Frontier MFG Global Sustainable Fund
Institutional Class (FMSGX), Service Class (FMSRX)
Sub-advised by MFG Asset Management – Sydney, AU

FRONTIER FUNDS

Quarterly Commentary, June 30, 2021

Global stocks soared to record highs as they rose for the ninth quarter in 10 during the three months ending June 30, 2021, after investors backed that vaccines and more government spending would drive economies, dismissed an acceleration in inflation as transitory, and thus believed statements from central banks they would keep monetary policy loose. During the quarter, 10 of the 11 sectors rose in US-dollar terms. Information Technology (+12%) climbed the most on healthy earnings while Utilities (-0.7%) declined on concerns that longer-term bond yields might rise.

U.S. stocks gained as companies, especially tech ones and the banks, reported healthy earnings reports for the first quarter, the administration of President Joe Biden announced plans for another US$4 trillion in spending (that Congress is still to approve), consumers spent as they grew in confidence, and, by the White House count, 67% of adults have received one vaccine dose. Reports, however, on inflation provoked spasmodic caution. Consumer inflation rose 5.0% in the 12 months ending May 31, 2021, the fastest pace since 2008, while producer prices surged 6.6% in the year ending May 31st. These reports fanned talk the U.S. Federal Reserve might rethink its loose monetary policy. A Fed survey of its policymakers show they had brought forward their expectations of when they would sanction a higher U.S. cash rate. They (as represented by their median forecast) now expect to approve two increases in the cash rate from close to 0% by the end of 2023.

European stocks rose as countries relaxed pandemic restrictions as vaccine programs rolled out and the European Central Bank said it would keep aggressive monetary stimulus in place, though gains were limited by news that an ever-more debt-heavy eurozone economy is contracting. A report showed the eurozone economy shrank 0.3% in the March quarter, which followed a contraction of 0.6% in the December quarter. Another report showed government debt stood at 98% of eurozone GDP at the end of December.

The Fund recorded a positive return for the quarter. The biggest contributors were the investments in Alphabet, Facebook and Microsoft. Alphabet rallied after the parent of Google reported that rising spending on digital ads boosted first-quarter sales to US$55.3 billion, a higher-than-expected rise of 34% from a year earlier. Facebook surged after first-quarter sales smashed expectations to rise 48% to US$26.2 billion as advertisers sought access to the social media platform’s 2.9 billion users and a U.S. judge unexpectedly dismissed two complaints against the social-media giant from the U.S. regulator because the judge said the Federal Trade Commission failed to prove the company was a monopoly. Microsoft rose as rising demand for PCs, gaming consoles, and digital services delivered over the cloud boosted the software giant’s first-quarter sales by a higher-than-expected 19% to US$41.7 billion. As well, in April, Microsoft agreed to buy speech-recognition firm Nuance Communications for US$19.7 billion, to expand the services it can offer business customers.

The biggest detractors were the investments in Lowe’s Co, Sydney Airport and U.S. Bancorp. Lowe’s declined after investors decided the more than doubling of its stock price in the 12 months to March had gone too far. Sydney Airport fell as the city entered its only second city-wide lockdown since the pandemic struck in early 2020. U.S. Bancorp slid because banks lost their appeal as an inflation hedge when investors dismissed faster inflation as a fleeting problem.

The Fund underperformed the benchmark, MSCI World Index (Net), over the quarter. This reflected a modest outperformance of cyclical stocks over defensive stocks, on average, within the index. Uncertainty around the Chinese regulatory outlook weighed on Chinese technology platforms, while the portfolio's utility holdings were hampered by a company-specific regulatory decree and the threat of higher interest rates in the medium term.

The global economic upswing appears set to last a couple of years, driven by a record level of monetary and fiscal stimulus as well as a vaccine-driven reopening. However, there are two key risks.

The first is that the supply side of the economy takes much longer to recover than the demand side, leading to inflationary pressures that are larger or more persistent than expected. While we and most central banks expect inflationary pressures to be transitory, a surprise here may force central banks to tighten policy faster than expected, perhaps materially so. The second is a COVID-19 mutation that requires replacement vaccines to be developed and distributed, a process that could take three to six months.

COVID-19 has not changed the longer-term economic outlook. The global economy remains structurally low growth and low inflation, resulting in structurally low interest rates. What has changed is a steep rise in government debt and potentially a greater acceptance of central-bank-financed government deficits.

The equity market outlook for the next 18 months is more challenging than usual to predict. The cyclical economic upswing and policy accommodation should support equity returns, but the two economic risks mentioned earlier could trigger a 20% or more decline in equity prices. Another potential trigger is a correction in overvalued pockets of the market such as 'meme' stocks, as this could spread to the broader equity market.

Index movements and stock contributors/detractors are based in local currency terms unless stated otherwise.