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MARKET INSIGHT

AUGUST 2021

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Market Analysis

August 2021

2021 — a more difficult year to manage than it appears at first sight!

Whilst part of Europe is still awaiting its arrival, the summer is nevertheless about to move into its second phase, (sometimes) synonymous with a rockier period on stock markets.

Nonetheless, apart from a few brief bouts of volatility in July, markets have continued to rise over recent weeks, even hitting new record highs, particularly in the US.

With the notable exception of China, indices have thus overcome the mounting uncertainties of recent months, not least the COVID-19 pandemic.

The delta variant raises many questions, although we should rejoice in the fact that despite its highly contagious nature, it does not seem to have resulted in an explosion of serious cases. This is thanks to the vaccination campaign and a reminder of the importance of continuing with the process, in order to achieve herd immunity as soon as possible.

The information available to us makes us inclined to assume that we will not be confronted with further widespread lockdowns in developed economies, despite some worries that have fuelled chatter on the markets.

On the economic front, numerous questions remain around inflation, after the publication of US CPI data that clearly shows continued acceleration.

Although market operators have remained calm in response to these figures, as is illustrated by the easing in US 10-year rates, this attitude is surprising at the very least.

Everything suggests that the Federal Reserve has been successful in its mission of convincing us that inflationary pressure is transitory.

The coming months will provide greater clarity on this, but in our opinion, bond markets do not reflect the risk that inflation could become a more permanent feature in both the US and Europe. In this environment, we remain cautious on sovereign debt, particularly as real rates are not compatible with the period of economic recovery that we are experiencing.

The issue of economic recovery has also resurfaced, with some commentators doubting its ability to continue during the coming quarters. Given leading business indicators, particularly PMI data, we are maintaining our scenario of a robust economy on a 12-month horizon. In other words, we do not subscribe to the doubts mentioned above, which we consider overblown, and which further increase the risk of a new correction in bond markets.

> "We have continued to actively adjust our allocations over the summer period."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

We are therefore sticking to our target of a return to the 1.80% – 2.00% level for US 10-year yields by the end of 2021 and, accordingly, to our recommendation to restrict overall duration in a bond portfolio.

These different aspects lead us on to questions regarding monetary policy, which have been growing in recent weeks.

This is due to increasingly contradictory statements from different members of the Fed, and confirmation of a change in the framework for managing rates at the ECB.

We remain convinced that J. Powell and his colleagues will announce a program to reduce asset purchases in the autumn, to be implemented at the beginning of 2022.

As for the ECB, it is likely to wait longer before acting, given that it now has a symmetric inflation target of around 2%.

Nonetheless, investment policies must now reflect the fact that the liquidity that has been a major contributor to the rally in equities during the last 15 months will no longer provide such strong support for stock markets, which will henceforth be driven by economic fundamentals and earnings growth.

As regards earnings growth, exceptional second quarter corporate results did not disappoint. At some point there will be a gradual normalisation of earnings, but this issue does not currently seem to be enough to destabilise investors in the immediate future. However, it will become increasingly important as we approach 2022.

This all leads us to believe that the medium-term (18-month) potential of the stock market should not be overestimated, but we do not see any imminent threat of a significant correction in markets.

Demanding valuations in some stock markets and a backdrop of pressure on bond yields may result in more erratic movements in equities; however, a cautious normalisation of monetary policy and a positive economic outlook mean that we consider the likelihood of a stock market correction to be limited.

We therefore continue to prefer equity risk to bonds, and continue to buy on weakness, where applicable.

In addition, as we believe that the recovery will be sustained, we are of the opinion that the reflation theme should be played in the coming quarters, despite the profit-taking we have seen since May.

We have continued to actively adjust our investment policy over the summer period.

In light of the easing in long rates, which we consider unjustified, we have restricted our interest rate risk by reducing some exposure to the "safest" debt; in contrast, we have strengthened our holdings in short-dated high-yield paper. This reflects our conviction that economic conditions in the coming quarters should prove favourable for corporate bonds with adequate carry.

In our search for convex products that offer exposure to equity markets, we have strengthened our weighting in convertible bonds.

As regards our regional equity exposure, we are maintaining our overweight position in Europe, partly given the greater cyclicality in indices here.

In contrast, we are no longer overweight emerging equities due to the sale of a position in Chinese stocks. Regulatory intervention by the Beijing authorities continues to rise, making medium-term developments difficult to predict. We do not welcome this return of state intervention. Despite poor performance since the beginning of the year, we took the decision to sell the aforementioned position until we have a clearer view of Xi Jinping's real intentions as regards the role of the private sector in China's economy.

In terms of our investment themes, we seized the opportunity provided by recent consolidation to strengthen our investment in the "return to normal" theme; in other words, we increased our exposure to cyclical stocks in recent weeks.

In addition, we have also raised the weighting of ETF indices. This is partly due to technical considerations (the reduction of an active management product following the planned departure of the management team).

Last but not least, despite an upturn in the greenback in recent weeks, we continue to position ourselves for further euro appreciation. After a sideways trend that is likely to continue in the short term, we maintain our target of seeing the EUR/USD rate testing 1.25 during the coming quarters.

In conclusion, apart from the closure of our Chinese equities theme, there has been no change in the main focus of our investment strategy versus spring 2021.

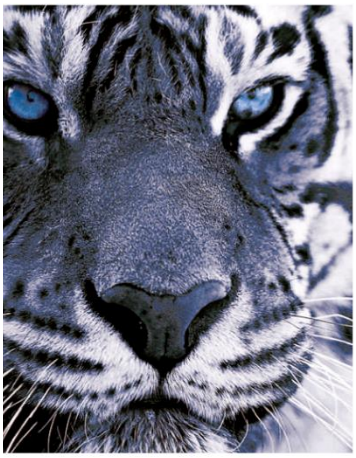
On the contrary, strong easing in sovereign debt yields resulted in us reducing our positions, increasing our underweight in this segment of bonds in favour of cash and corporate high-yield debt with short maturities.

Our cyclical bias in the equity allocation remains appropriate. The pressure we expect on returns means that we advise against exposure to growth at any price. We remain convinced on this issue. We continue to recommend a diversified sector approach and are banking on an upturn in themes linked to reflation.

2021 is not an easy year to navigate, given the sometimes erratic movements in interest rates, currencies and sector rotation in equities.

We are holding fast to the premise that the underlying principles of an investment policy should be reassessed on a daily basis in order to change tack when this proves necessary. In this respect, the various changes to our asset allocation highlighted above illustrate that we do actually practise what we preach.

Geneva, 29 July 2021



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