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MARKET INSIGHT

JUNE 2021

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Market Analysis

June 2021

Summer period expected to provide significant clarification

Financial markets have not displayed any clear direction in recent weeks, which is not surprising given the economic context.

Recovery of the economy is still on track, fuelling the continued steady performance of assets based on the assumption that the reflationary theme is set to remain (equity markets, more cyclically-oriented stocks).

However, continued stabilisation of long-dated bond yields, particularly in the US, suggests that investors are no longer as concerned about inflation, at least in the medium to long term.

Similarly, ongoing downward pressure on the dollar in May indicates broad investor support for the monetary scenario as "sold" by the Federal Reserve; in other words, the prospect of a rise in interest rates in the United States remains low, at least for the next 18-24 months.

From our perspective, financial markets continue to be guided by the key issue of inflation. This is likely to remain the case over the next three to six months, during which time we will get a clearer picture as to whether the price pressure suggested by the most recent global figures is temporary or more permanent.

As such, the subdued reaction of bond markets to inflation data, which is rising faster than expected globally, seems to us rather paradoxical – at least in part.

Market participants seem to have "definitively" tilted towards a scenario of short-term inflationary pressure, and its subsequent downward normalisation towards the end of 2021.

We are comfortable with this idea, as it is broadly in line with the views we have been advocating for several months now. However, we believe that consensus is a little hasty in adhering so "strongly" to a single scenario in terms of inflation.

There are still a number of unanswered questions regarding the economic situation – especially in the US, which will be key to gauging inflationary risk over the medium term.

First, there is the matter of job creation, which slowed in the spring. Is this trend likely to continue? We will need to keep a close eye on this over the summer period.

It will also be important to monitor changes in wages, linked to a (likely) return to more marked improvements in the US labour market. Increased wage pressures would undermine even the most optimistic inflation scenarios.

"Financial markets continue to be guided by the key issue of inflation."

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

Another factor worthy of attention is the Biden administration's fiscal activity.

The past few weeks have shown that securing bipartisan support for major infrastructure investments will be far from easy. While the US government seems ready to negotiate on its plans – at least in quantitative terms – the Republicans refuse to budge.

In other words, it is now clear that the questions of how long it will take to implement such investments and how much it will cost and what financing measures (taxes) will be required, remain vague. The answers to these questions will be vital in the medium term with regard to growth and inflation forecasts. It seems we will have to wait until summer to get any clarity in this respect.

While the question of inflation is less relevant in Europe, where significant production capacities and an economic recovery lagging behind that

of the United States suggest a more moderate risk of escalating prices, we must not forget that recent economic surprises have had an upward bias.

Can Europe's economic growth surprise the more bearish among us? We believe so, especially given that Europe's recovery plan is now in its final stages and ready to be implemented alongside national fiscal stimulus plans.

At the beginning of this report we suggested that there was an air of investor hesitancy in May. This is reflected by a return to calm on the inflationary front, and is evidence that investors are waiting for greater visibility on the economic cycle. This last point would seem the most important, as it suggests a healthy attitude of market participants.

A V-shaped recovery in 2021 is now highly likely given the economic figures available to us, and demonstrated by leading indicators.

Today, the main question on everyone's mind is how long will it take for the economy to normalise – probably as early as the fourth quarter of 2021 in the US and in spring 2022 in Europe.

With so many questions still unanswered, we must acknowledge our limitations and opt for a wait-and-see approach, before determining a "credible" mid-term scenario.

The summer months will provide greater clarity in terms of inflation risk, especially in the US, giving us a clearer picture of the 2022 outlook in the autumn.

At this point, we will be able to try and answer questions on the speed and scope of the Federal Reserve's reduction in asset purchases, which will undoubtedly be a key factor in 2022. We will also be able to judge whether or not the risk of the US economy sinking into stagflation, as L. Summers seems to believe, has been underestimated.

With the Covid-19 pandemic now largely under control in developed economies, after several rather challenging quarters across the board, it is rather reassuring to see investors pausing to reflect.

We are therefore unfazed by recent market developments, and do not see them as the beginning of a stock market correction.

We remain cautious about bonds and believe that government debt offers little value in a diversified portfolio. We maintain our view that yields will come under further pressure in the coming quarters, with our target yield unchanged at 2% on 10-year US yields by the end of 2021.

In terms of equities, we have taken advantage of the last few weeks to strengthen the cyclical portion of our portfolios, in line with a reflationary trend continuing over the coming months.

However, we have not increased our overall exposure to stocks, in light of the significant market rally since the beginning of the year. We believe there is room for consolidation in the first half of the year, and that this could provide opportunities as part of our ongoing strategy to buy equities on dips.

Gold continues to recover in the wake of stabilising interest rates and persistent dollar weakness. While we remain positive about gold in the medium term, we are cautious for the coming months. As such, we continue to take profits on our positions while we wait for a dip in prices that will allow us to reposition ourselves.

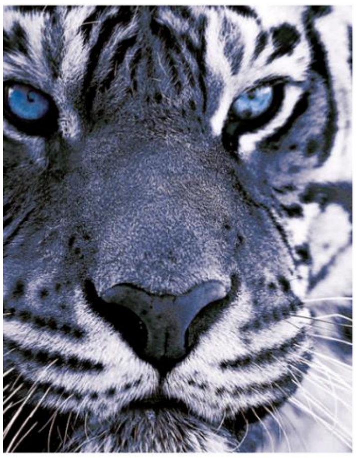
Recent dollar developments are positive given our cautious stance on this currency. We keep our EUR/USD target of 1.25 and continue to limit our exposure to the greenback. We do not rule out a move towards the 1.30 level, but this will once again depend on how inflation risk evolves over the coming months. We maintain our position, and expect the Euro/USD exchange rate to fluctuate between 1.20 and 1.2350 over the next few weeks.

While we were definitely overly pessimistic in the first half of 2021 – at least in terms of our equity allocation – this has allowed us to achieve considerable control over volatility in our investment profiles since 1 January.

And while we acknowledge our mistakes, we must highlight the positives: May saw a reassuring improvement in the performance of our allocations. This supports our decision not to "jump" into the markets at any price in an environment where they are quite expensive.

A summer consolidation may offer us more attractive entry points. We will decide based on facts which opportunities are worth pursuing.

Geneva, 2 June 2021



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