Spotlight on Multi Asset

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Absolute equity valuations are historically high

History is not on the side of those looking for strong returns

Shiller Total Return CAPE ratio and 10yr Subsequent Returns since 1945

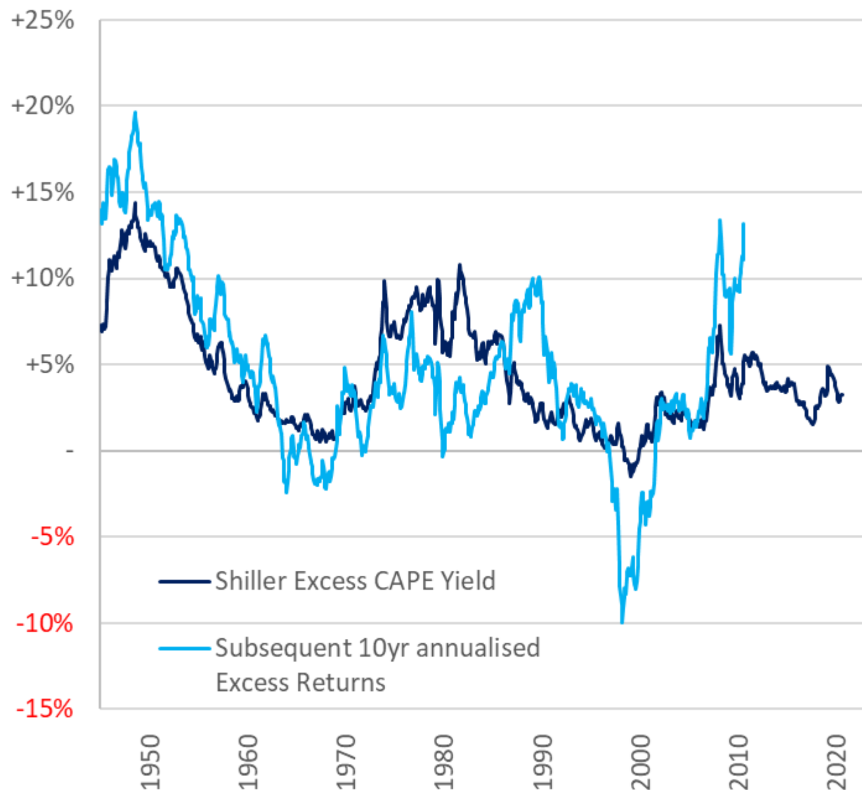
- Valuations appear high in absolute terms for equities versus history, especially in the United States.
- High absolute valuation starting points have historically been attached to lower subsequent medium-term returns.
- Some long-term measures of valuation like Shiller’s Cyclically Adjusted Price Earnings Ratio are consistent with a very poor outlook for equity returns.
- But equity valuations do not exist in a vacuum.

Source: Columbia Threadneedle Investments, Robert Shiller, 17 September 2021. Please note performance targets may not be attained.

Relative equity valuations are middling

Equity valuations don't exist in a vacuum

Shiller Excess CAPE yield and 10yr Subsequent Excess Returns since 1945



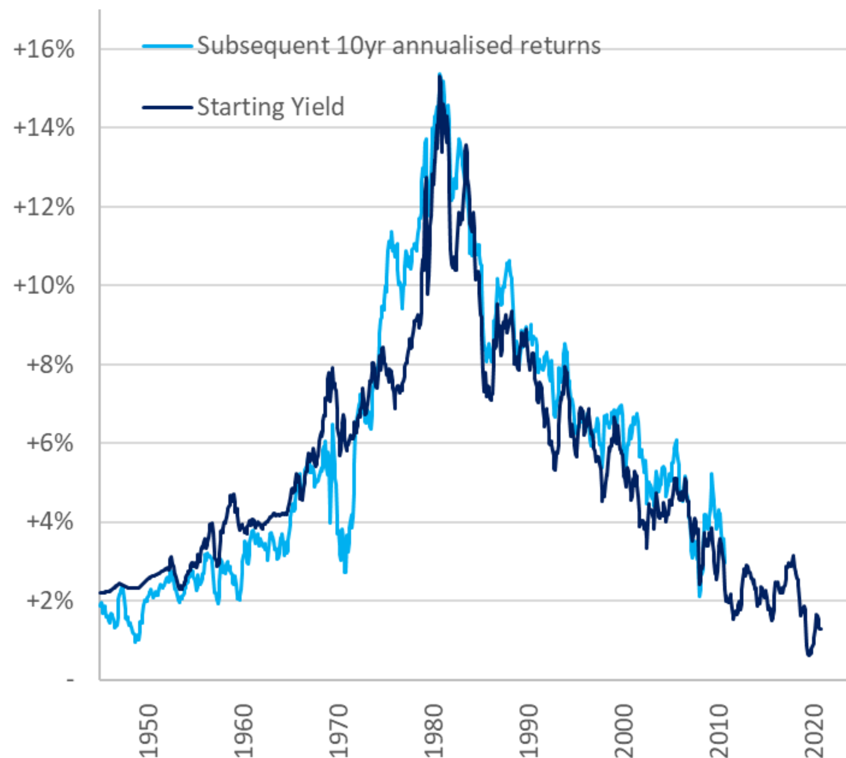
- Equity earnings yields are fairly middling versus bonds.
- The relationship between excess returns to bonds and valuation against them is variable.
- Some long-term measures of relative valuation against bonds like Shiller's Cyclically Adjusted Price Earnings Ratio are consistent with a reasonable outlook for equity returns versus bonds.

Source: Columbia Threadneedle Investments, Robert Shiller, 17 September 2021. Please note performance targets may not be attained.

The next ten years for public markets?

Low bond yields are not a good place to start

10yr US Treasury Yields and 10yr Annualised Subsequent Returns since 1945



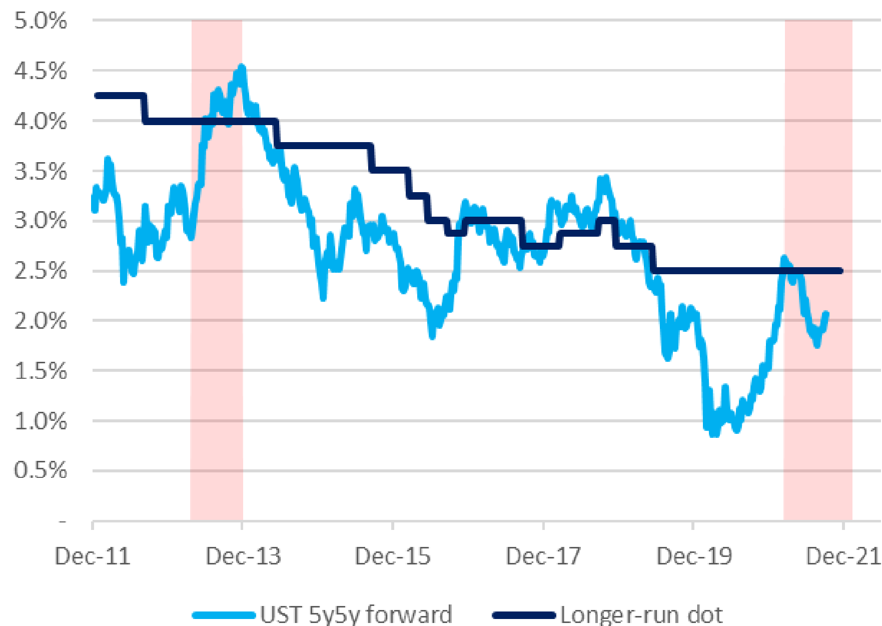
- Forecasting bond returns in the short-term can be tricky.
- Forecasting bond returns over the long-term is not complicated or controversial.
- Structural economic challenges contributing to the low yield environment:
  - Demographics: ageing population eager to save
  - Debt: servicing requirements reduces rate which ‘bites’
  - Distribution: local and global
- Threats to the low yield environment:
  - Stronger growth raises neutral real rate (new fiscal paradigm, fourth industrial revolution)
  - Deglobalisation raises local market inflation risk premia
  - Deanchored inflation expectations raises inflation
- Low returns from bond markets, at best.

Source: Columbia Threadneedle Investments, Robert Shiller, 17th September 2021. Please note performance targets may not be attained.

Whither bond yields?

The US as monetary hegemon

US Treasury 5y5y forwards vs Long-run FOMC Dot, 2011-21



- The Taper tantrum of 2013 scarred the FOMC meaningfully.
  - Bonds sold-off, EM was smashed and financial conditions in aggregate tightened more than desired.
- As we approach taper announcement (November base-case?), should we brace for similar?
- Five-year five-year forwards have been approximately contained by the FOMC long-term dot over the past decade.
  - In 2013 5y5y were 130bps below Fed LT dot
  - Today 5y5y are 40bps below
- Threats to the median dot:
  - Effective US fiscal; new global fiscal consensus;
  - Deanchored inflation expectations.
- Hard to see UST offering 'value', but a bigger place in portfolios 40bps north of here?

Source: Bloomberg and Columbia Threadneedle Investments, 4 October 2021.

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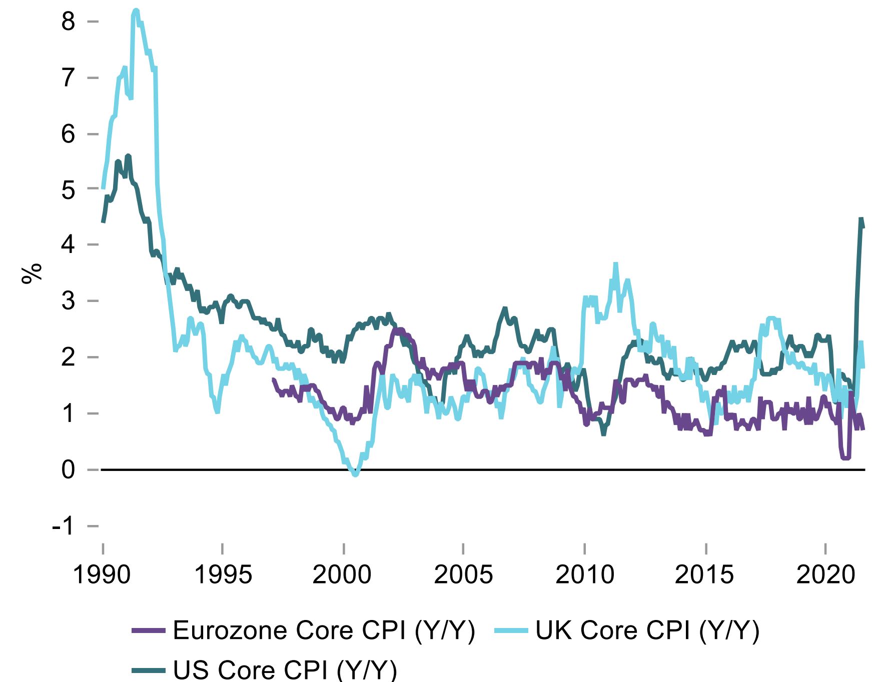
Inflation risk?

To us, inflationary risks appear transitory

- Short-term risks
  - Capacity loss
  - Bottlenecks
  - Increased costs from COVID
  - Less globalisation
  - Environmental/regulatory costs
  - Raw material prices
  - E.G.
    - Seen a spike in inflation – in US largely driven by 2nd hand car and airline ticket prices (both hit 10%)
    - In UK shortage of truck drivers becoming an issue
- We do not expect a material increase over the medium term
  - Capacity restored
  - Long-term deflationary forces return
  - Productivity improvements in the pipeline, e.g. automatic supermarket checkouts, drone delivery, driverless cars, app ordering

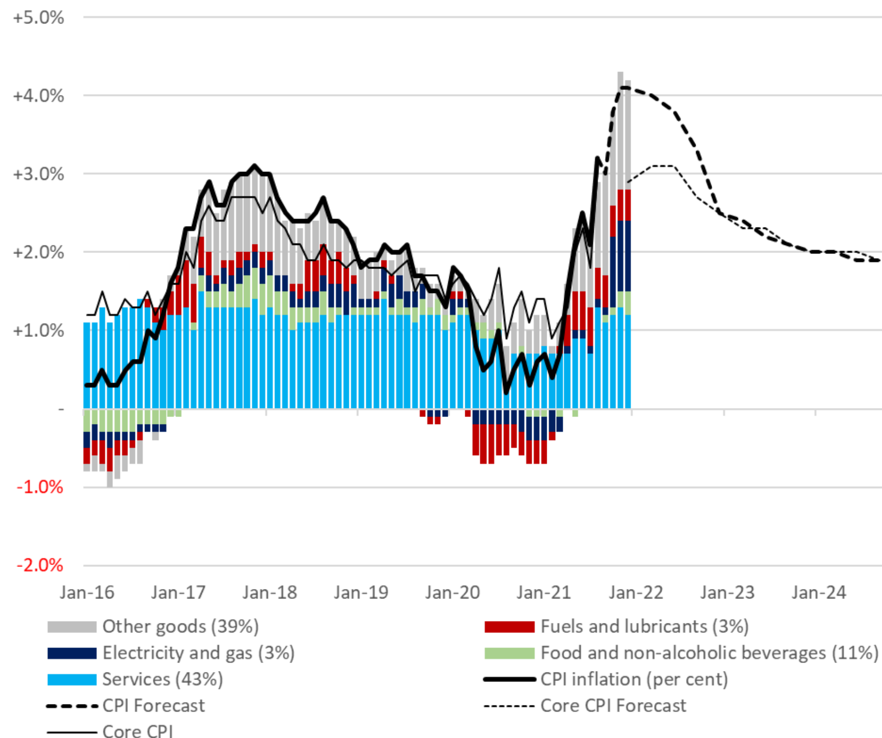
Eurozone, UK and US Core Inflation:
Range bound between 2000 and 2020



Source: Macrobond, as at 19 August 2021.

Inflation risk?
Case study: UK

UK CPI 2016-2021



- Base case:
  - Reopening spike to mean-revert as labour supply bottlenecks resolve
    - Restaurants @ 8%
    - Hotels @ 12%
    - Second hand cars @ 18%
  - Higher electricity prices, international logistics costs take time to work through
    - Fuel @ 18%
    - Electricity projected to be +30%
    - Furniture @ 8%
- Upside risks:
  - Boot-strapped one-offs continue to domino through until deglobalisation matures into a more permanently volatile inflation environment.
  - The re-opening experience post-World War II serves as a good model.

Source: Bank of England and Columbia Threadneedle Investments, 5 October 2021.

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