Economic Outlook

First Quarter 2021

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A Healthier World, but a Sicker Bond Market

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SEI recently released its first-quarter Economic Outlook. A summary of the conclusions is provided below:

- The war against COVID-19 is not over, but vaccine rollouts show the path to victory. Vaccine distribution will enable countries to end their lockdowns and reopen their economies. Therefore, business activity is expected to surge during the second half of 2021, not just in the US and Europe but in other advanced nations too. Accordingly, investors appear to anticipate a return to a more normal world.

- This outlook is reflected in the rapid rise in global bond yields—which has been the most important change in the financial environment so far this year. Fuelled by sharp gains in economic growth and concerns about surging government debt, the 10-year US Treasury bond climbed from 0.92% to 1.60% since the start of the year.

- This jump in yields has caused outsized price drops in long-term fixed-income securities (bond yields and prices move inversely) which helped fuel a sharp equity-market rotation away from expensive growth stocks and into value-oriented and cyclical sectors around the world.

- Higher bond yields raise concerns about rising inflation and may cause bouts of indigestion in the stock market, but we do not think they will derail the bull market. Rather, we expect to see cyclical and value-oriented stocks continue to advance relative to growth and defensively oriented sectors of the market.

- Time will tell whether the turn in favour of value will be more than just another ephemeral cyclical advance like those recorded at other points in the past decade. In our view, the economic backdrop also strongly supports cyclical and value-oriented equities in emerging markets, just as it does in developed markets

- We believe the expansion in trade should continue over the course of 2021, perhaps reaching or exceeding the year-on-year gains of 5% recorded in 2017. When global trade volumes are strong, developing-country stock markets tend to perform well against those of economically advanced countries.

- Emerging economies look less susceptible to a 2013-style taper tantrum because their external trade positions are much healthier. Current account balances as a percentage of GDP are generally much smaller now than eight years ago.

- We project that more commodity-price gains are on the way. Demand for metals and other commodities should get a boost from several sources including strong manufacturing and construction demand in the US and China; the recovery in Europe and Latin America as vaccines become more widely available; the global push for electric vehicles and other climate-projects; and the coming US infrastructure package.

- At SEI, our base case is an optimistic one. As vaccines continue to roll out throughout the world in the months ahead, countries will be able to end their lockdowns and reopen their economies. Business activity should therefore charge ahead, not just in the US and Europe but in other advanced nations too.

- Developing countries will likely take longer to reopen fully since their vaccination distribution will take time—yet their economies should improve on the upswing in developed-market consumer demand.

A full-length paper is available if you wish to learn more about these timely topics.

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