

# Deuterium Global Dynamic Allocation

Quarterly Strategy Report Q3 2021

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30 June 2021



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## DGDA Investment and Economic projections for Q3 2021

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All data in this report are sourced from Deuterium Global Asset Allocation proprietary models.



# Deuterium Global Dynamic Allocation Outlook for Q3 2021

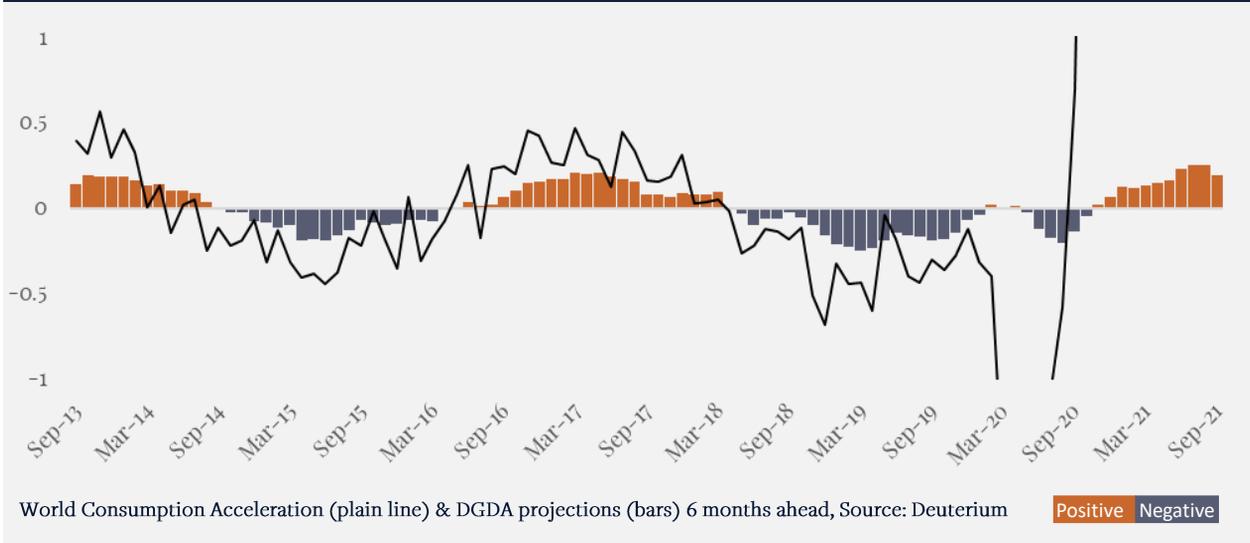
The outlook for risk assets will remain positive through this quarter, with equity valuations benefitting from a renewed surge in global output. The cyclical rebound and steady rise in consumer and producer prices likely will again have long term bond yields moving higher on sudden strength in global demand and output, even as major central banks keep short-term rates anchored at their lows.

This is an abrupt return to the global environment of the first quarter this year where share valuations found support in higher sales and earnings growth expectations while global central banks provided extraordinary liquidity and collapsed credit spreads. An unexpectedly high real economy expansion will be the key support for risk-asset valuations, even as the recent jump in inflation moderates, leaving central bank authorities ample room to maintain their current accommodative policies.

The principal market surprise in Q3 2021 may well be the size and breadth of the global economic expansion during the quarter, which would favour equity market valuations and in particular those of industrial and commodity sectors benefitting directly from higher volumes and prices in the wake of greater global trade and rising aggregate demand. We anticipate that Asia and Europe will benefit from and contribute to the accelerations in global consumption and output, and that developing market shares likely will find valuation support as well.

**In Q3 2021 investors may do well to maintain high allocations to risk assets, given that improvements in equity fundamentals from a major cycle expansion likely will shift valuations to the upside. Sudden strength in economic output rather than in prices probably will be the source of upward pressure on long-term bond yields, favouring the performance of corporate bonds over sovereign debt.**

Deuterium Global Asset Allocation projections show world production reaccelerating in Q3 2021



# DGDA Market Projections for Q3 2021

DGDA projections for Q3 2021	At 30 June 2021	Market moves projected for end Q3 2021
<b>USA</b>		
3 Month yields	0.05%	
10 Year yields	1.44%	
US Dollar Index	92.37	
S&P 500 Index	4298	
<b>China</b>		
3 Month yields	3.08%	
Chinese Yuan	0.155	+
MSCI China	109	+
<b>Japan</b>		
3 Month yields	-0.1%	
10 Year yields	0.05%	
Japanese Yen	0.009	--
Topix Share Index	1944	+
<b>EMU</b>		
3 Month yields	-0.65%	
10 Year yields	-0.20%	
Euro	1.19	
Euro Stoxx 50 Share Index	4064	
<b>UK</b>		
3 Month yields	0.07%	
10 Year yields	0.72%	--
British Pound	1.38	
FTSE 100 Share Index	7037	+
<b>Commodity Markets</b>		
All Commodities	480	
Oil & Energy	359	
Gold & Precious Metals	532	--

Source: Deuterium, Bloomberg



# DGDA Global Investment Conclusions

**1.** The global business cycle will show strong signs of recovery for Q3 2021 while major central bank support continues. Equity valuations likely will benefit from the continued rebound in global output following unprecedented monetary and fiscal stimulus. Sovereign bond markets, given accelerating economic activity, will face poorer prospects. This suggests that as economic growth expands more rapidly in Q3 2021, the positive effects for risk assets will endure despite another rise in long bond yields.

<b>Market Projections</b>	Major Equities	Positive	++
	Developing Equities	Positive	++
	Oil, Industrial Commodities	Positive	++
	Major Bonds	Negative	--
	Developing Bonds	Negative	--
	US Dollar	Neutral	
	Japanese Yen	Negative	--
	Euro	Neutral	
	British Pound	Neutral	

**2.** The US Federal Reserve has provided extraordinary liquidity to the US financial system, and to US banks in particular, so much so that the repo market for excess cash looks about to surge beyond its 2014 extremes. Although US QE purchases have slowed, the ECB and BoE look to be counting on both fiscal and monetary policy interventions to support domestic activity and prices, while the PBoC appears reversed policy to again begin support for domestic credit growth.

<b>Monetary Policy Projections</b>	USA	Loose
	China	Loosening
	EMU	Extraordinarily Loose
	Japan	Loose
	UK	Extraordinarily Loose

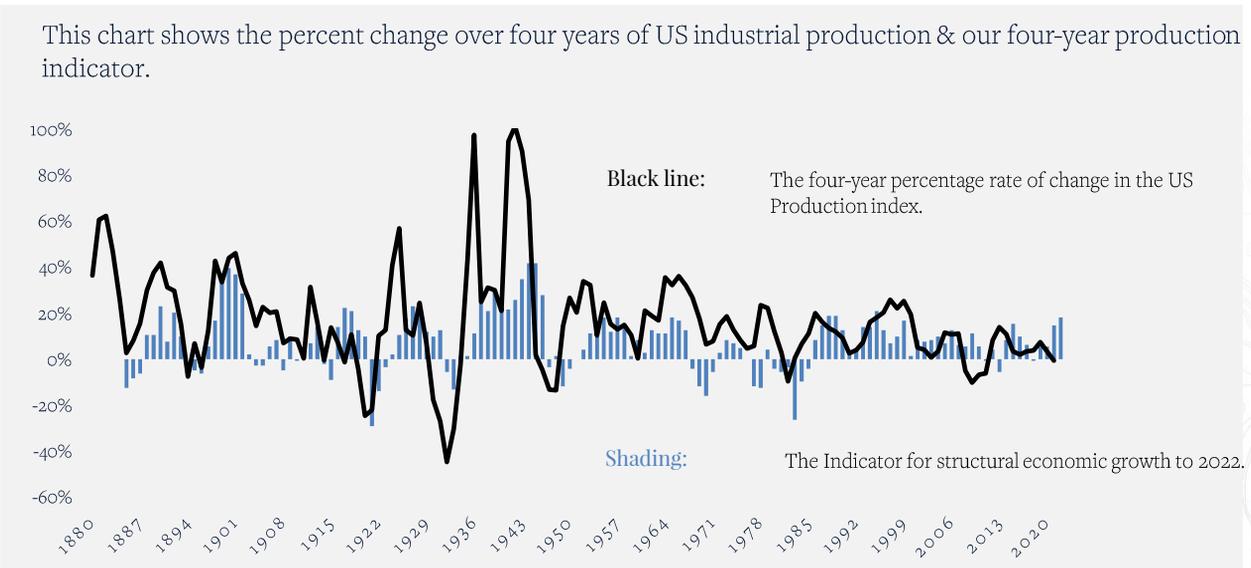
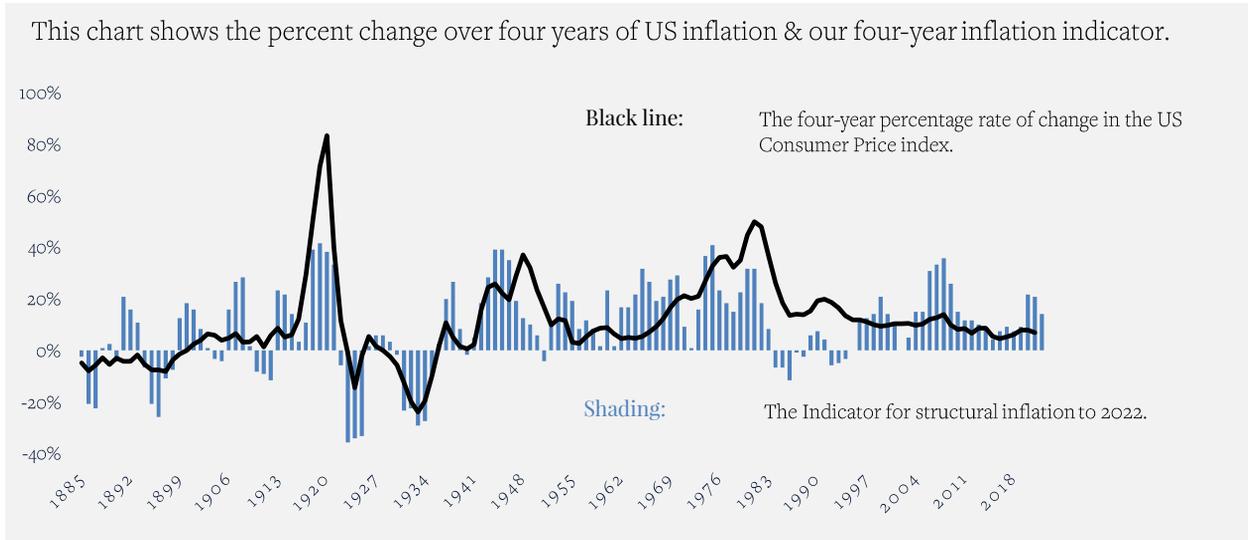
**3.** In Q3 2021 the US and Far-East ex Japan economies will continue to show rapid expansions in aggregate demand, and likely will be joined by European and developing economies reporting sustained consumer and industrial activity growth. Monetary and fiscal interventions have maintained sufficient liquidity and income support to have the recovery extend to rising output and trade measures.

<b>Economic Projections</b>	USA	Rapid Expansion
	China	Expansion
	EMU	Rapid Expansion
	Japan	Expansion
	UK	Expansion

# Deuterium Global Dynamic Allocation Outlook for Q3 2021

Our Q3 2021 projections for moderate inflation and higher industrial activity match our structural projections for US CPI and Production out through 2022, based on our 150-year historical analysis (published separately).

The charts below show our predictive Indicators for US Structural Inflation and Growth from 1885 to 2022.



The key measures that underpinned the historical evolution of prices and industrial activity were money supply, commodity prices, interest rates, fiscal policy, and output. These therefore lay behind the booms and bust in the equity, precious metals, and bond markets. Our quarterly projections for a cyclical upswing align well currently with our historical projections, available on our website.

# Global Economic Acceleration in Q3 2021

DGDA projections for production, orders, and exports show strong accelerations across all regions in Q3 2021

## Global Short Term Production Monitors (+/- 1) ↗

Best Worst

Production Monitor	Production	Orders	Exports	Direction	Average
USA					0.49
Europe					0.47
Japan					0.29
UK					0.09
Canada					0.31
France					0.54
Switzerland					0.30
Germany					0.48
Australia					0.50
Netherland					0.22
Spain					0.29
Sweden					0.53
Italy					0.52
China					0.22
South_Korea					0.54
Taiwan					0.44
Hong_Kong					0.46
Singapore					0.11
Indonesia					0.12
Thailand					0.08
India					0.14
Brazil					0.35
Russia					0.32
Mexico					0.23
South_Africa					0.12

Source: Deuterium

Fiscal measures in the major economies have supported the incomes of those faced with labour market shocks, while monetary interventions have provided depth and liquidity to the debt markets.

Record disposable income and savings rates with high US bond, housing, and equity markets will continue to support domestic consumption and production as well as Far East output, while European and developing market GDP expansions will follow in the wake of US and Asian strength



# Equity Markets and Bond Markets are overvalued

As equities have risen to highly overvalued levels in anticipation that the Covid-19 recession effects would fade, underlying fundamentals have improved as much as prices have increased.



Nearly all major equity markets have risen far above fair value, with only that of China among major markets showing as fairly valued.

Country	Current Price	Target Price	Price Move required to get to target price
World	3017	2409	-20.2%
Majors	2305	2021	-12.3%
United States	4298	3225	-25.0%
EMU	4064	2984	-26.6%
Japan	28792	27107	-5.8%
United Kingdom	7037	6526	-7.3%
Canada	20166	16687	-17.2%
France	6508	5349	-17.8%
Switzerland	11943	10737	-10.1%
Germany	15531	13780	-11.3%
Australia	7313	4668	-36.2%
Netherlands	730	557	-23.7%
Spain	8821	8580	-2.7%
Sweden	2263	2568	13.5%
Italy	25102	27016	7.6%
Asia Ex Japan	838	719	-14.3%
China	110	112	2.1%
South Korea	3297	2672	-18.9%

Country	Current Price	Target Price	Price Move required to get to target price
Taiwan	17755	13649	-23.1%
Hong Kong	28828	27466	-4.7%
Singapore	3130	1996	-36.2%
Indonesia	5985	6000	0.2%
Malaysia	1533	1930	25.9%
Thailand	1588	1209	-23.8%
Philippines	6902	6678	-3.3%
Emerging	1375	1252	-8.9%
India	52483	52278	-0.4%
Brazil	126802	156692	23.6%
Russia	3842	2789	-27.4%
Mexico	50290	47773	-5.0%
Turkey	1356	1463	7.9%
Resource	350	346	-1.1%
South Africa	66249	68267	3.0%
Colombia	427	312	-27.0%
Chile	4331	3772	-12.9%
Argentina	62372	58389	-6.4%

Source: Deuterium, Bloomberg

Negative Positive

# Equity Markets and Bond Markets are overvalued

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- › Equity markets in all regions show valuation extremes given that markets have risen on anticipations of continued earnings rebounds, while trailing fundamental measures have moved up at nearly an identical pace but from a low, recessionary base. Overvaluations on trailing price to earnings metrics are typical in the initial recovery quarters following an economic contraction, and current equity valuations continue to benefit from record low worldwide interest rates and tight credit spreads.
- › Q3 2021 will show good fundamental support for shares, with a poor outlook for bonds worldwide, as expansions in US and Far East activity and prices will be generalized throughout Europe or most developing economies. Difficulties for bonds will reappear during the quarter as consumption, industrial production, and exports all begin accelerating across the major regions.
- › A significant rotation back into sector relative returns similar to those in Q1 this year is likely, with pro-cyclical sectors such as industrials, technology, financials, and real estate providing better returns than counter-cycle sectors such as utilities, telecommunications, consumer staples, and healthcare that do poorly in relative terms when faced with rising long-term interest rates.

## Deuterium Global Asset Allocation Conclusions for Q3 2021

The shift up in the global cycle will give further support for corporate earnings expectations, and along with fiscal and monetary policies designed to support incomes and output, will continue to benefit risk asset valuations throughout Q3 2021. Industrial activity accelerations during the quarter again will put upward pressure on long term bond yields, all the while providing support for equity fundamentals.

The shift in Q2 2021 away from accelerating inflation pressures that provided a somewhat better recent environment for fixed-income assets, looks to evolve into a global context where accelerating output, rather than rising prices will put upward pressures on long-term interest rates. Central banks have greater freedom and can keep supportive monetary policies in place for longer in such circumstances.

Investors may do well to maintain their allocations to risk assets through Q3 2021, as faster economic growth worldwide provides increased support for corporate revenue and earnings projections, and long-term bond yields again adjust higher while central banks keep short rates at their lows, The generalised expansion in the global cycle likely will extend suddenly to higher consumer and industrial activity rather than to higher price inflation.

# USA Regional Investment Conclusions

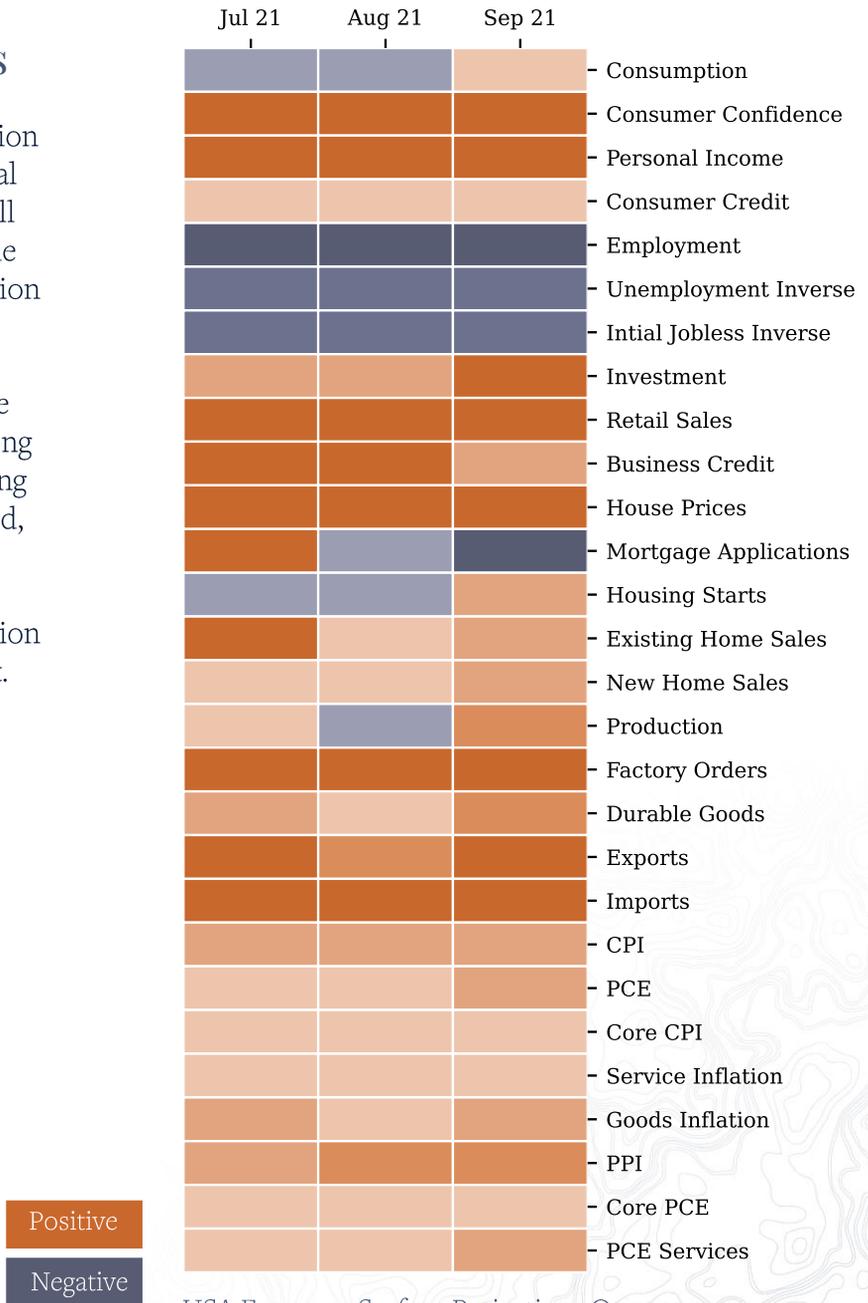
## Q3 2021:

### DGDA Economic Projection Surfaces



### Economic Projections

Deuterium Global Asset Allocation models project that US industrial production and trade growth will lead the US expansion during the next quarter, with US consumption and personal income showing further additional rises. US investment growth looks to have bottomed as well, with very strong upturns in housing prices. During Q3, US inflation will be sustained, with producer prices expanding year on year, and with personal consumption expenditure inflation up near the central bank's target.



USA Economy Surface Projections Q3 2021



# Market Valuations

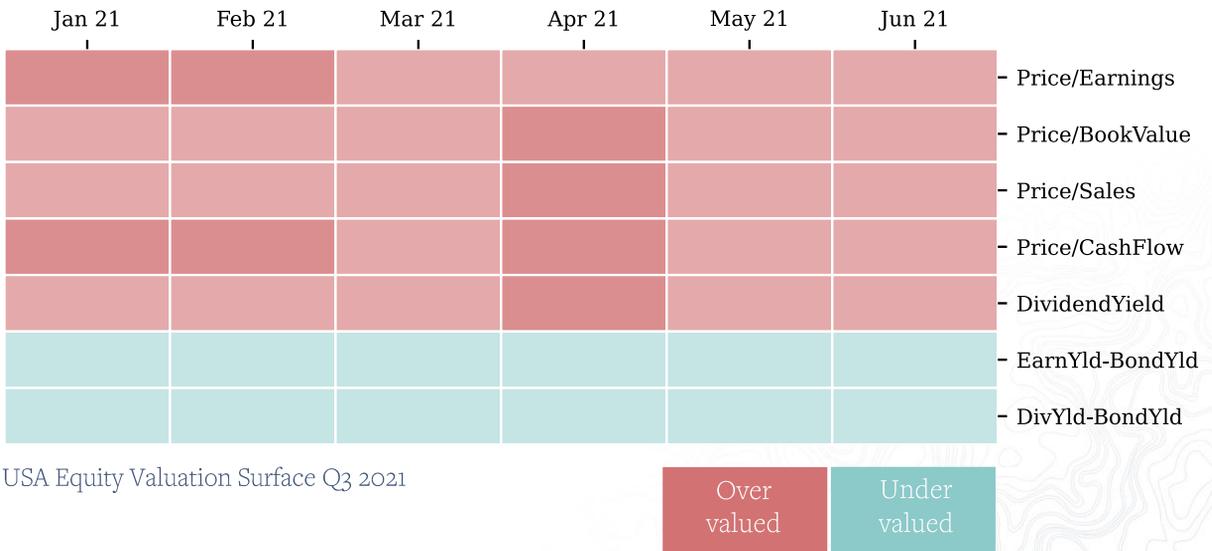
## Outlook Summary

<p><b>USA</b></p> 	<p><b>Equities</b></p> 	<p><b>Three Month Bills</b></p> 
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## Market Valuations

Equity valuation metrics show US shares to be overvalued, yet less so than those for other major markets. Comparisons of US trailing earnings and dividend yields against low but positive US bond yields, with EMU and Japanese equity market fundamentals measured against their zero yields, still show US equities with a significant edge.

The Federal Reserve’s policy interventions mean that US bond valuations are expensive compared to long term metrics and are likely to correct. The US Dollar is overvalued on inflation and external account differentials.



DGDA Models show US equities to be overvalued on metrics such as price/earnings and dividend yields, while earnings yields compared to bond yields are more aligned to historical averages

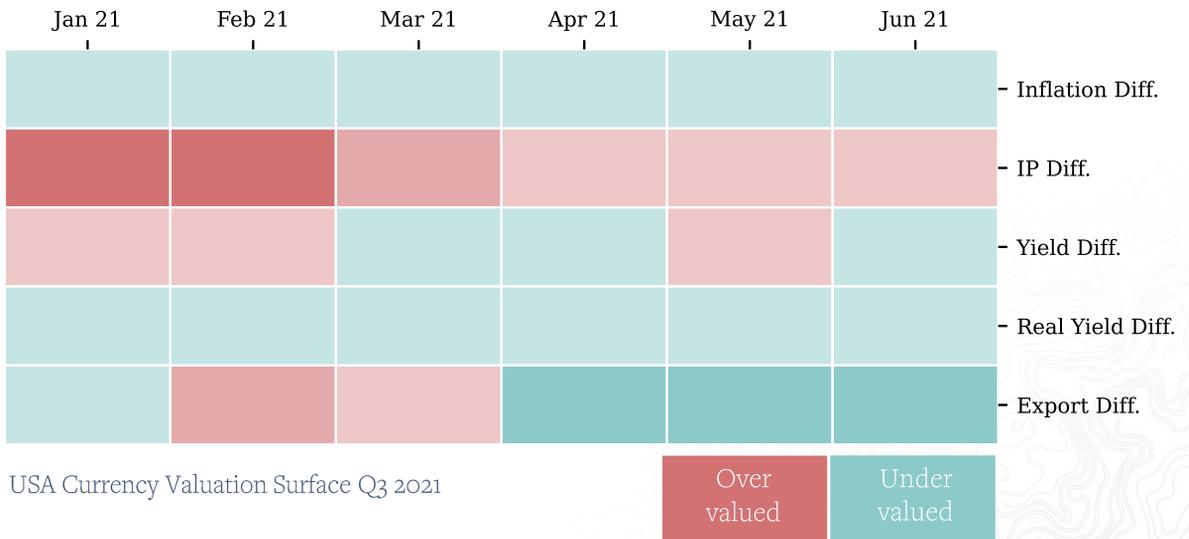
# Monetary Policy and Transmission

## Outlook Summary

<p><b>USA</b></p> 	<p><b>USD</b></p> 	<p><b>Ten Year Bonds</b></p> 
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## Monetary Policy and Transmission

DGDA Models suggest that USA inflation will accelerate over the course of Q3 2021, and that while the Federal Reserve will continue to implement extensive policy measures designed to support US prices and output, provide financial system liquidity, and facilitate credit market functioning, long-term yields will face upward pressures.



DGDA Models show the USD to be overvalued on international real yield comparisons and reasonably valued on external account measures

# China Regional Investment Conclusions

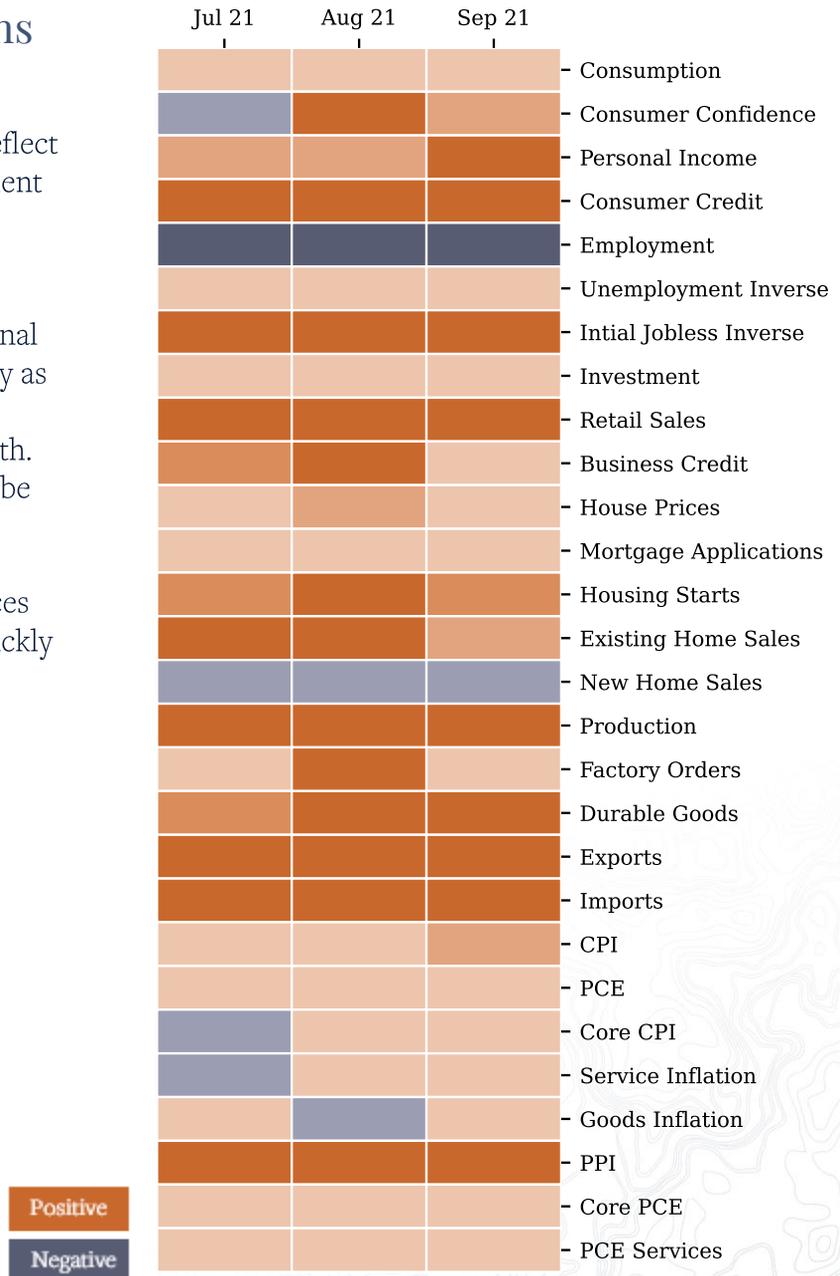
## Q3 2021:

### DGDA Economic Projection Surfaces



### Economic Projections

DGDA Models show that real output growth in China will reflect ongoing support for employment and housing, with consumer credit and retail sales growth more positive during Q3 2021. Chinese production and external trade look to grow significantly as the global cycle upswing relaunches world export growth. Chinese authorities appear to be shifting again toward loose monetary policy, now that producer and commodity prices are accelerating much less quickly worldwide.



China Economy Surface Projections Q3 2021



# Market Valuations

## Outlook Summary

China



Equities



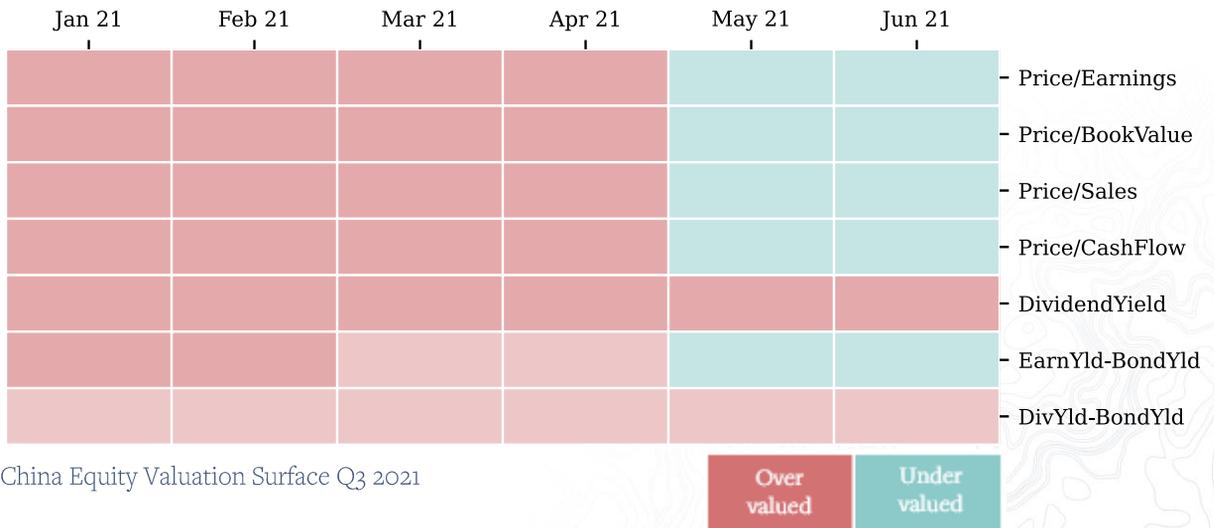
Three Month Bills



## Market Valuations

Valuation tools suggest that Chinese shares in mainland indices have moved to undervalued levels compared to long-term metrics for trailing cash flow and earnings yields, while Hong Kong equities now are at expensive valuations compared to fundamentals.

Chinese bond market valuations are unattractive, and the Yuan remains attractive on international comparisons.



DGDA Models show Chinese equities as undervalued on historical price to earnings and cash flow measures



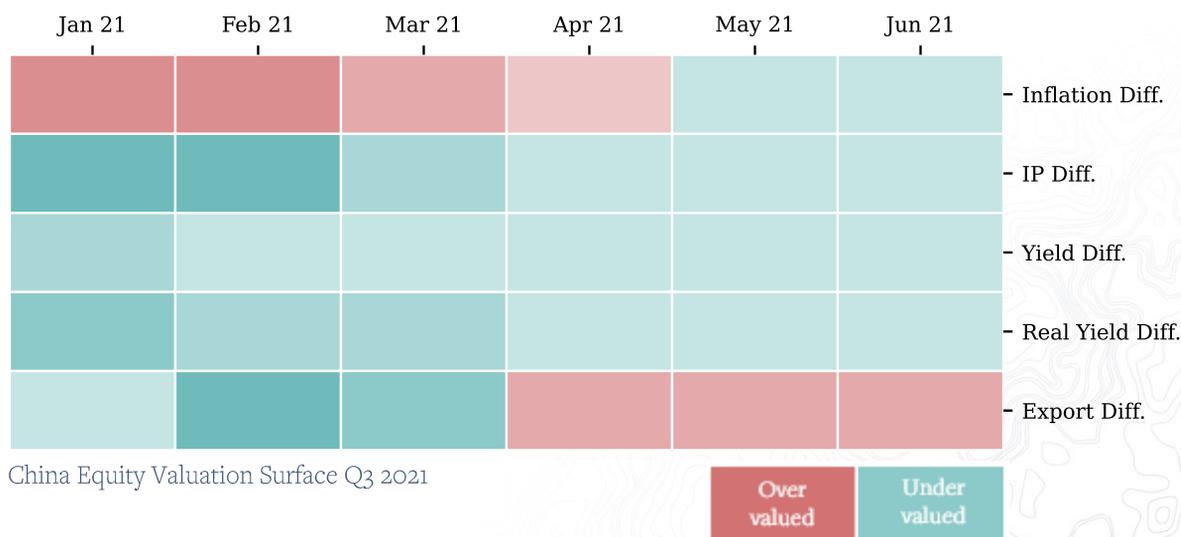
# Monetary Policy and Transmission

## Outlook Summary

<b>China</b> 	<b>CNY</b> 	<b>Ten Year Bonds</b> 
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## Monetary Policy And Transmission

Chinese monetary authorities appear to be slowing or reversing the significant steps to contain credit expansions they have been implementing this year, responding in part to more contained domestic inflation pressures subsequent to the Yuan's strengthening. China's monetary channels have yet to show significant positive transmission effects into the real economy, which would lead through positive effects on consumption, employment, and external trade to higher real GDP growth.



DGDA Models show the CNY to be overvalued on interest rate and domestic cycle comparisons

# Japan Regional Investment Conclusions

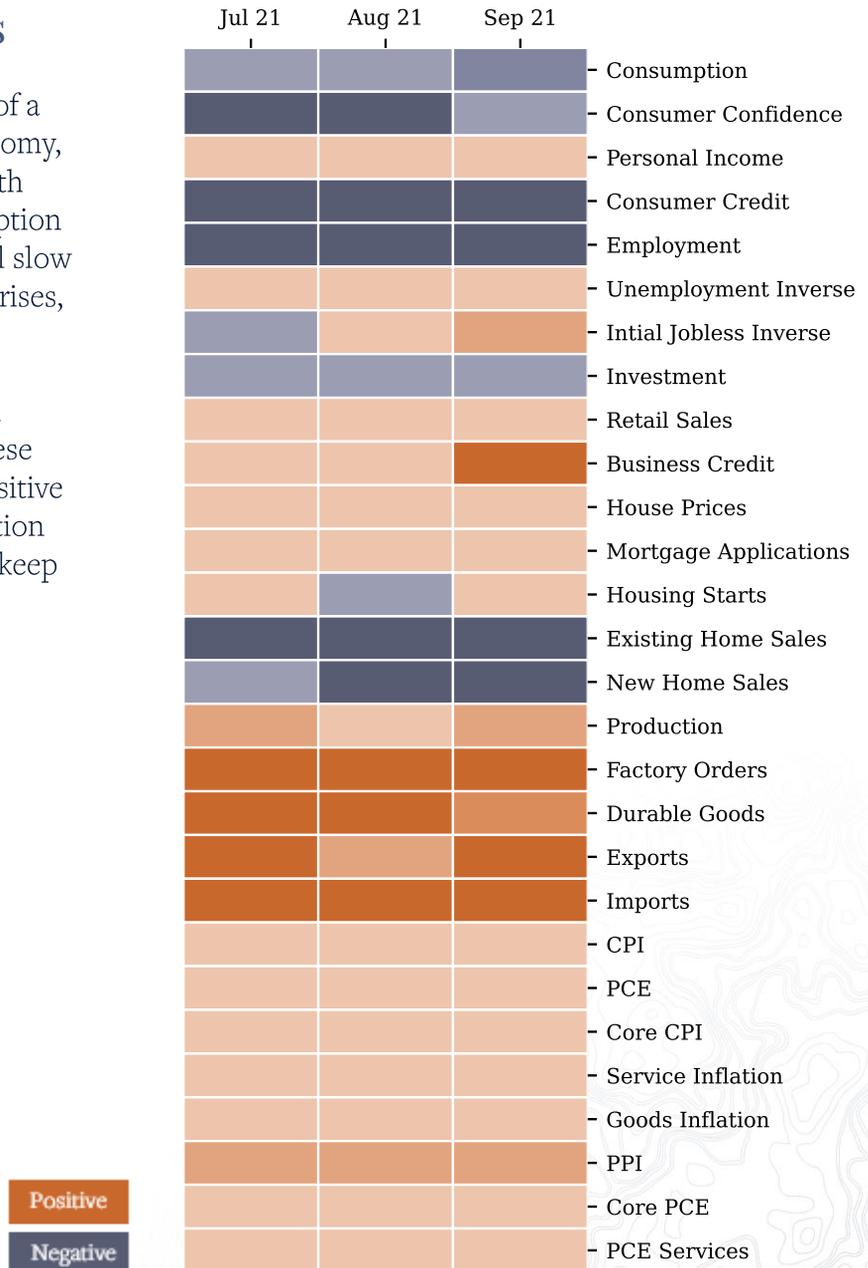
## Q3 2021:

### DGDA Economic Projection Surfaces



## Economic Projections

DGDA Models show much less of a downturn for the Japanese economy, with production and trade growth expanding in Q3 2021. Consumption and consumer credit growth will slow despite higher personal income rises, and investment will decline less rapidly as housing growth and expanding industrial output and exports provide support. Japanese inflation measures will show positive consumer price and goods inflation rates, while the weaker Yen will keep producer prices positive.



Japan Economy Surface Projections Q3 2021



# Market Valuations

## Outlook Summary

Japan



Equities

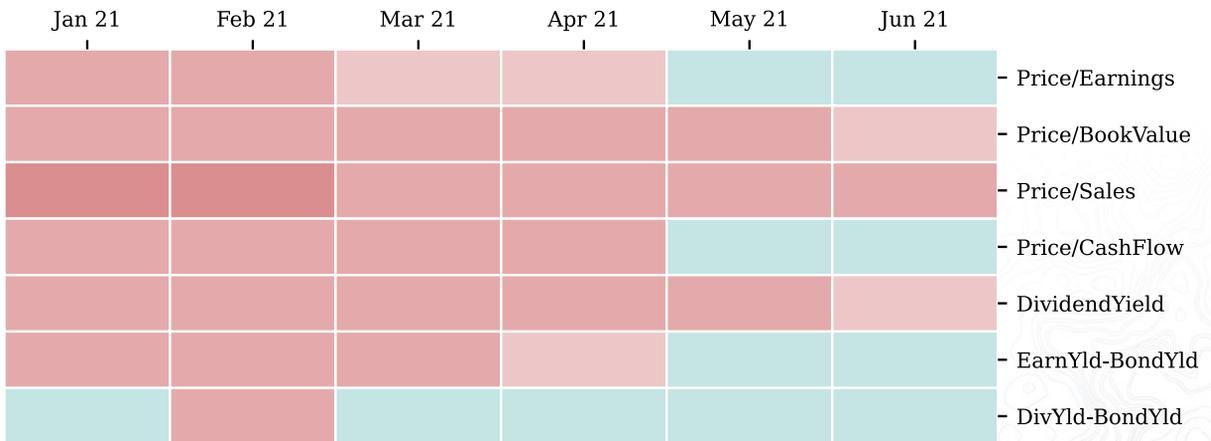


Three Month Bills



## Market Valuations

Japanese shares are more fairly valued than those for most major markets, with several metrics including dividend and earnings yields compared to long bond yields in line with their historical averages. The Yen looks to be very attractively valued.



Japan Equity Valuation Surface Q3 2021



DGDA Models show that Japanese equities are slightly overvalued on standard historical metrics



# Monetary Policy and Transmission

## Outlook Summary

Japan



JPY

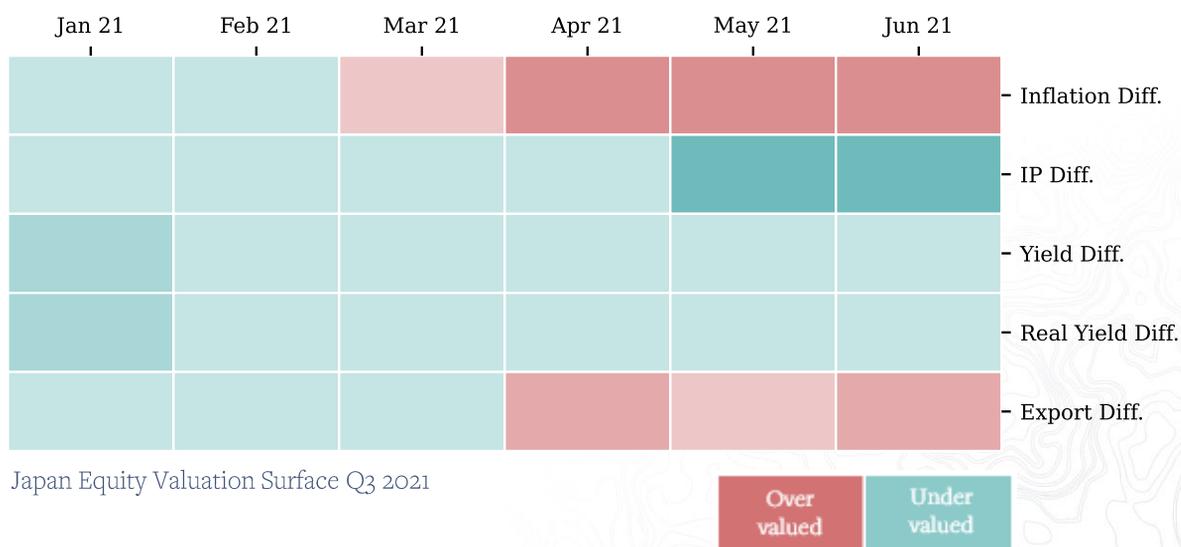


Ten Year Bonds



## Monetary Policy And Transmission

DGDA Models indicate that Japanese monetary policy has continued to be supportive of prices and real economy growth, in line with policies of the US Federal Reserve and the ECB. The BOJ has kept policy loose enough to benefit as well from the implicit reflationary pressures that stem from a weaker Yen.



DGDA Models show the JPY to be attractive on international fundamentals

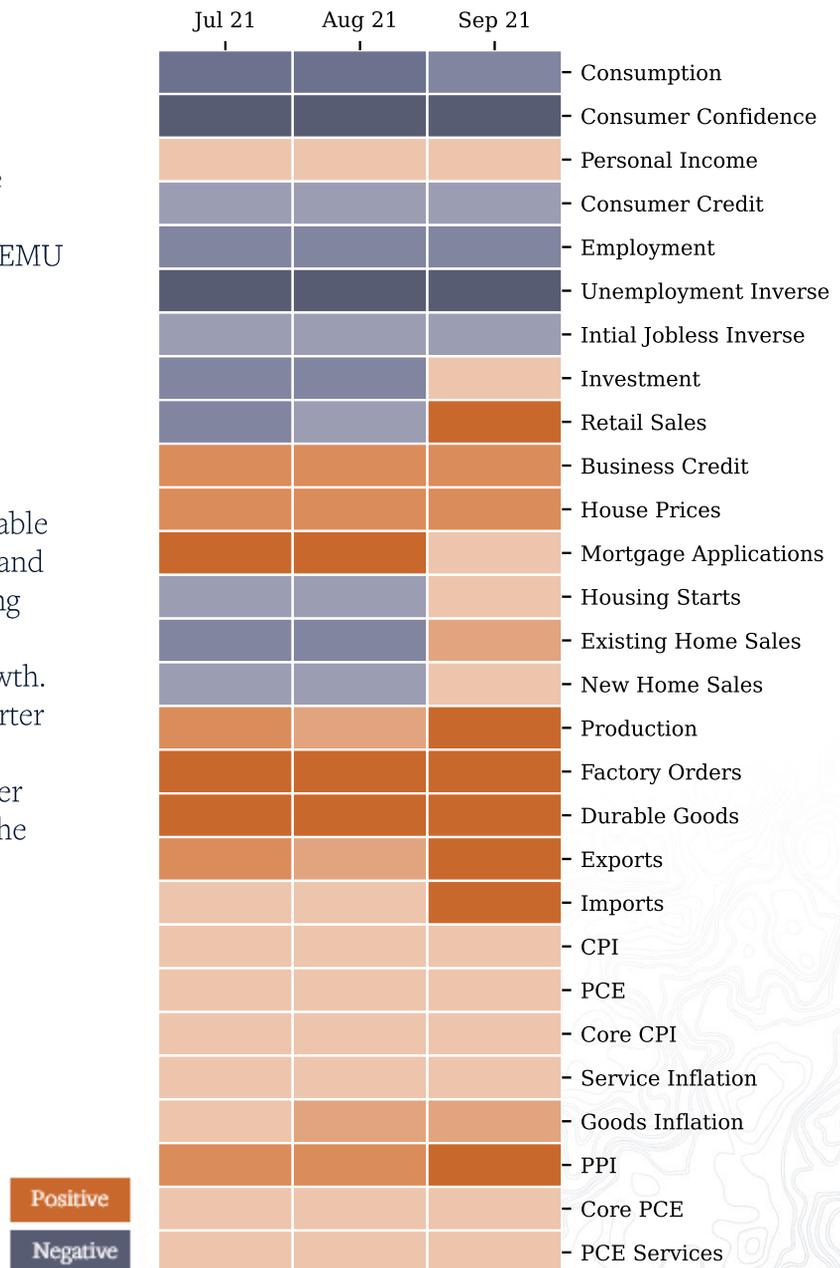
# Eurozone Regional Investment Conclusions Q3 2021: DGDA Economic Projection Surfaces



## Economic Projections

DGDA Models show that economic growth in the Eurozone will reflect expansions in production and trade during Q3 2021. Our models show negative readings persisting for the EMU consumption surface, with lagging growth in personal income, employment, consumer credit, and retail sales.

After a year of severe weakness in production, factory orders, and durable goods, Eurozone industrial activity and trade will begin to normalize, moving toward their historically positive contributions to overall output growth. EMU inflation over the coming quarter will be positive, with the earlier pressures that weighed on consumer and producer prices countered by the global economic expansion.



Eurozone Economy Surface Projections Q3 2021

# Market Valuations

## Outlook Summary

**Eurozone**



**Equities**

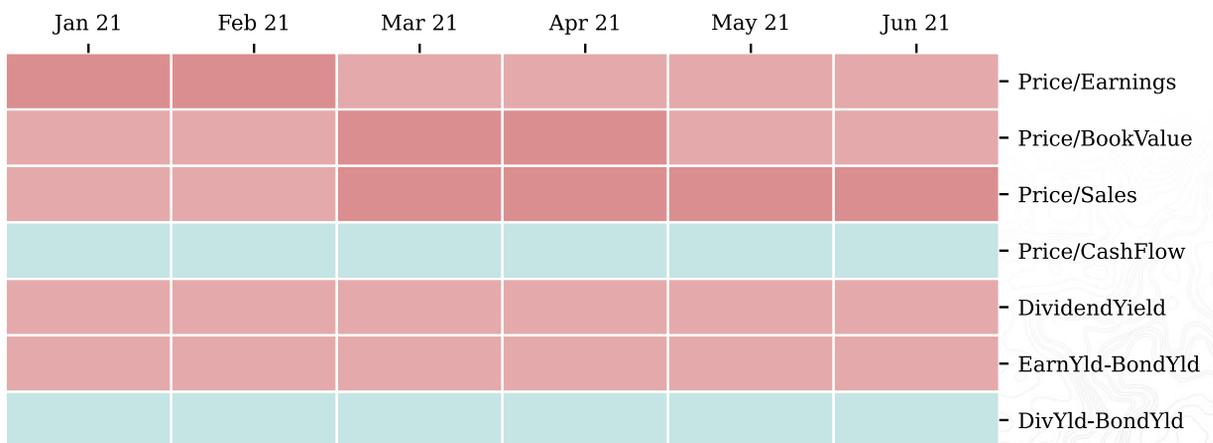


**Three Month Bills**



## Market Valuations

Eurozone equity valuations are unattractive on all measures compared to their long-term averages, and are significantly more so than US shares. This is because European corporate trailing earnings and cash flows have compared poorly to their international peers. Bonds look to be overvalued at present given the Eurozone’s likely higher inflation and output growth, while the Euro is attractive.



Eurozone Equity Valuation Surface Q3 2021



DGDA Models show EMU equities to have unattractive price earnings, dividend yield, and earnings yield to bond yield comparisons



# Monetary Policy and Transmission

## Outlook Summary

**Eurozone**



**EUR**

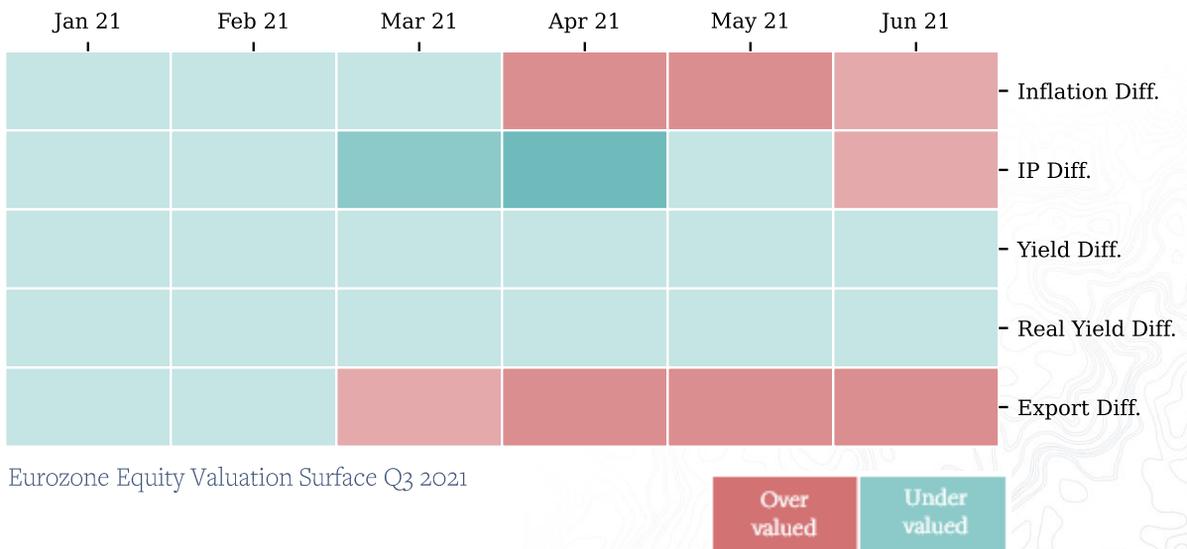


**Ten Year Bonds**



## Monetary Policy And Transmission

The ECB engaged with significant monetary policy loosening in support of the Eurozone’s financial system, intervening as did the Federal Reserve for the USA, and at present is showing no signs of hesitation as to whether monetary stimulus is required. The ECB president’s clear support for additional fiscal measures in the major Eurozone economies have met with positive responses, and Europe’s monetary authorities look to continue working with political leaders to boost EMU income and output.



DGDA Models show that the Euro looks to be somewhat overvalued on historical comparisons



# UK Regional Investment Conclusions

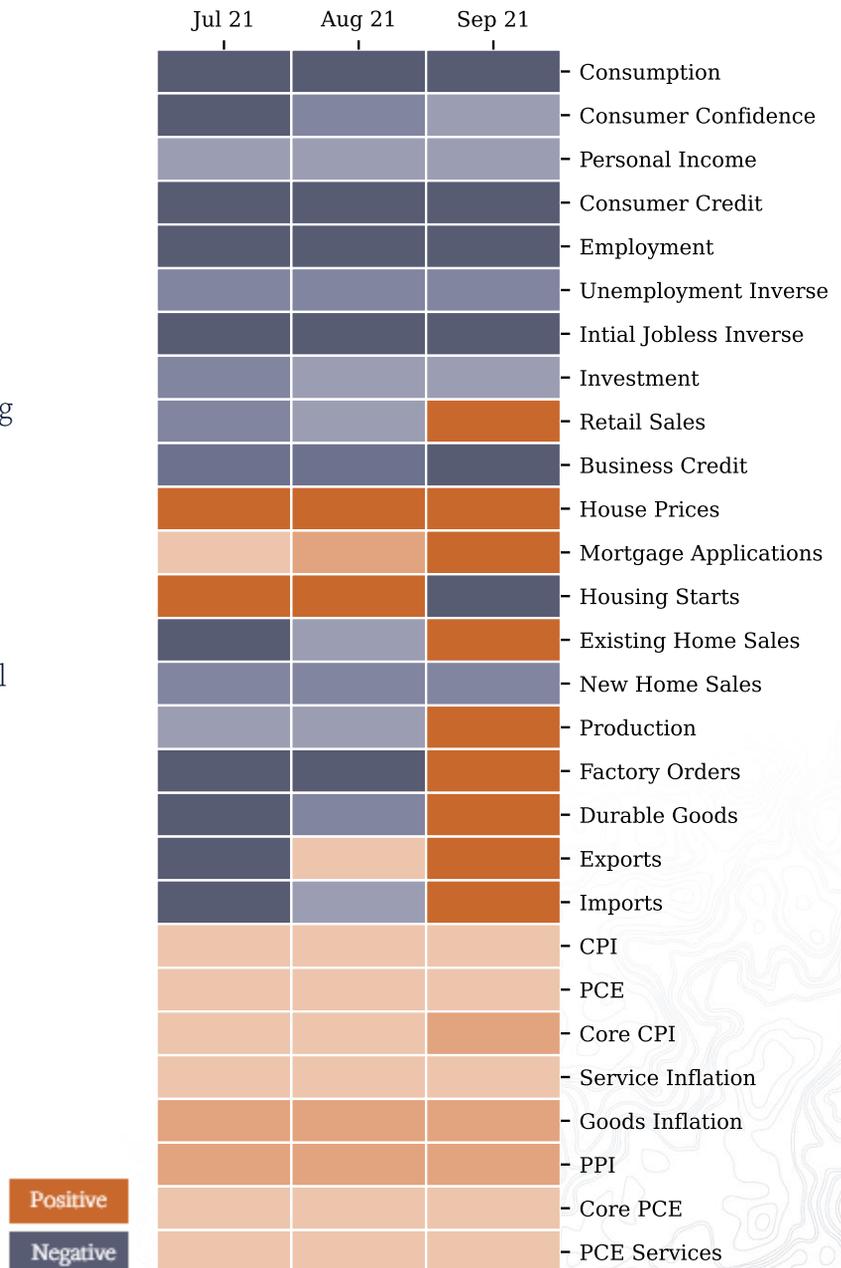
## Q3 2021:

### DGDA Economic Projection Surfaces



## Economic Projections

DGDA Models still show slow economic output expansions in Britain during Q3 2021, with consumption constrained by weak consumer confidence and poor labour market readings. Next quarter's trade growth looks to be mildly positive, with some impediments to expansion lessening as EU trade issues eventually are settled in some fashion. Construction and housing look to expand, with some prospect for growth in production, while the overall outlook for UK investment has yet to improve. UK inflation will remain positive, with consumer, goods, and producer price inflation all moving up during the quarter.



UK Economy Surface Projections Q3 2021



# Market Valuations

## Outlook Summary

**UK**



**Equities**



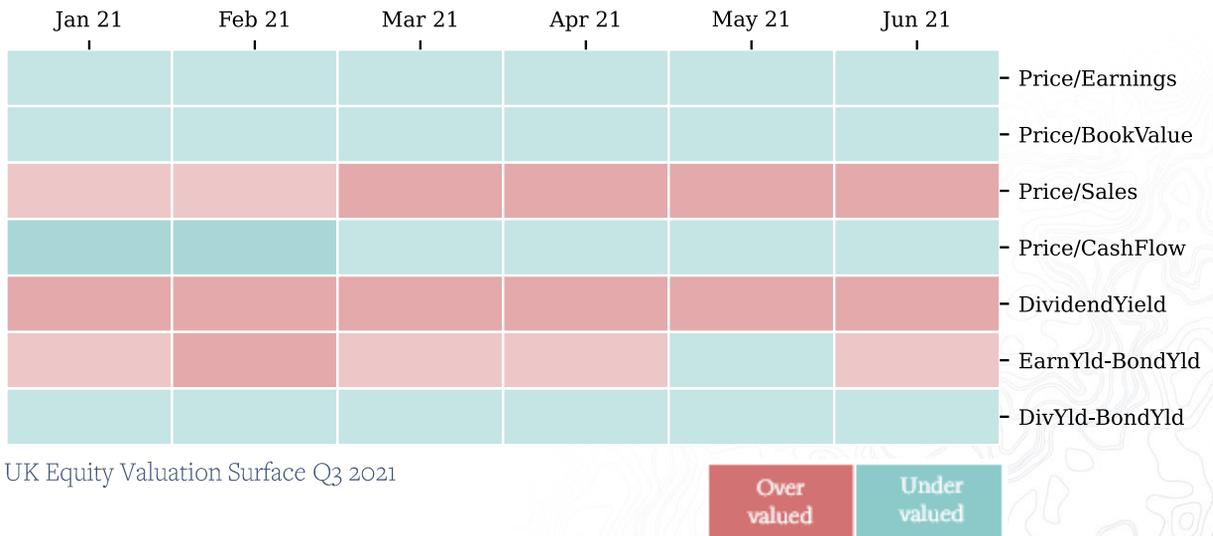
**Three Month Bills**



## Market Valuations

UK shares have fair valuation characteristics, better than those for most major equity markets. The deep contractions in UK GBP, combined with FTSE 100 companies often having global commodity related earnings, have made UK shares reasonably valued across several metrics.

The Pound probably will remain weak, unlikely to recover previous highs of five years ago, given the outline UK trade agreements appear to be taking, while UK bonds look to have expensive valuations given their low yields in both nominal and real terms.



DGDA Models show UK equities to be fairly valued on several measures including price to earnings and price to cash flow comparisons

# Monetary Policy and Transmission

## Outlook Summary

UK



GBP



Ten Year Bonds



## Monetary Policy And Transmission

The BOE joined the rest of the world’s major central banks in supporting output and prices over the past eighteen months, and along with the ECB looks to be keeping those very loose monetary policies in place for some time yet. Domestic political stability and less uncertainty as to the UK’s trade relationships have allowed the UK authorities to set monetary policies adapted to the UK’s needs, now working through domestic transmission channels to help contain severely contractionary pressures from both internal and external shocks to the UK economy.



DGDA Models show the Pound to be somewhat undervalued on international comparisons



# Emerging, Far East ex Japan, and Commodity Markets

## Regional Investment Conclusions Q1 2021



### Outlook Summary

#### Emerging Equities



#### Far East Equities



#### Commodities



## Economic Projections

Accelerating global demand will be very beneficial for developing market economies that rely upon commodity exports to generate international reserves. Strong, recent, valuation support for major equity markets as world output has rebounded has not yet been matched by shares in developing countries. This has meant that Brazilian, Mexican, Indian, and other developing equity markets currently at discounts to or in line with historical valuations, showing a relative valuation advantage compared to major markets. World output and prices will continue to rise, relieving pressure on such countries' external accounts, and lifting their equity valuations in line with the cycle. Economies such as those of Taiwan or South Korea in the Far East region have maintained their industrial expansions and will continue to have an advantage in the Q3 2021, while the USA and China continue their economic expansions, and Europe begins catching up to growth on the North American and Asian continents.

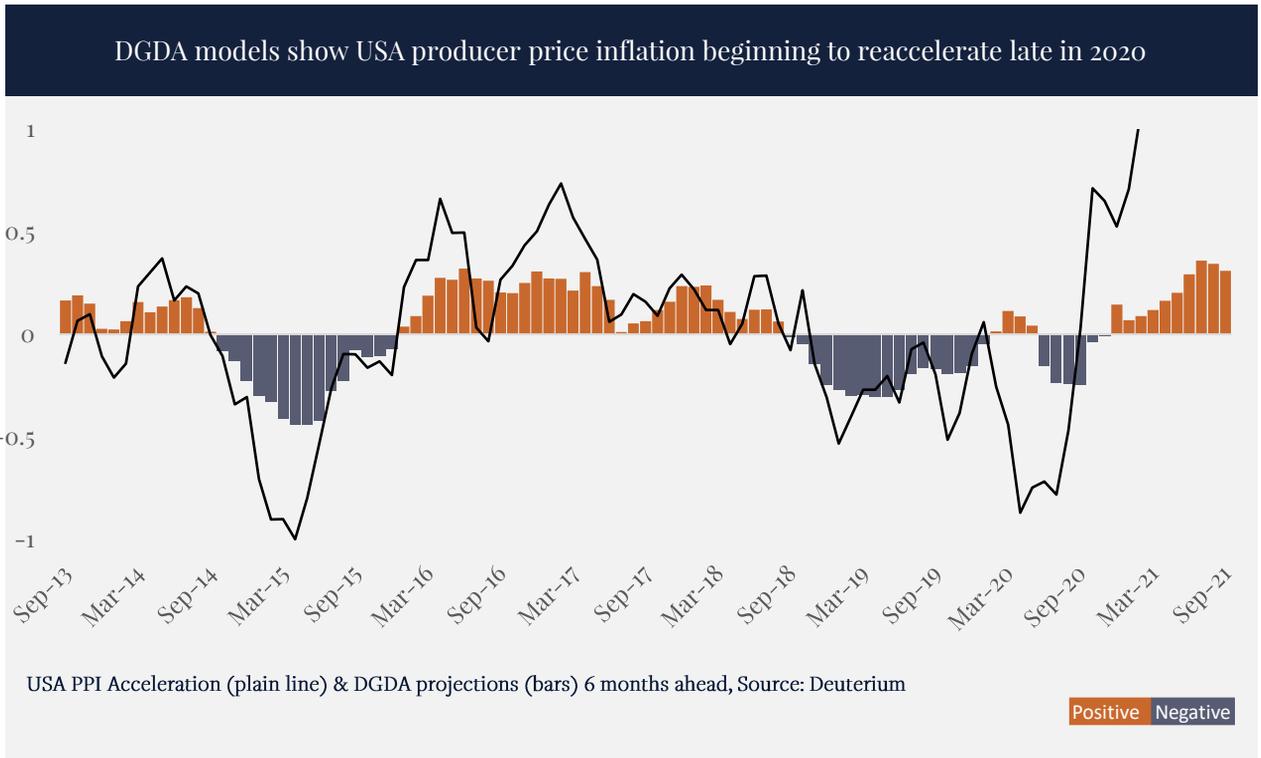
## Monetary Policy And Transmission

Central Banks around the world aligned their monetary policies to unprecedented loosening, with the Federal Reserve having implemented rapid rate cuts and expanded its balance sheet, the ECB having extended its quantitative easing, and the BoJ and PBoC providing further domestic monetary support. Directed short-term interest rates remain close to all-time lows and with real economic activity expanding GNP from here, rather than accelerating, prices, monetary policies likely will stay very supportive worldwide, maintaining low short-term interest rates in developing regions as well.



# Market Valuation And Sentiment

Shares for Far East ex Japan countries such as South Korea and Taiwan are very expensive compared to historical measures, while those of developing markets such as Mexico and Brazil now are showing as moderately expensive as well.



# About the Author: John Ricciardi

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Head of Global Asset Allocation, Deuterium Capital Management, LLC

Before joining Deuterium in January 2021, John was the Head of Global Asset Allocation at Merian Global Investors (MGI). John co-founded Kestrel Investment Partners LLP in 2011, whose global asset allocation business was acquired by MGI. Prior to Kestrel, John served as the Head of Asset Allocation at Iveagh Limited between 2006 and 2011, where he launched the Iveagh Wealth Fund.

Earlier in his career, John cofounded Cursitor Management. Cursitor was one of the first firms to offer top-down, global asset allocation solutions for institutions. Upon the sale of Cursitor to Alliance Capital in 1996, John became the Head of Global Asset Allocation for AllianceBernstein, where he served until 2003. With AllianceBernstein, John also cofounded Bullrun Financial in 2000, a pioneer of quantitative portfolio strategies for institutions and advisers. John chaired the business through to 2010 when it was sold to Quantal International Inc.

## About Deuterium

Deuterium Capital Management, LLC has been in business as a US registered investment adviser since April 2018. The firm provides comprehensive investment management solutions through both direct relationships and partnerships with family offices and/or similar institutions. Deuterium also provides investment management services to an umbrella Irish Collective Asset-management Vehicle. Deuterium Investment Advisers Limited is Deuterium's UK presence, and is an Appointed Representative of Duff & Phelps Securities Limited which is authorised and regulated by the Financial Conduct Authority in the UK. Deuterium's website can be viewed at [www.deuterium.us](http://www.deuterium.us)

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