# MANAGEMENT DISCUSSION AND ANALYSIS

## ECONOMIC OUTLOOK

The global economy contracted by 3.5% in 2020 according to the International Monetary Fund ("IMF"), a 7 p.p loss relative to the 3.4% growth forecasted back in October 2019. The lockdowns and distancing restrictions imposed by major authorities across the world to contain the pandemic caused manufacturing activities to halt resulting in a global supply shortage. Meanwhile with mobility restrained, workers were put out of jobs or their salaries were cut causing changes in consumption patterns. Demand from contact-intensive services shifted to goods.

The pandemic triggered an unprecedented response from governments as the fiscal support reached nearly $16 trillion (around 15% of global GDP) in 2020. Various relief packages were provided from loan guarantees to businesses in Europe to individual stimulus checks in the United States while interest rates were cut to levels similar to the financial crisis in 2008 in order to maintain the economies. The increase of the fiscal deficit in advance economies doubled that of emerging and middle-income countries on the back of the contraction in output and fiscal revenues.

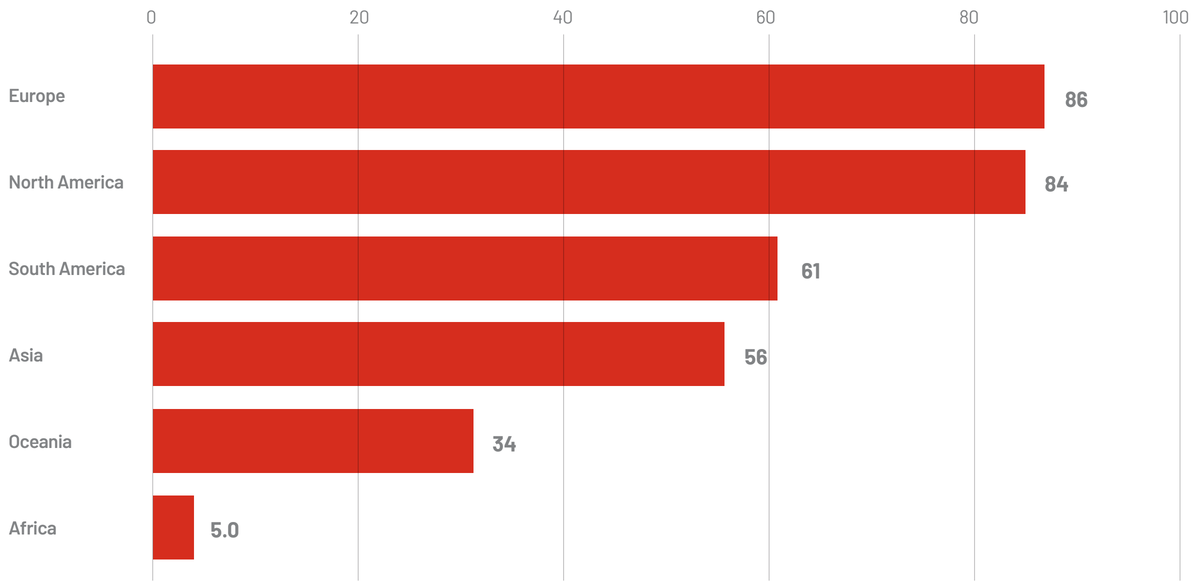
### 2021, Obstacles along the path to recovery

As the pace of vaccinations accelerated, though uneven globally, the share of people working has been rising. Activity in different sectors has picked up and adapted to pandemic restrictions over recent months. Global growth is expected to accelerate to 5.6% in 2021, following the reopening of major economies such as the United States and China. Central banks have maintained their accommodative stances to support the global recovery as the U.S. Federal Reserve entertained high inflation readings until employment is normalised, the European Central Bank readjusted its inflation target to 2%, allowing for consumer prices to rise when necessary, while the People's Bank of China has implemented timely cuts in the bank reserve requirement ratio ("RRR") to support the real economy, particularly small firms.

Still, two factors are still unnerving markets; the rise of the delta variant dampening economic outlook and global inflation, which has increased along with the economic recovery.

**Vaccination rates by continent**

Doses administered per 100 people




More than 4.1 billion doses have been administered across 180 countries, according to data collected by Bloomberg - enough to fully vaccinate 26.7% of the global population. However, countries and regions with the highest incomes are getting vaccinated more than 30 times faster than those with the lowest.

On top of ramifications such as the semiconductor and other components shortages, the delta variant is adding concerns to labour constraints. Schools reopening are being delayed and the forecasts of rapid employment growth in the second half of 2021 hinge on many more parents, particularly women, returning to work as child-care concerns ease. Furthermore, the spread of the variant in Asia is accentuating problems in the global supply chain while factories are faced with high raw materials prices. Higher inflation is thus persisting in the short term and economies will only recover from these transitory spikes in 2022. Businesses are still benefitting as many consumers are using savings built up over the past year to spend on goods and services, especially travel, leisure and other experiences curtailed during the pandemic.

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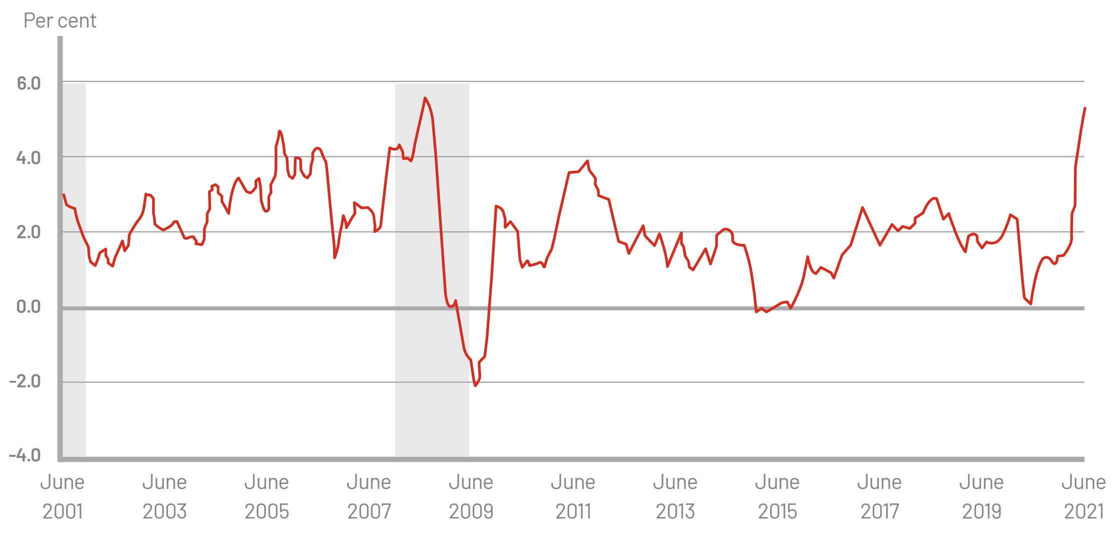
## ECONOMIC OUTLOOK (Cont'd)




*U.S. CPI (all items) over the last 20 years*

### Financial Markets

In the early stages of the recovery, the best performing asset classes were small cap and non-US equities, commodities and the value factor. China and the US have returned to pre-pandemic levels and have experienced exceptional growth since the third quarter of 2020. Since the beginning of the year, China's growth has been disappointing and political tensions, particularly over China's large technology companies, have worried investors who have withdrawn their investments. The US also reported disappointing growth in the second quarter, at 6.5% as compared to consensus expectations of 8.5%. The peak of growth in the US can be expected to be behind us, despite very strong corporate results in the second quarter, which surpassed estimates in almost 90% of cases. However, the forward guidance has been mixed, with some Mega-cap companies worrying about the third quarter and beyond. This slowdown in growth should also reduce inflationary pressure driven by commodities base effect and improved consumption. Cyclical sectors such as financials, industrials, materials and energy have proven to perform well in a high inflation environment.

All this will help the FED to reduce its USD 120 billion bond purchase program at a manageable pace, although the start of tapering is now scheduled to be between September and December. The FED will have almost 15 months prior to increase interest rates if needed in 2023. The digitization, lowering demography growth and aging of the population is deflationary by essence therefore the question is how long could the "high" inflation last. Moreover, the FED has relaxed its target in July 2020 regarding inflation rate to ensure that an inflation above 2% is not short-term problem. Bond traders are therefore already pricing this medium-term low inflation environment pushing the 10-year rate range bound between 1.2-1.5% versus inflation expected in 2021 above 3.4%.

In contrast, Europe, which lagged behind the other two giant economies last year, and even went back into recession in first quarter 2021, is now well positioned and showing an increasing growth rate while experiencing relatively low inflation, just above 2%. The ECB has also eased its inflation target to avoid reducing its bond purchase program too early. The current PEPP (bond purchase program) is due to end in March 2022 but could be replaced by another accommodative program depending on the recovery of underperforming European countries (such as Italy).

To summarize, we continue to favor European and US equities although we may see a short-term spike in volatility depending on the timing of the Fed's cuts. We remain concern about political tensions in China although China is looking for foreign investors to extend its growth. Until we have a clearer view on the FED's tapering, we would remain away from bonds except TIPS (inflation linked bonds). Considering that at current level the S&P 500 index is priced 21x 2022 earnings, it is also advisable to opt for products with capital protection and an attractive half-cycle return.



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## ECONOMIC OUTLOOK (Cont'd)

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