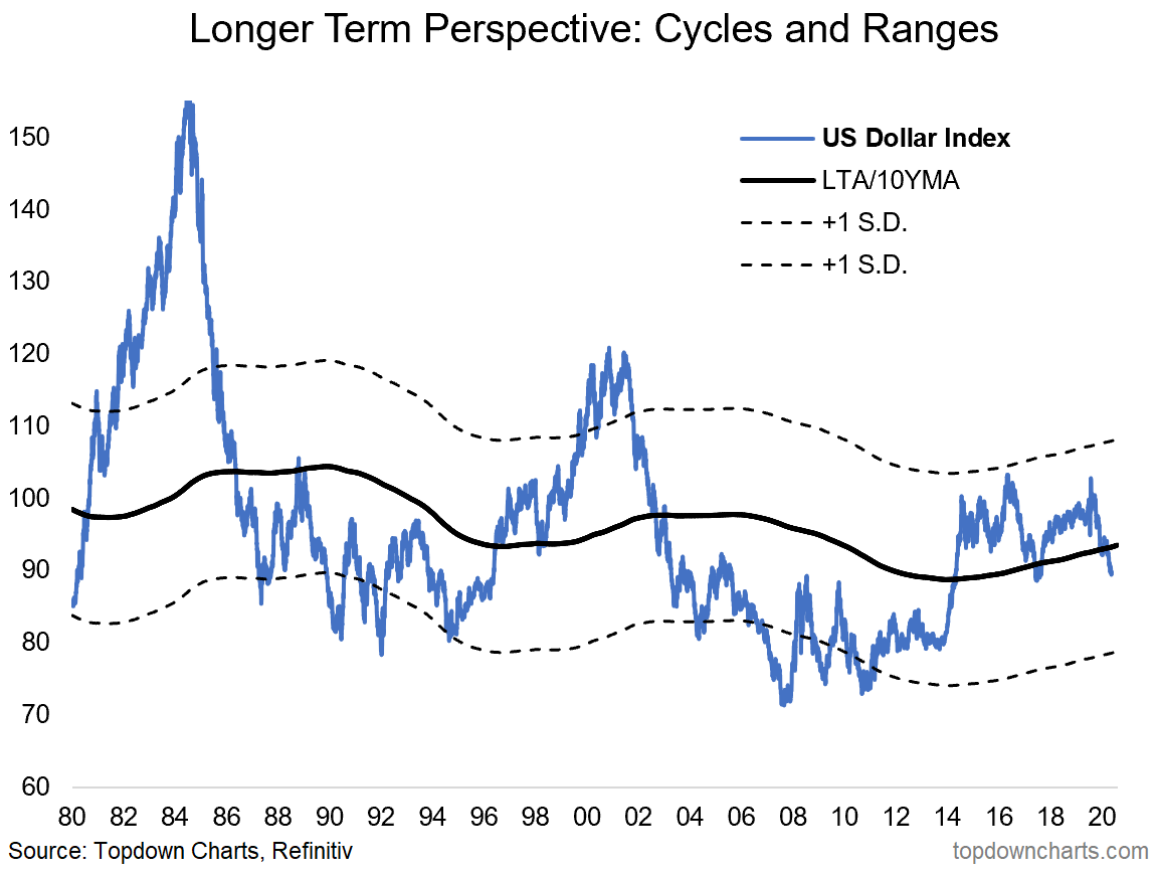
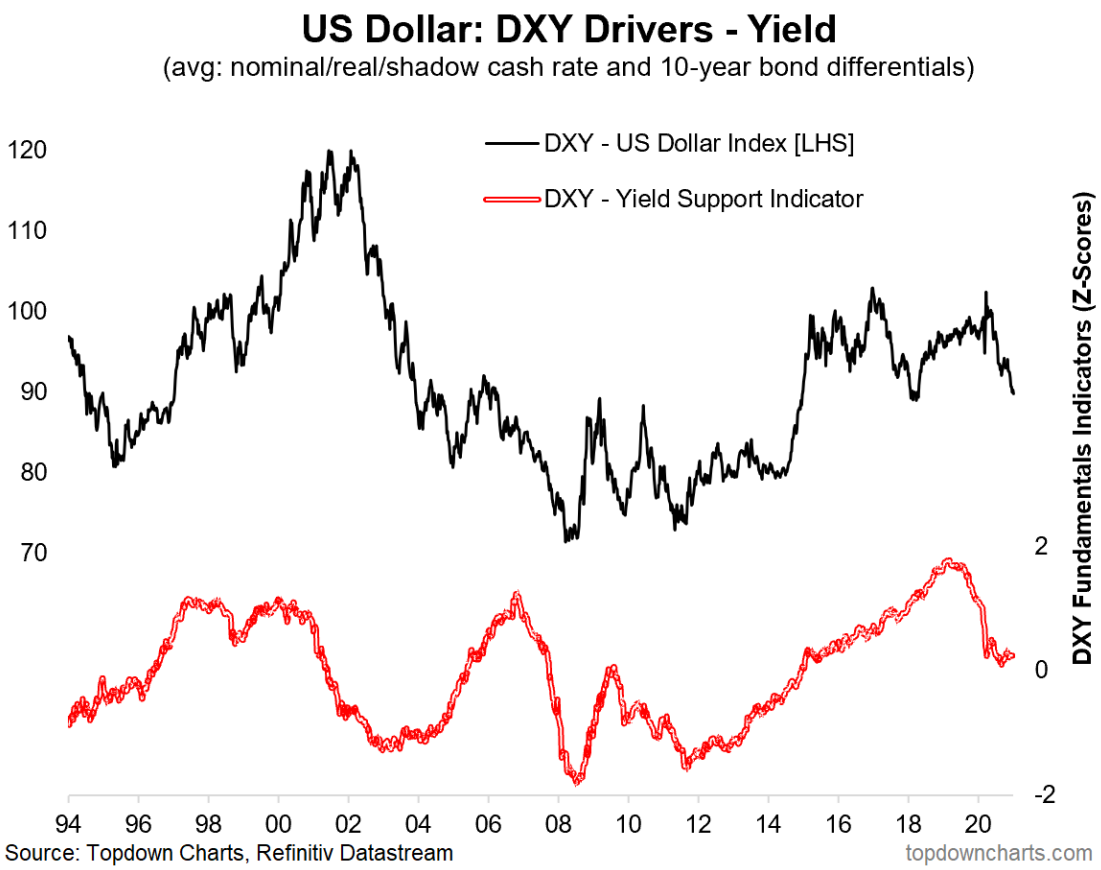
Retain the bearish medium-term view on the US dollar as the longer term cycles play through, expect valuation to overshoot to the downside (now slightly cheap), and yield support has dissipated. That said, the DXY is still sitting around a key support level and sentiment/positioning have gone from extreme bullish to extreme bearish now, and technicals look oversold…





3. Core Views: bullish Commodities

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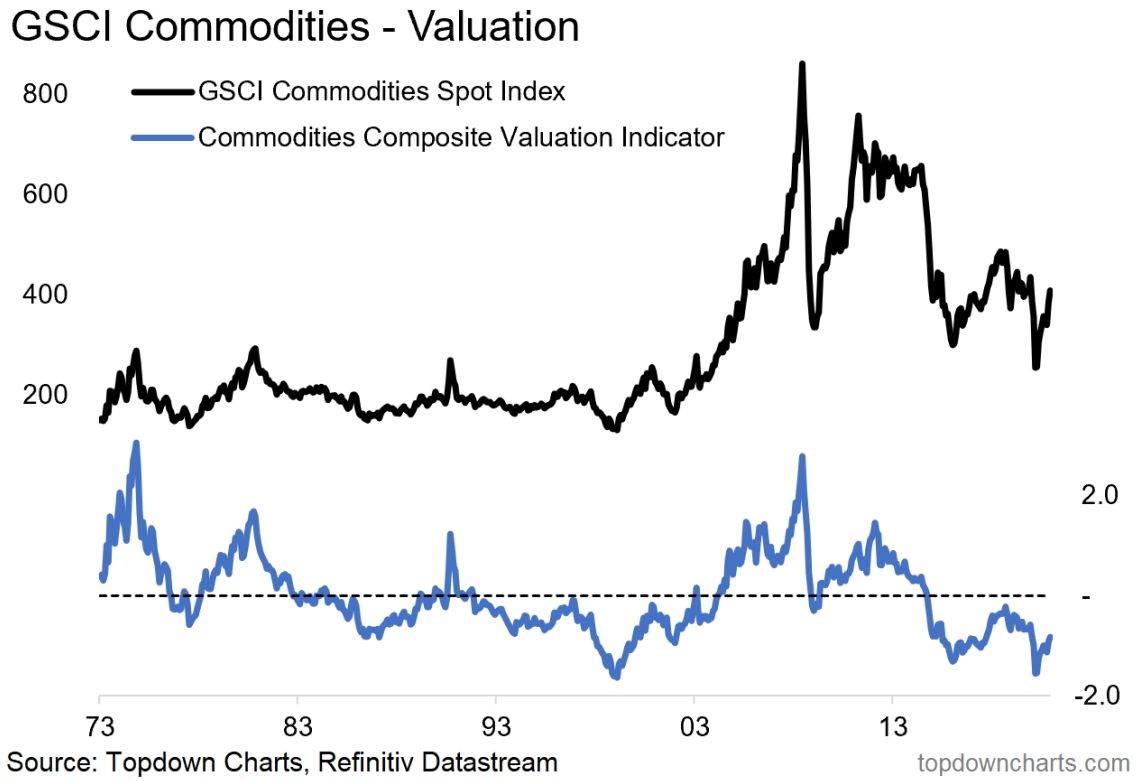
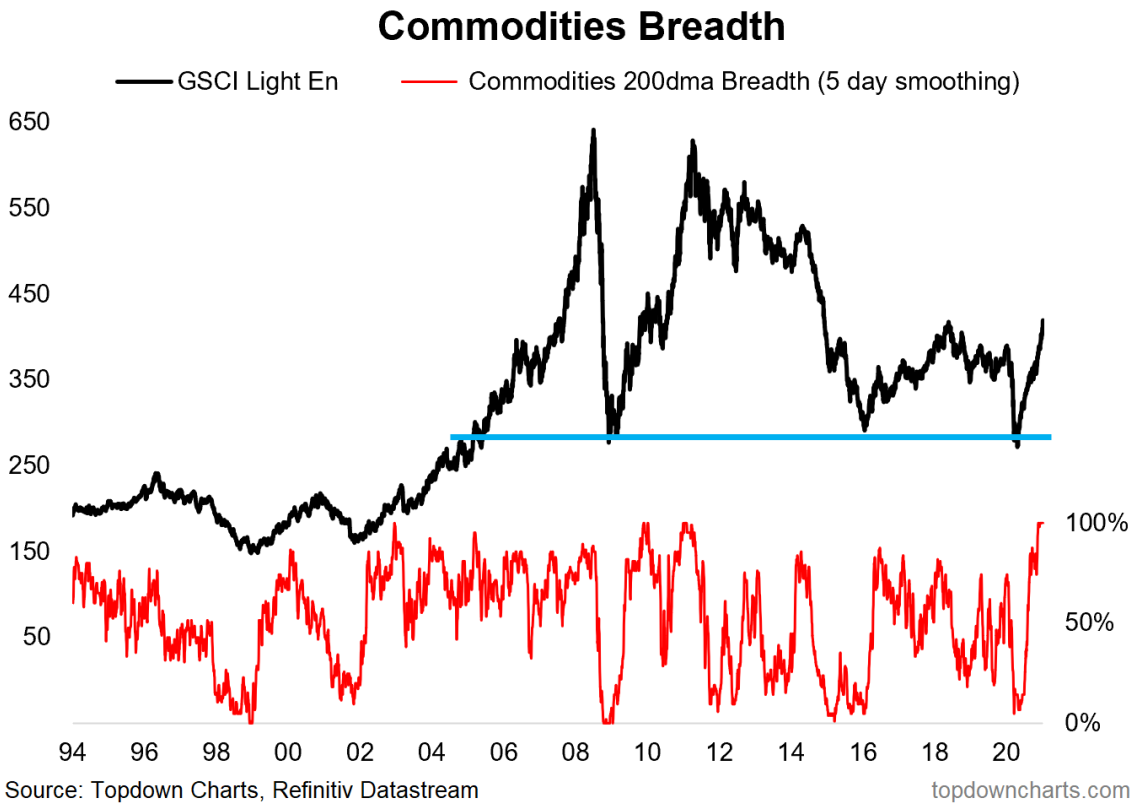
Remain bullish commodities medium-term (but like the US dollar are at risk of a short-term correction as sentiment/positioning have moved to excess optimism). Helping the case here is cheap valuations, weak capex, positive medium-term technicals (e.g. market breadth), and commodities are likely to benefit from a prospective global growth rebound (and weaker USD).





3. Core Views: bullish EM equities

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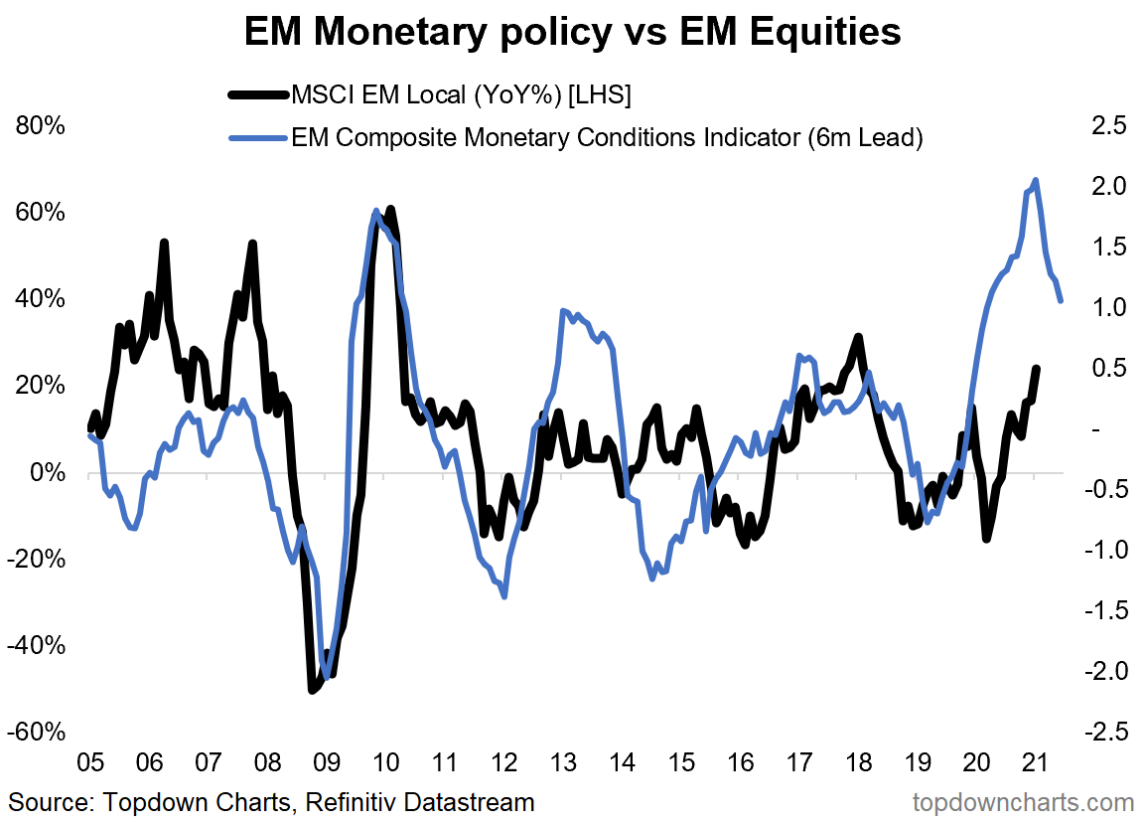
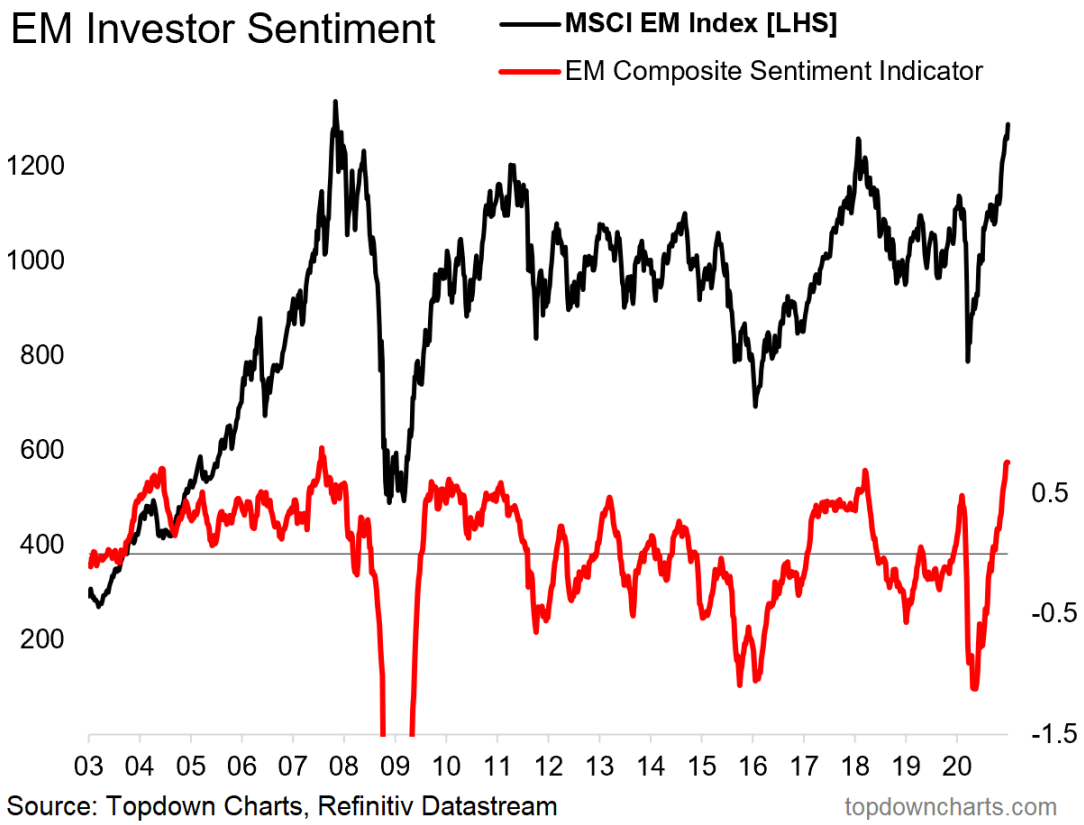
On a similar note, remain bullish EM equities on the basis of still reasonable valuations (PE10 – absolute and relative) and monetary tailwinds (see chart below). It's also internally consistent with the view on commodities and the US dollar (EM equities tend to benefit should the views there play out). However, sentiment has become quite stretched.





4. Interesting Ideas: EMFX

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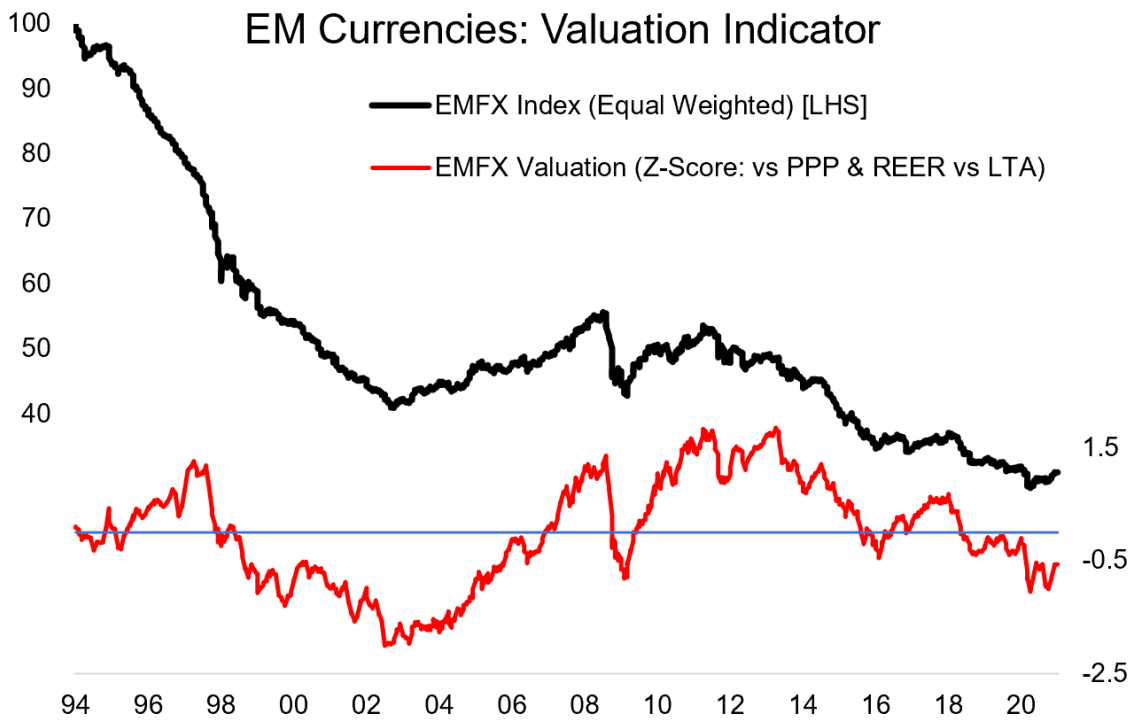
On a similar, and closely related note (cheap valuations for EMFX add to the case for EM equities), our composite valuation indicator for EM currencies (equal weighted 25 currencies) makes for a bullish medium-term bias, and stronger sentiment on EM assets should help from a flows perspective; again it ties in closely with the commodities & US dollar view.



Source: Topdown Charts, Thomson Reuters, BIS, IMF

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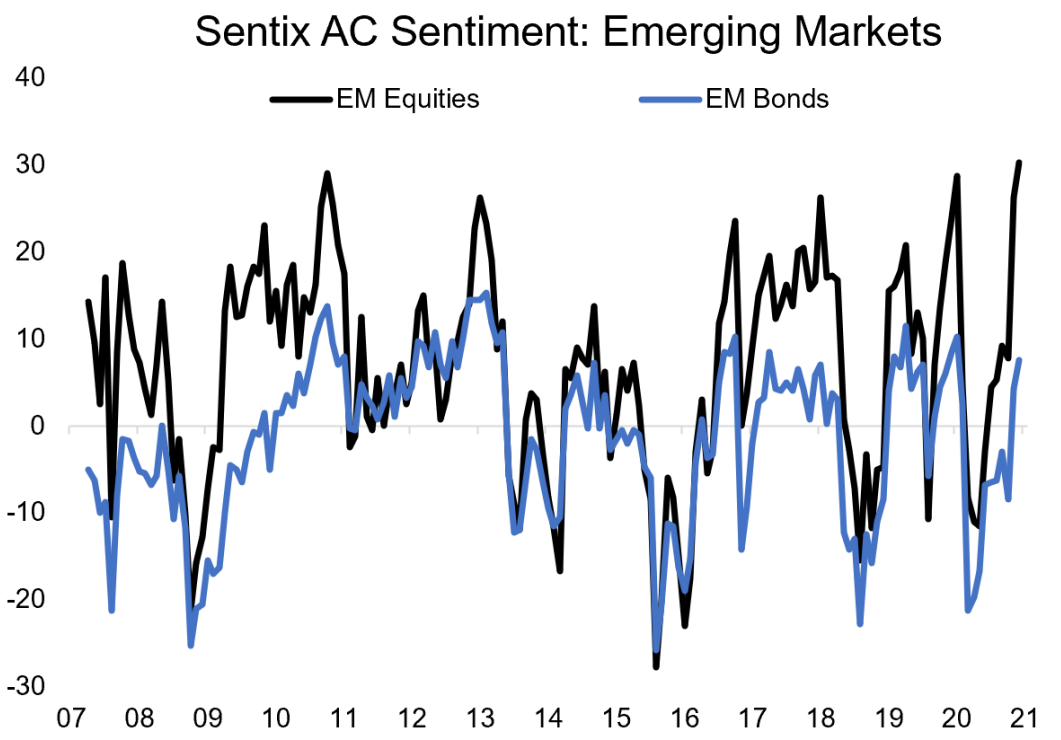

Source: Topdown Charts, Refinitiv Datastream, Sentix

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4. Interesting Ideas: EM ex-Asia

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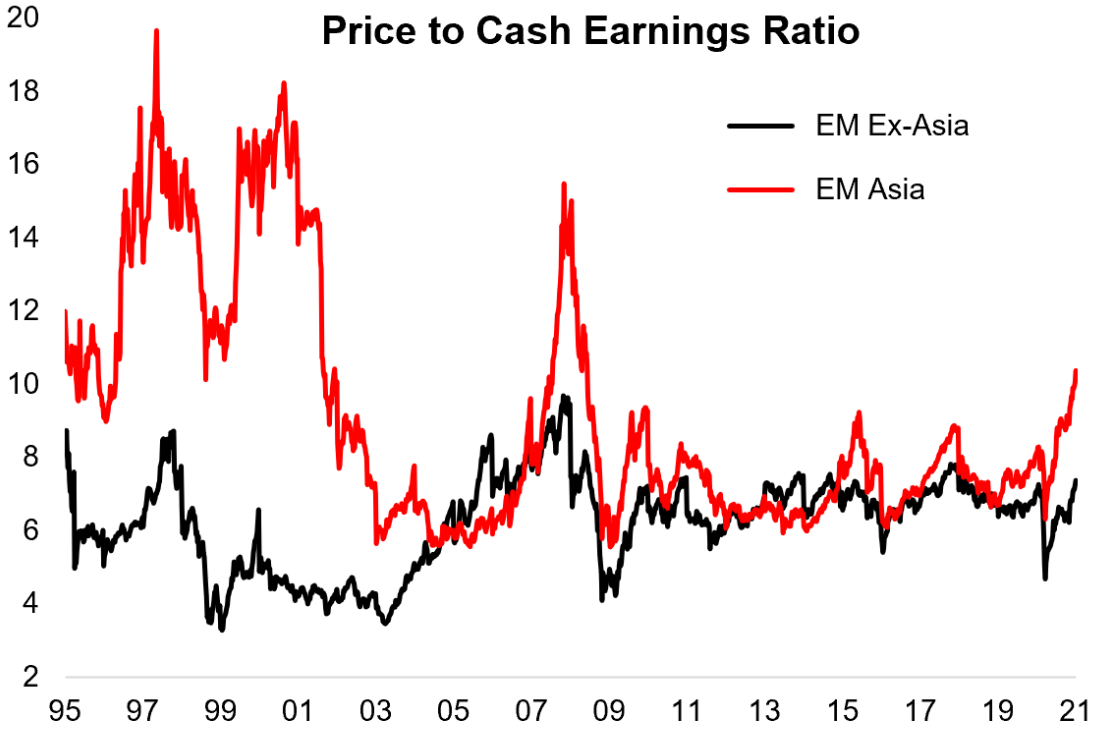
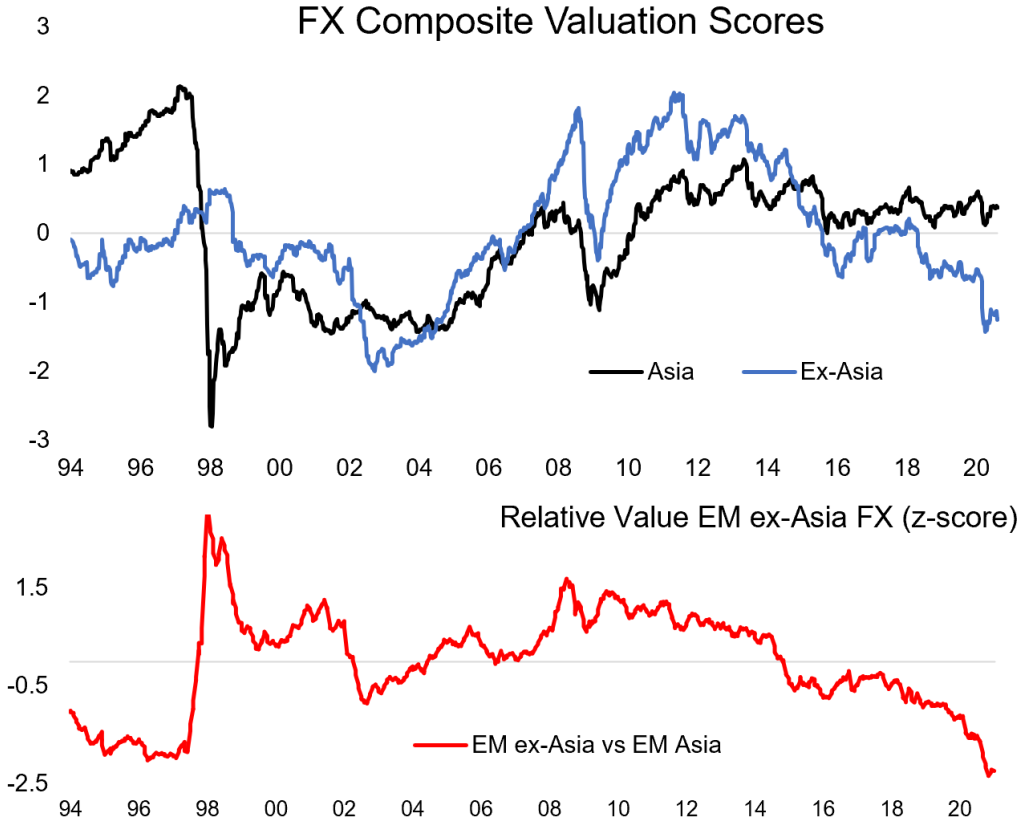
As a side note for both EM equities and EMFX, the valuation picture looks particularly good (cheap) for Emerging Markets ex-Asia. Added to that, EM ex-Asia has lagged well behind EM Asia (and typically you see catch up when the annual underperformance gets this extreme). Further, ETF AUM implied allocations suggest investors are under-allocated and excess bearish sentiment.



Source: Topdown Charts, Datastream, I/B/E/S topdowncharts.com



Source: Topdown Charts, Thomson Reuters, BIS, IMF topdowncharts.com

4. Interesting Ideas: Value (the 2 types) vs Growth

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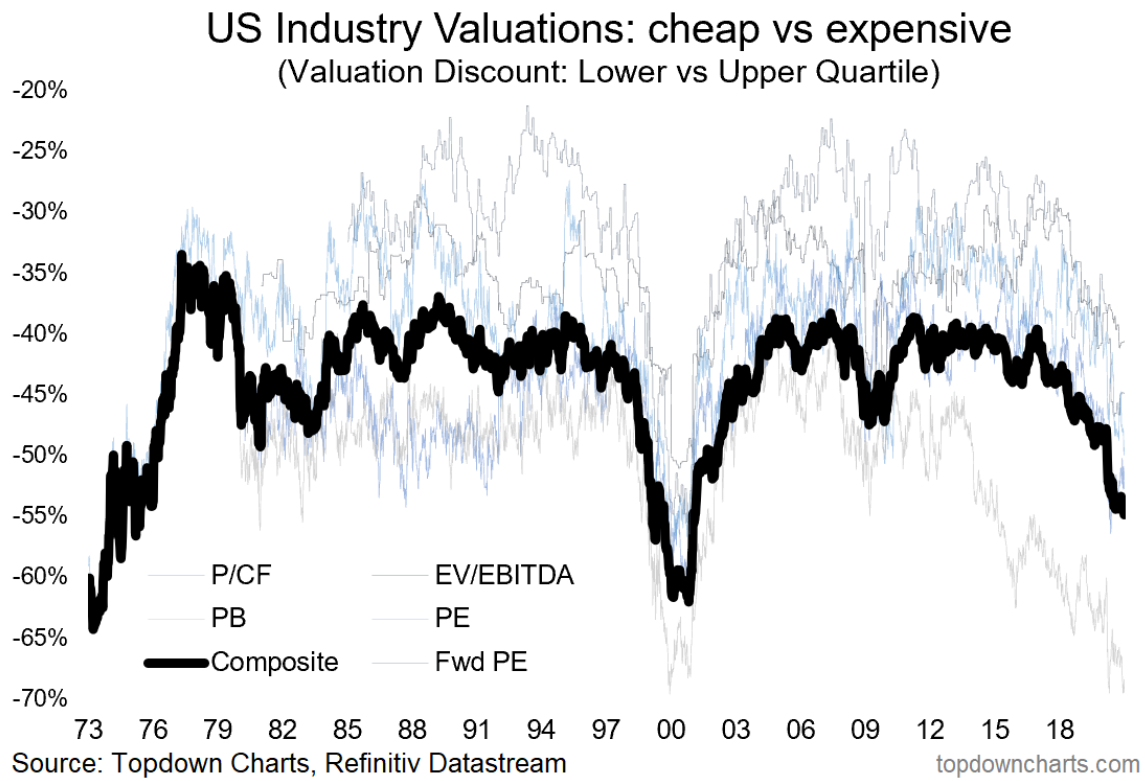
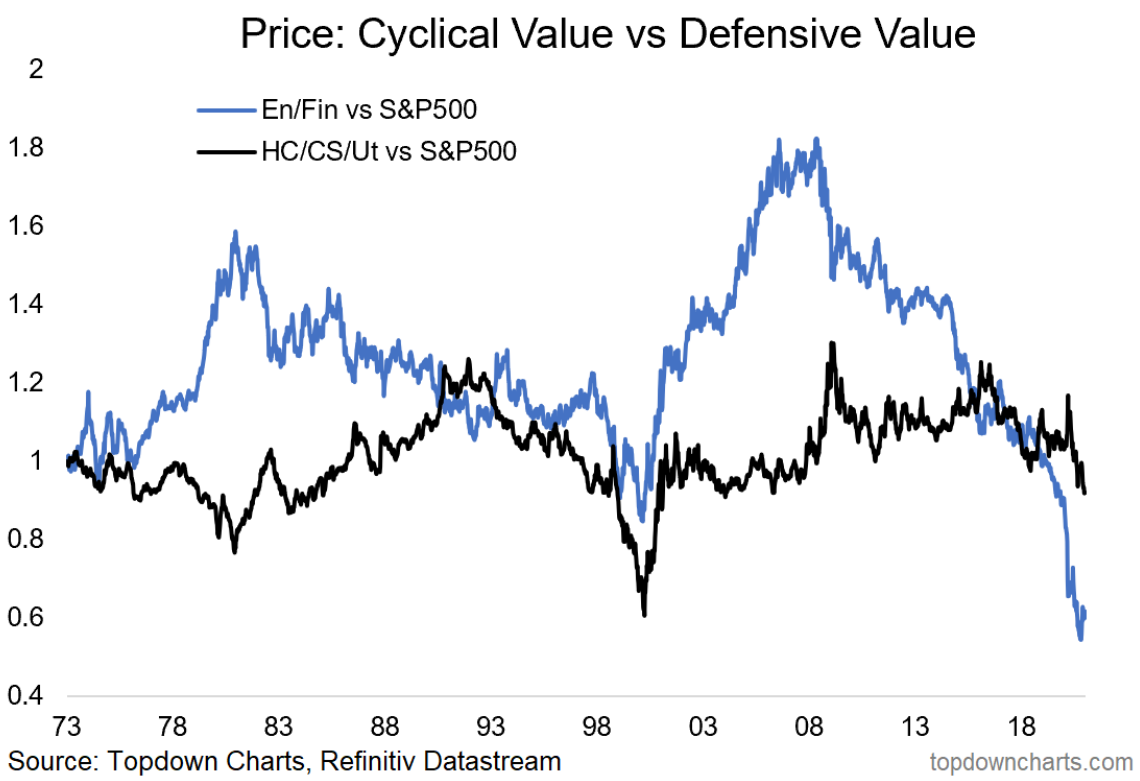
As noted in the mega theme, value vs growth is a key pick for 2021 and beyond. Relative value is a key argument, but also "growth" is heavily overweight the tech sector – and tech has received a one-off boost from the pandemic, while "cyclical value" needs the cycle/macro to come through (and we are starting to see that already). Look for cyclical value to be the key performance driver.





4. Interesting Ideas: Agri/Grains

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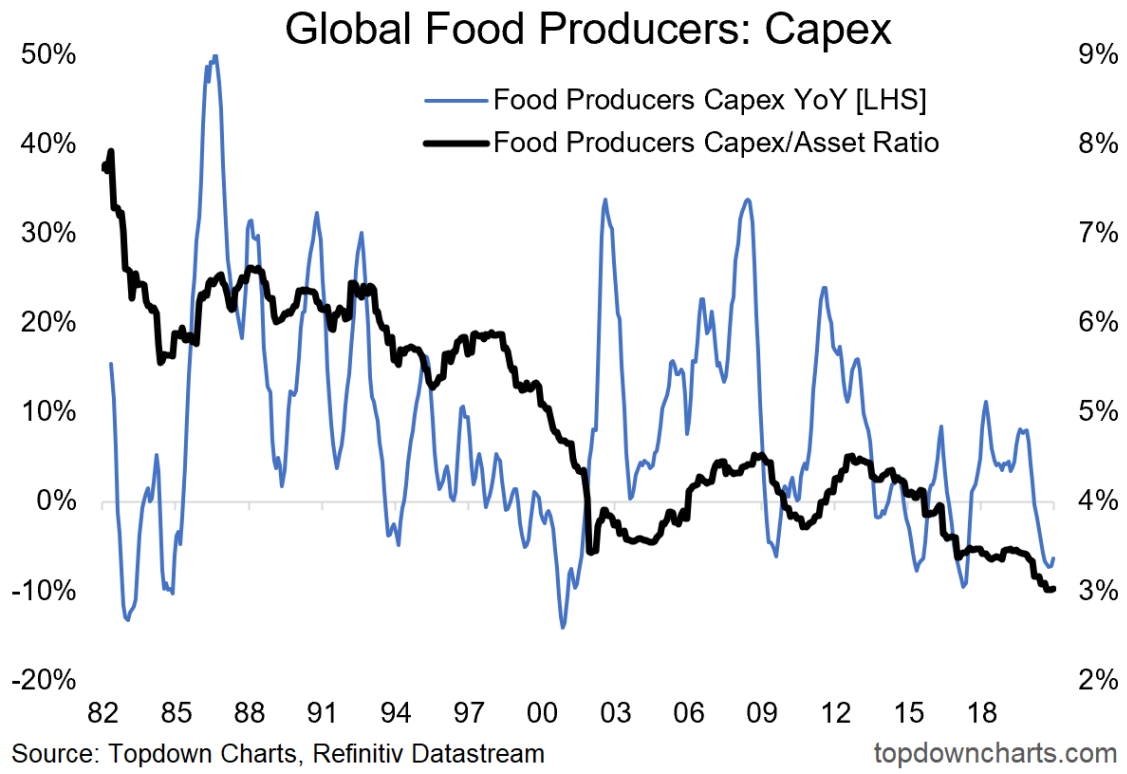
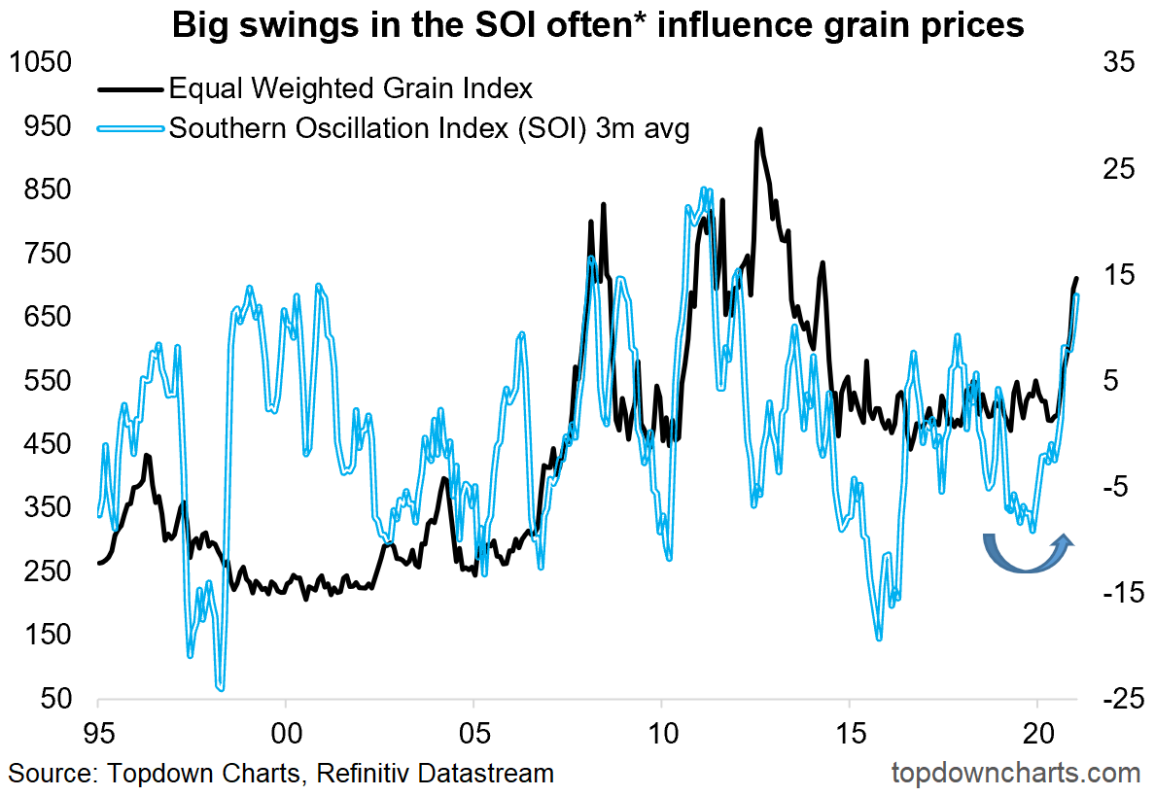
This one is both an idea and macro risk: we've seen a surge in positioning/sentiment in agri related commodities, and a few fundamental factors come into focus e.g. multi-year/record lows in global food producer CapEx, a turn up in the SOI (indicating a shift in weather regime), and pandemic disruptions. So a jump in food price inflation is a credible risk, and already grain prices are surging.





4. Interesting Ideas: Oil vs Gold

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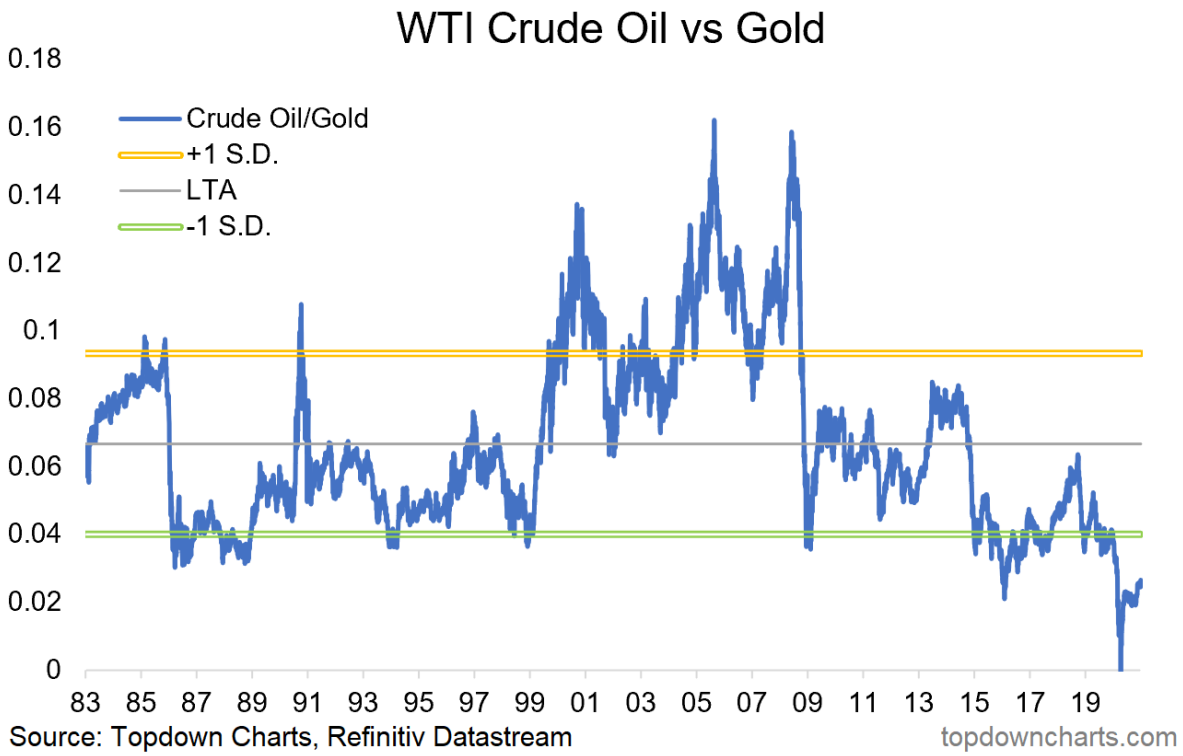
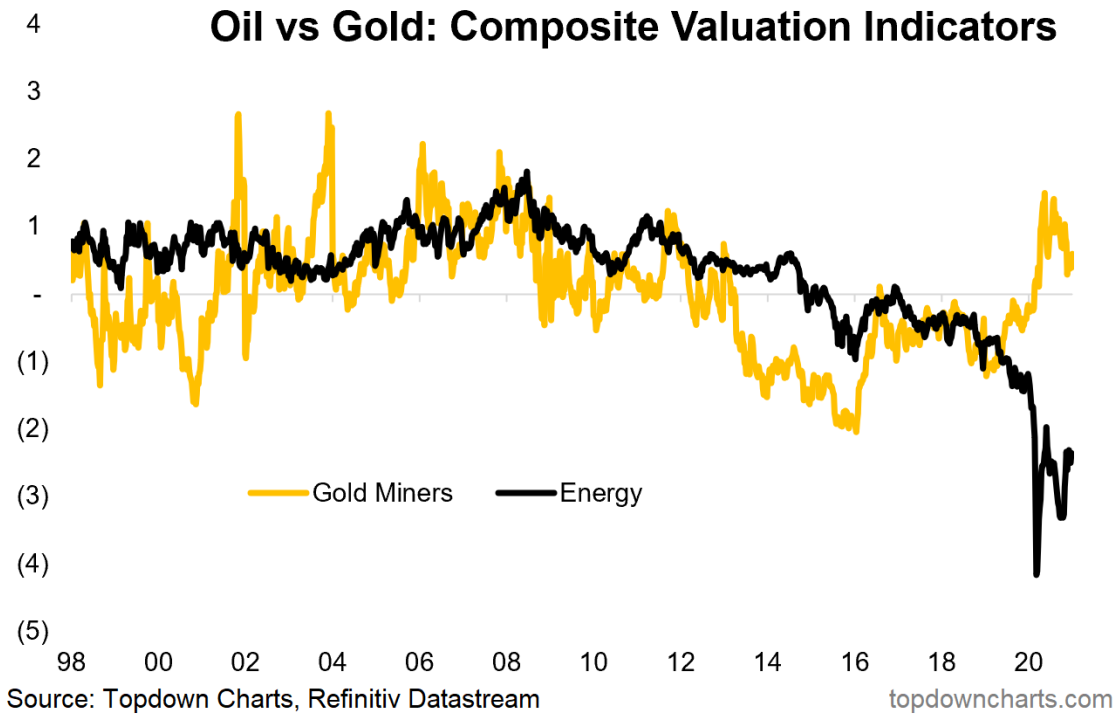
Given the fiscal stimulus outlook in the US, crude oil (and energy stocks) likely disproportionately benefit at the expense of gold (and gold miners): energy benefits from greater demand and normalization, gold faces headwinds from prospective rising real yields and improving risk sentiment. Quite a non-consensus idea.





4. (un)interesting Ideas: REITS

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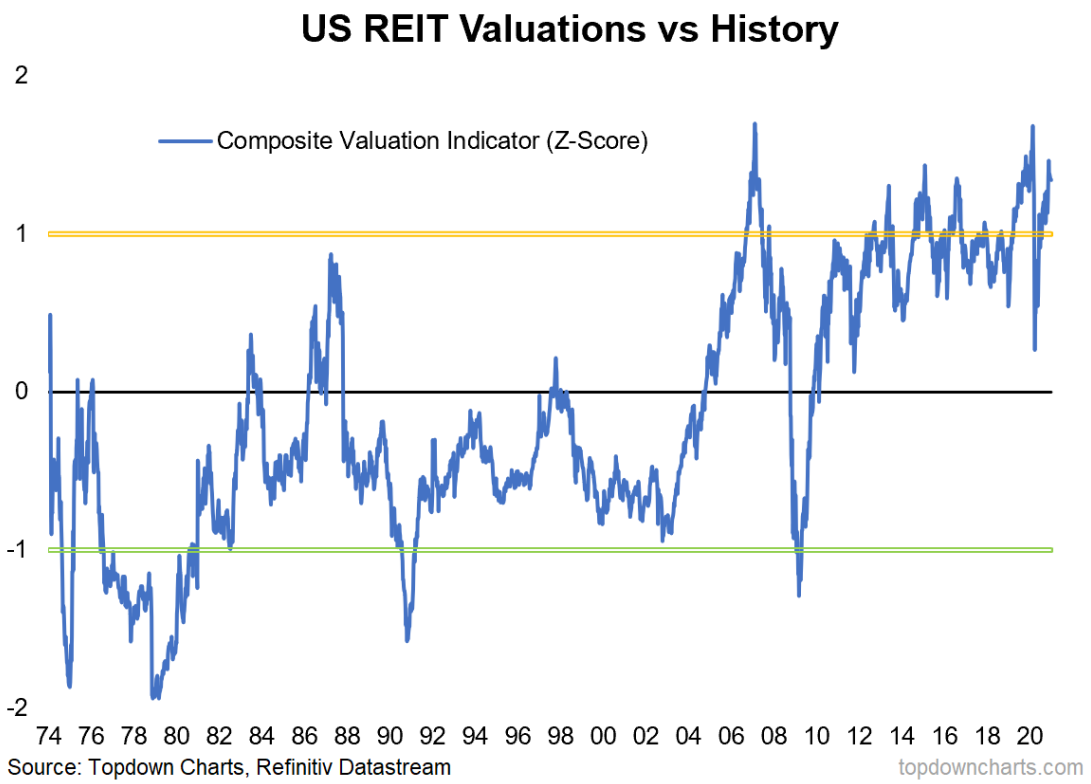
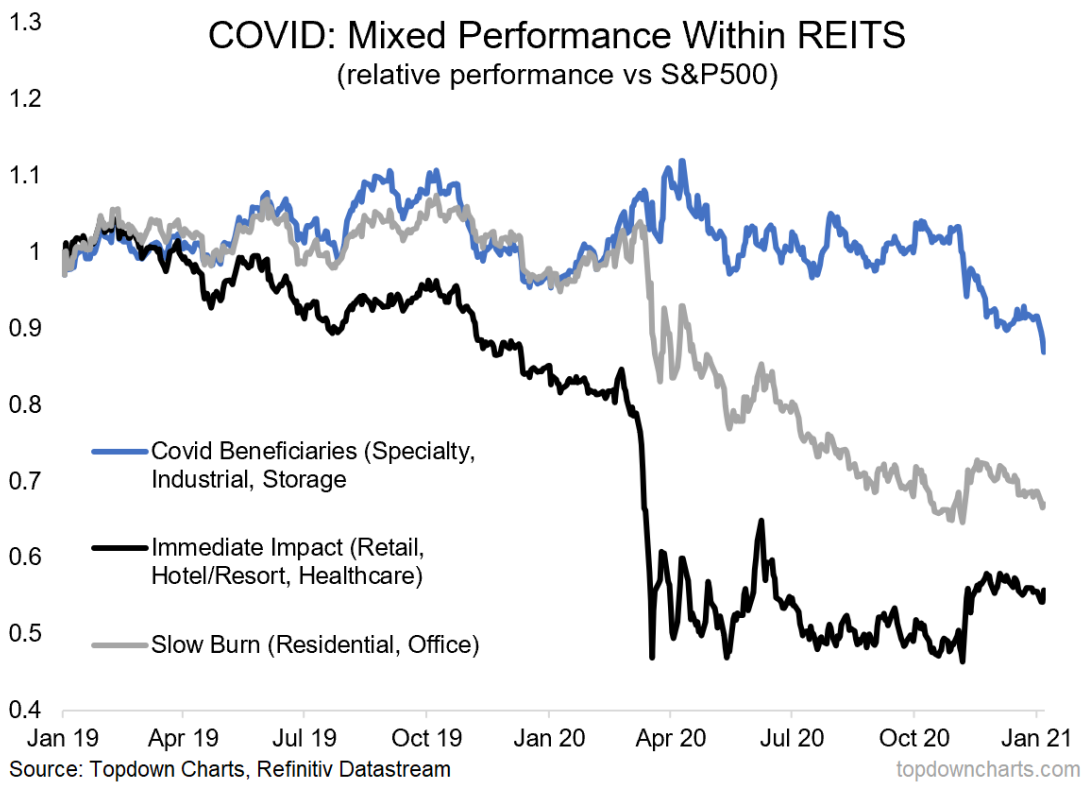
REITs have rebounded back to expensive levels following a brief reset during the corona crash, but rather them often acting as a defensive asset (relative performance links with bond yields), they've turned into a corona asset. The property market has taken a real short-term hit due to shutdowns and cash crunches, but there remains uncertainty about the longer term outlook as well with a number of trends e.g. WFH, rise of retail, being accelerated by the pandemic.





4. (un)interesting Ideas: Credit

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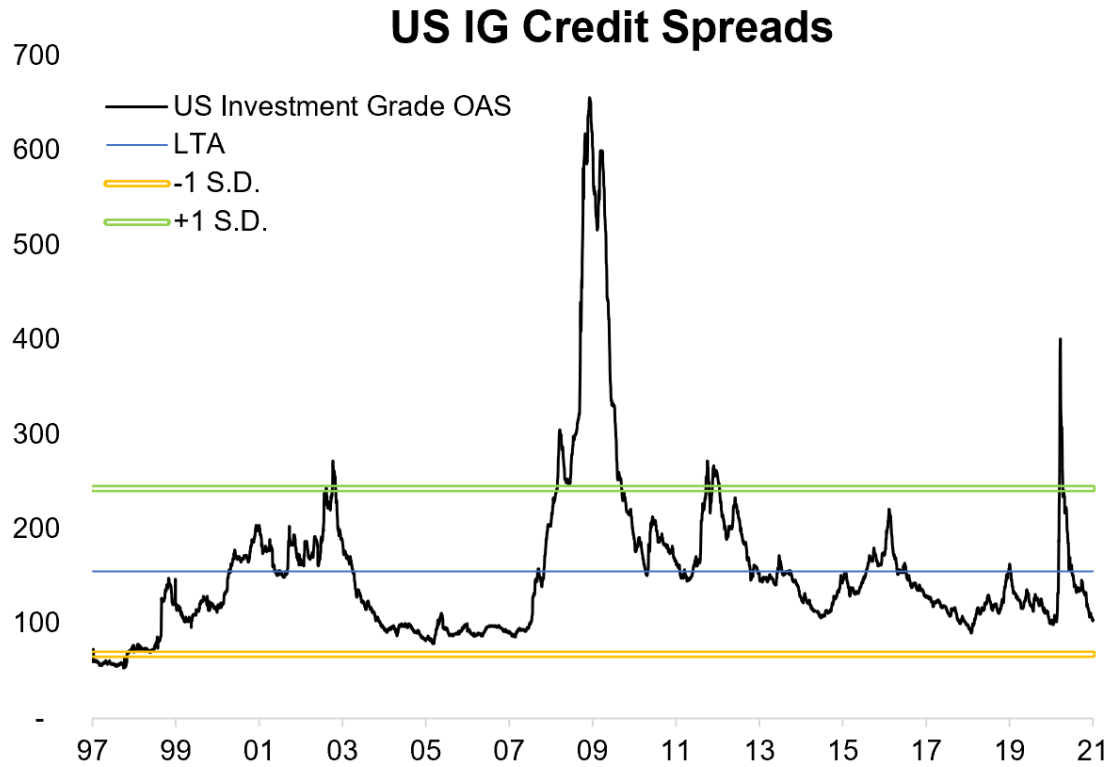
Hard to get excited about credit with spreads having come down substantially and sentiment likewise rebounding sharply. Although the asset class enjoyed direct support from the Fed with secondary and primary market purchases, there remains the spectre of a default cycle (even if just for specific sectors). Given the optimistic macro view it's not a clear short/underweight yet, however spreads have narrowed a lot, and are close to rock bottom: neutral but leaning bearish.



Source: Topdown Charts, Refinitiv Datastream

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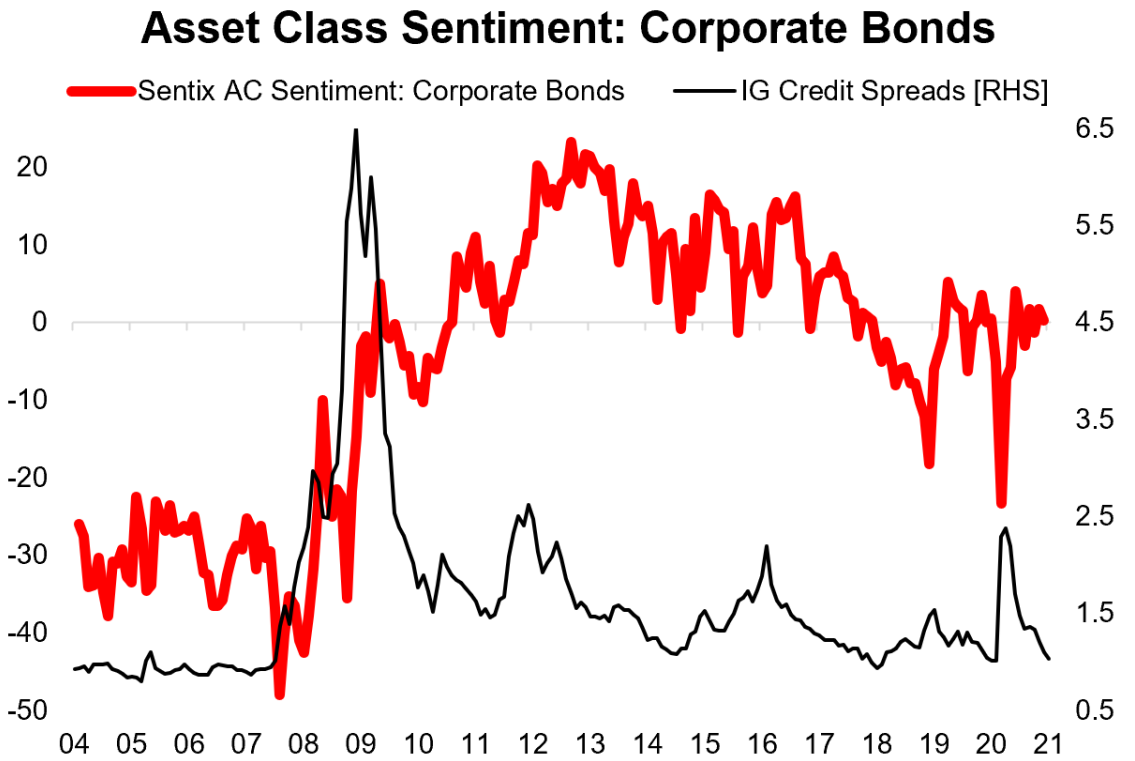

Source: Topdown Charts, Refinitiv Datastream, Sentix

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5. Positioning/Summary

Summary view across asset classes (global unless otherwise noted)

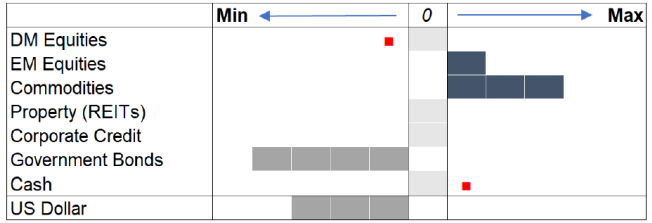
Asset Class	Short-Term View	Medium-Longer Term View
DM Equities	ERP cheap, but significant snapback in valuations and sentiment, some technical indicators highlight risk of a short-term sell-off/correction.	Favour DM ex-US on relative value. Reset in absolute valuations across DM make for solid medium-term case (more so on an ERP basis).
EM Equities	Sentiment rebounded to near record highs, but valuations still attractive on balance, and weaker USD + stronger commodities helping the case.	Relative value vs DM (US) and reasonable absolute valuations a positive. EM looks attractive longer term. Aligns with medium-term bearish base case for USD.
Commodities	Positioning becoming crowded, sentiment stretched, at risk of a pullback, but wider case still stacks up.	Bullish medium-term as supply resets (weak capex), cheap valuations, and monetary/fiscal tailwinds.
Property	US REIT valuations back in the expensive zone (absolute), yield gap supportive though, sentiment recovered but not yet extreme.	Still high absolute valuations and reliance on low yields is an issue, some uncertainty on longer term effects of the pandemic (changes in behaviour, tenant stress).
Corp. Credit	QE tailwinds helped, spreads now increasingly expensive – maybe even too complacent, sentiment mixed.	Diminishing margin of safety for taking on credit risk as spreads tighten, default cycle is a real risk in the immediate term.
Govt Bonds	Sentiment turning from previous bullishness. QE programs a tailwind, but valuations expensive, numerous indicators point to higher yields.	Low bond yields = low expected returns for buy and hold. Despite overvaluation (which is now extreme), bonds retain some value as a diversifying asset.
Cash	Low cash rates = expect negative real returns. Yet, short-term cash remains a reliable means of capital preservation.	Cash rates globally increasingly anchored to zero. Forward guidance suggests lower for longer for short term rates globally.
US Dollar	Breadth collapsed, short-term oversold, sentiment flipped from crowded bulls to crowded shorts. Bearish overall, but could rebound/chop around.	Remain bearish on a medium/longer term basis as longer-term cycles playout, valuations overshoot to downside, yield support removed, fiscal outlook.

Asset Class Ratings and TAA Overlay

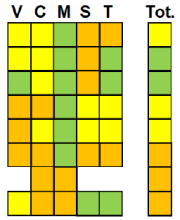
TOP DOWN CHARTS

As a reminder, we do not manage any money, or provide personal financial advice, nor offer securities. The purpose of the following tables is to provide a high-level positioning preference based on our analysis and indicators across the various asset classes, from an unbiased/generic multi-asset portfolio perspective.

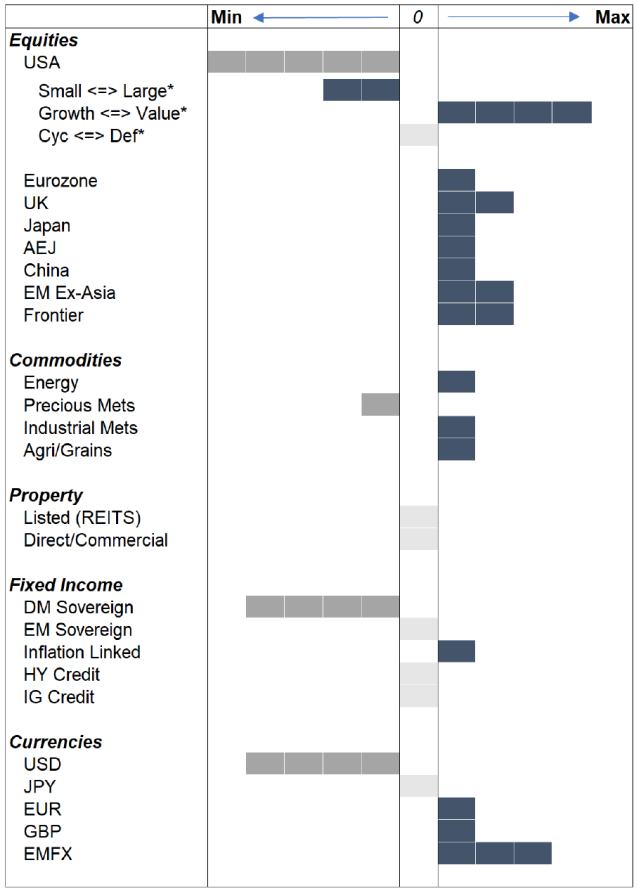
TAA Positioning Indication - Main



Asset Class Ratings



TAA Positioning Indication - Extended



■ **= Short Term View**
(i.e. less than 1yr)
(only if strong ST view)

= Medium Term View
(i.e. more than 1yr)

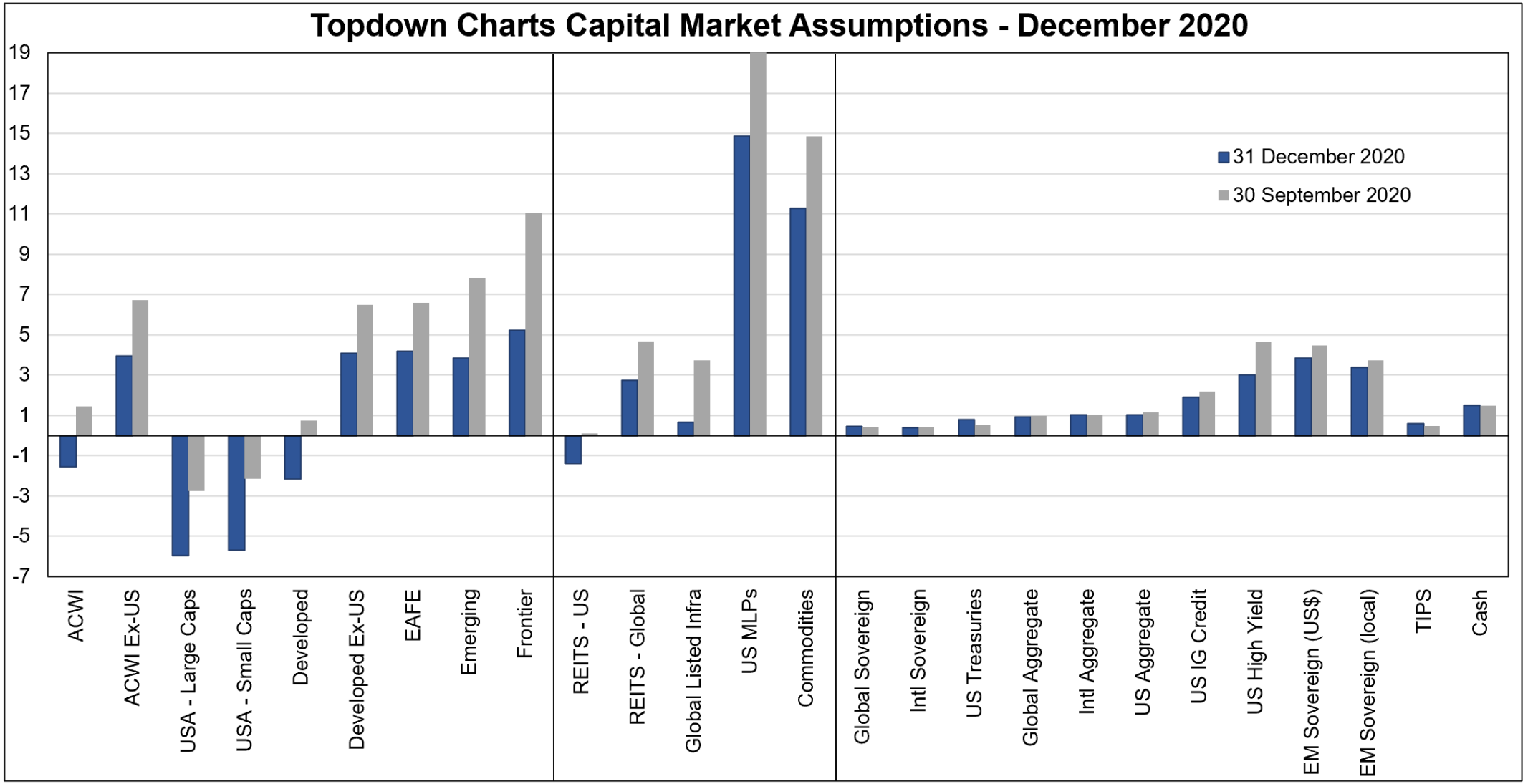
Asset Class Ratings:
V = Valuation
C = Cycle
M = Monetary policy
S = Sentiment/positioning
T = Technicals

Max/Min: Qualitative ratings. Refers to overall view on that asset with 5 squares representing the highest possible conviction in either the Max (long/OW) or Min (short/UW) direction.

***XXX vs XXX:** Relative views, e.g. small vs large, interchange "min" with first mentioned e.g. for small vs large a maximum bullish view on small caps vs large caps would show as 5 boxes on the left side.

5. Capital Market Assumptions

TOP DOWN CHARTS



Source: Topdown Charts

Projections as 31 December 2020, based on expected trend earnings growth, dividend yield, valuation mean-reversion adjustment, hedging and FX changes, yield to maturity, trend nominal GDP. Over a 5-10yr Projn. Period.

Figures are subject to change and are not a guarantee of performance or offer of securities. Full details on methodology available on request.

www.topdowncharts.com

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Best regards,

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