MARKET INSIGHT

MAY 2021

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Market Analysis

An excellent and well-timed earnings season!

Expectations in terms of earnings growth in the first quarter of 2021 were high, and yet figures reported by companies are proving even better than expected, both for technology stocks and across the board.

The marked improvement in companies' profits, a trend that is expected to continue over the next few quarters, only reinforces what we have been asserting for several months now: there will be a strong economic recovery on a global scale, expected to span all business sectors. This development is all the more important given the disruptions on international stock markets in the first quarter, due to ongoing uncertainty about a lasting economic recovery and, not least, considerable tension on bond yields.

On this last point, we cannot ignore the fact that the stabilisation of yields in recent weeks has provided strong support for equities. Fears of 10-year US yields surging to 2%, which had weighed heavily on growth sectors since the beginning of the year, have been laid to rest.

The combination of a return to calmer conditions on bond markets and strong earnings growth helped stock markets achieve their best performance since November 2020 in April, even setting new records (as in the case of the S&P 500).

In general, the past month has put an end to the erratic behaviour observed on all financial markets in the first quarter. This is something of a welcome development, since the performance of our allocations has picked up after a difficult start to the year.

The weakening of the US dollar – in line with our medium-term scenario – not only reflects the recent stabilisation of US yields, but is also an important factor that justifies maintaining some of our exposures, in particular to emerging market assets; indeed, the latter have achieved their best absolute and relative performances in recent weeks.

Similarly, our decision not to opt for "exclusive" sector choices, instead favouring marginal adjustments or a rebalancing of our sector-based equity allocations, has proven sound.

From a purely economic standpoint, reported earnings have confirmed the argument we have been making for several quarters: a V-shaped global recovery is emerging in which the US is the driving force having overtaken China, which is now managing the potential "excesses" of the 2020 stimulus package.

In this respect, both the Federal Reserve and the ECB have confirmed their highly accommodating monetary policy, at least until the end of 2021.

"We do not recommend taking on additional risk at this time."

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

In the case of the Fed, discussions on the need to start reducing asset purchases have not even begun, if Jerome Powell's recent statements are to be believed; in other words, it is highly likely that the tapering of bond purchases will not begin until the end of 2021, at the earliest. This outlook should maintain sufficient liquidity to fuel economic growth and financial markets over the coming months.

As for fiscal support for the recovery, this is not being withheld. While the German Constitutional Court has removed a major obstacle to the European recovery plan by confirming its legal standing, the most significant developments are currently taking place in the US.

The Biden administration continues to roll out its massive infrastructure investment drive (USD 2.4 trillion) and efforts to address inequality (USD 1.8 trillion).

The President intends to spend a whopping USD 6 trillion, based on the various plans proposed since he took office; although the new programmes to address infrastructure and inequality have not yet been approved by Congress, they reflect the President's determination to "change the game". This is evidenced by the fact that new spending will primarily be financed through an increase in taxes on companies and wealthy individuals.

This political activism is not without risk. On the one hand, the impact of the announcement may lead to undue expectations on the part of financial markets, especially if the programmes actually passed prove more modest than expected; on the other hand, the size of the tax increase will be an important question over the next few quarters, during which the final amount of approved stimulus packages will become clearer.

These matters are likely to fuel erratic changes in expectations amongst economic and financial players, especially as concerns about inflation over the medium and long term have not yet been dispelled.

And while we must recognise the new US administration's remarkable resolve to change course, we remain sceptical about its ability to achieve bipartisanship, given the proceedings in the Senate (filibuster) and the nearly 50-50 split between the Democrats and Republicans in the upper chambre.

Moreover, the matter of tax increases should not be taken lightly, as their impact on earnings growth as of 2022 will make forecasting more complicated, at least until there is a clearer picture of what Congress is willing to accept.

In general, the past few weeks should not prompt a rethink of the global economic scenario that has been taking shape over the last few months. Certain developments, however, such as fiscal stimulus, should be taken into consideration.

With market participants having already expressed concerns about the ability of monetary authorities to keep inflation under control in the medium term, it appears that the risk of error in the management of macroeconomic policies is mounting.

As such, while market participants should fully embrace the strong earnings season currently underway, which is reducing the lofty valuation levels on some stock markets, they should certainly not lower their guard on the macroeconomic front. Conditions over the coming quarters should not be extrapolated too soon, especially if inflation turns out to be greater than the most optimistic scenarios predict.

In addition, tax hikes, which we have always considered an inevitable part of a post-COVID-19 economic cycle, seem to be fast approaching. In this context, the introduction of a minimum tax rate on multinational companies by OECD countries could become a reality, as the US is now on board!

Having initially decided to maintain the focus of our major tactical options at the end of March, and in view of recent developments confirming this approach, we have not altered our allocation over the past few weeks.

Our main choices (underweight in bonds versus equities, and reasonable exposure to equities) remain in place.

Similarly, we continue to prioritise European equities over their US counterparts, reflecting our desire to continue leveraging cyclicals to fully take advantage of the global economic recovery; in addition, valuation considerations, a greater risk of US interest rate pressure and our scenario of a weakened US dollar justify this choice.

The only notable change in our allocation is a reduction of the gold position in the portfolios, following a rally in prices in recent weeks. A return to the upper end of the fluctuation range (1650-1850) in the short term prompted us to make this adjustment. This choice should obviously be considered in the context of our scenario of further pressure on US bond yields by the end of 2021, which should drive 10-year US yields to 2%. This does not undermine our positive view on gold over the long term (three years).

Conversely, we have increased cash in our portfolios somewhat. This is a temporary move, and is in keeping with our decision to seize opportunities in risky assets where they arise.

As we enter a historically weak period for equities ("sell in May and go away") and in view of the excellent stock market performances since 1 January, now is not the time to overexpose ourselves to stock market risk.

On the other hand, fundamental conditions suggest that equities remain the preferred asset

class over the next six months. The economic outlook and expectations that the COVID-19 pandemic will be increasingly contained over the next two quarters are driving this assumption.

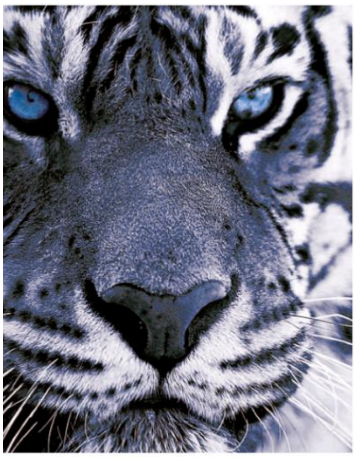
As signs of a return to sustainable growth become clearer, we are seeing a return to more "traditional" market behaviour. In this context, profit-taking and/or consolidation phases are to be expected, without the need to forego the "buying on weakness" strategy we have adopted for the past year.

We did not expect 2021 to be an easy year on the markets. Navigating an economic recovery is never plain sailing, owing to traditional asset and sector rotations and a shift towards an environment in which stock selection becomes increasingly important.

The post-COVID-19 cycle is no exception: unprecedented large-scale cash injections, and the fact that stock markets have largely priced in an economic cycle lasting for the next few years, make investment decisions even more complex.

Given the current context, we do not recommend taking on additional risk at this time.

Geneva, 1 May 2021



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