Our View in May

11 May 2021

VP BANK

Good news, but too much at once?

Full order books in the manufacturing industry, consumers eager to spend and the prospect of easing: The economic recovery is picking up speed. So much so that there are bottlenecks in the supply chains and prices are rising. This is where the Fed comes into play.

The economic data could hardly be better. Businesses are overly optimistic in economic surveys. No wonder, if you look at the order intake in the manufacturing industry, for example. But the service sector is also enjoying brisk demand. After more than a year with the pandemic, pent-up demand is now being unleashed. In addition, the third Corona wave seems to have been broken in Europe, so that the travel industry and restaurants will soon also be able to breathe a sigh of relief.

However, these catch-up effects may lead to problems. In many sectors, demand has recently risen so strongly that bottlenecks have occurred. In the construction industry, for example, materials such as wood have become scarce. Long delivery times threaten to delay construction projects. And whenever supply becomes tight, prices rise.

These bottlenecks will not disappear overnight. Nevertheless, we assume that they will only be temporary. In many cases, supply capacities are now being expanded too much. This cyclical phenomenon is well known and is called the hog cycle. In response, prices will fall. Until that happens, the central banks will be challenged, especially the Fed. We expect that they will soon have to announce a reduction in bond purchases.

Against this backdrop, we confirm our underweight and short duration in government bonds. In equities, we remain our neutral stance with a regional preference for European equities.

Dr. Felix Brill, **Chief Investment Officer**

Our View on the **Portfolio**

- **Short duration**
- **European equities** in regional comparison
- **Diversification** with alternative investments

- **Government bonds** in an environment where inflation concerns preoccupy the markets and discussions about central bank policy changes arise

Money market	● ● ● ● ○
Bonds	● ○ ○ ○ ○
• Government bonds	● ○ ○ ○ ○
• Corporate bonds	● ● ● ○ ○
• USD bonds	● ● ● ○ ○
• Emerging markets	● ● ● ○ ○
Equities	● ● ● ○ ○
• Switzerland	● ● ● ○ ○
• Europe	● ● ● ● ○
• USA	● ● ● ○ ○
• Japan	● ● ● ○ ○
• Emerging markets	● ● ● ○ ○
• Themes	● ● ○ ○ ○
Alternative assets	● ● ● ● ○
• Hedge funds	● ● ● ○ ○
• ILS	● ● ● ● ○
• Convertible bonds	● ● ● ○ ○
• Gold	● ● ● ○ ○

● ● ● ● ● strong overweight
● ● ● ○ ○ neutral
● ○ ○ ○ ○ strong underweight

Based on mandate CHF balanced

Our View on the **Economy**

- Significant **vaccination progress** in Europe
- **Business climate** continues to improve
- Industrial **order boom**
- **Public money** available if necessary

- The **shortage** of **materials** in the industrial sector is a temporary economic burden
- **Emerging economies** will continue to suffer the consequences of the pandemic
- Future **fiscal** constraints

Europe steps up vaccination campaign

Europe is now at the top of the developed world in terms of daily doses of vaccine. This suggests a broader opening of the services sector in the months ahead, with a corresponding stimulating effect on growth. The euro area's gross domestic product (GDP) is therefore expected to get a strong boost in the coming quarters due to the reopening of hotels and restaurants as well as the leisure sector. Meanwhile, however, the shortage of materials in the industrial sector is becoming a burden. The lack of semiconductors and building materials does not call the economic recovery into question, but there is likely to be an economic drag. This phenomenon is expected to continue until the third quarter of 2021.

Our View on **Monetary Policy**

- Expansionary monetary policy is becoming less necessary in view of the **economic recovery**
- Central banks are in favour of **keeping the current course** for now

- In the coming months, the difficult discussion about the correct **monetary policy** is likely to intensify
- **Risk of a sudden rise in yields** at the long end of the interest rate curve increases

ECB sees no need for action for now

The third wave of the Coronavirus pandemic will again leave deep economic traces. For the European Central Bank (ECB), this is sufficient to justify ultra-expansive monetary policy. However, as the vaccination rate increases, the euro area will escape the Corona recession and return to growth. However, as the name suggests, the ECB's emergency securities purchase programme is designed for emergencies. So if there is no longer an emergency, the ECB will likely suspend the programme sooner or later. Against the backdrop of increased public debt, any reduction in the volume of bond purchases by the central bank will not be easy to digest. The monetary authorities have become a major creditor of governments. So the time for the big challenge is yet to come. The ECB still has a grace period.

Our View on **Government Bonds**

Strong underweight

- The ECB's **net** purchase volume covers the net issuance of government bonds in 2021
- **Peripheral euro bonds** may benefit

- Supply of government bonds **increased enormously**
- Rising public debt is likely to **worsen** sovereign **credit quality**
- Government bonds carry a **high interest rate risk**

Yields in upward mode

The rise in yields has taken a breather, which is in line with our expectations. Now, however, the focus is on the second half of the year. And, because the US economy remains on a recovery path, the Fed is likely to soon prepare markets for reduced monthly bond purchases. Therefore, the yield increase will continue. In the US, yields of 2% on 10-year Treasuries are expected to be on the agenda in the second half of the year. European interest rate curves will not be able to decouple from this. Ten year bonds issued by Germany and Switzerland could then leave the negative terrain. Given the much faster pace of European vaccination and the path it provides to return to normality, this is a perfectly fitting scenario.

Our View on **Corporate Bonds**

neutral

- Central banks have **unlimited means** to buy bonds
- The **low interest rate environment** is likely to continue for a long time to come
- Further **state support** will be provided if necessary

- **Fundamentals** have deteriorated markedly due to the pandemic
- **Bankruptcies** are likely to show with a delay
- Support by central banks will be called into question with rising **inflationary risks**

Low interest rate environment increases duration

The massive losses in long-term bonds in the first quarter illustrate the increased risks on bonds. The duration (interest rate risk) of 30-year US Treasury bonds in 1981 was about 6 years at an interest rate of 15%. At 22, it is now almost four times as much. For corporate bonds, this effect is exacerbated by the extension of maturities by issuers. The latest example is the software giant Oracle. The company issued USD 15 billion in bonds and maturities of up to 40 years to replace short-term securities. The low interest rates tend to increase debt affordability, which will be reflected in the default risk in the long term. Other examples of higher indebtedness are Canadian Pacific Railway or Rogers (Telecom Canada). Both issued new bonds to finance multi-billion takeovers.

Our View on **Equities**

neutral

- Strong development of **company profits** in the first quarter of 2021
- Return to **normality** within reach in many countries
- **Services in Europe** should be stimulated by easing

- Plans for **tax increases** in the US and Europe are taking shape
- **Shortage** of raw materials and semi-finished products causes disruption
- **Profit taking in growth stocks** starts feeding uncertainty

Weakened dynamics

The positive momentum in March lasted until mid-April, but since then the price dynamics in the stock markets have flattened significantly. Emerging economies were beating MSCI World by 1.1 percentage points. All other regions are close to the global benchmark. Japan, on the other hand, was losing 4% in relative terms, even though profit trends have been revised upwards. In general, the reporting season has seen an upward revision of profit expectations. In particular, the net profit margins developed very favorably. Despite a wealth of positive news, price dynamics declined. This is particularly true in the segments of renewable energy and electric mobility. But Asia, Switzerland, and Japan are also losing momentum. Price gains in these regions could turn out to take a break in May.

Our View on **Value Stocks**

Included in the portfolio

- **Order intake** ensures high utilisation in manufacturing industry
- Easing in retail trade and tourism triggers a **recovery**
- High fiscal infrastructure spending **mainly favours value stocks**

- The valuation of the "Value segment" is **not cheap** anymore, with a few exceptions
- Several sub-industries - such as the automotive sector, retailers and airlines - are undergoing an expensive **transformation process**

Are value stocks stageing a comeback?

The strong recovery in manufacturing provides above-average price gains in so-called "value" stocks. As growth stocks experience some profit taking at the same time, value stocks are now performing better. This situation may well persist, as important sectors such as financials, telecom and energy still have potential for recovery. Similarly, fiscal measures are particularly beneficial to manufacturing. A situation which, from a tactical point of view, may lead to a change to the pattern seen in the past few years. Europe, in particular, has an attractive starting point.

Our View on **Alternative Investments - Gold**

neutral

- **Economic uncertainty** often translates into higher gold demand
- Low interest rates provide an **opportunity dividend**
- **Diversification properties** in the portfolio

- **Negative sentiment** leads to outflows from ETFs and less bullish positioning on the futures market
- **Rising infection rate** in India is holding back jewellery demand
- **Potential headwinds** if bond yields rise, the US dollar **gains** strength, or markets **run into** liquidity shortages

India slows down strong jewellery demand

Thanks to a weakening US dollar, more stable bond yields, and far stronger jewellery demand from the major buying countries, China and India, gold prices recovered from their lows in March. According to the World Gold Council, in the first quarter, consumers were interested not only in golden jewellery (+52% year on year) but also in bars and coins (+36% year on year). However, the recovery is likely to be short-lived, as rising infectious rates on the Indian subcontinent will have a negative impact in the current quarter. Despite temporary inflationary risks and a commodity shortage that could slow the economy, there is no improvement in sentiment in sight. While listed gold funds continue to struggle with outflows, speculative positions have also been reduced recently.

Our View on **Currencies**

- **EUR :** Euro area economic data are currently unexpectedly strong, supporting the single currency
- **AUD:** Benefits from a better economic situation in China

- **Emerging-market currencies** benefited from the weakness of the US dollar to limited extent due to challenging fundamentals
- The **Turkish lira** remains weakened
- **CHF:** We expect a weaker franc against the euro

Euro strength still needs a break

The euro has been able to make up ground against the US dollar lately. This is due, among other things, to the European vaccination campaign that has been under way. Vaccinations, interest rate and currency moves are currently closely linked. However, following the strong euro appreciation in recent months, the market situation has still not been fully corrected. At the same time, European economic data are increasingly good and even suggest a boom in manufacturing. This was not expected on such a scale. So the euro is currently sitting between two poles, for the time being we are therefore expecting a sideways movement in the currency pair EUR/USD. However, we also think that we may see brief moments of prices below 1.20.

Authors and Disclaimer

Authors:

Dr. Felix Brill, Dr. Thomas Gitzel, Bernhard Allgäuer, Harald Brandl, Jérôme Mäser

Important legal advice