Our View in October

12 October, 2021

The next round of catch-up effects is already waiting

Rising energy prices are currently dominating the daily headlines. The skyrocketing gas prices have now even put politicians on the spot. The central banks, however, are not yet letting this upset them.

One-month gasoline contracts in Europe have increased more than sixfold within a year. This is causing a stir and has fuelled inflation concerns. The higher energy bills also threaten to depress consumer and business sentiment. The latter are already suffering from material shortages and supply bottlenecks. Not surprisingly, the spectre of stagflation, i.e. the ominous combination of a stagnating economy and rising inflation, has been making the rounds recently. In our view, however, the danger of a stagflationary development is low. In the short term, inflation rates will remain high and the growth figures for the fourth quarter will indeed be weaker due to the shortage of materials. But already at the beginning of next year, growth momentum should pick up again. This is supported by the empty warehouses and full order books in industry. When the material and supply situation begins to ease, the next round of catch-up effects is already waiting.

We also expect inflation rates to fall again. A harbinger of this is the development of commodity prices for metal, copper or nickel. After the strong increase at the beginning of the year, these have already fallen back significantly.

Against this background, we confirm our current portfolio positioning. We continue to exercise restraint with government bonds. On the other hand, we consider gold and insurance-linked securities to be interesting from a tactical point of view. In equities, we are sticking to the strategic quota and tactically focusing on European equities and Chinese consumer stocks.

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

Our View on the **Portfolio**

- Addition of **Chinese bonds**
- **Preference** for European equities
- Gold and ILS as **stabilisers** for the portfolio

- **Rising interest rates** negative for government bonds
- Rise in energy prices **fuels inflation** concerns

● ● ● ● ●	heavily overweighted
● ● ● ○ ○	neutral
● ○ ○ ○ ○	severely underweighted

Base: mandate CHF balanced

money market	● ● ● ● ○
bond	● ○ ○ ○ ○
• government	● ○ ○ ○ ○
• corporate bonds	● ● ● ○ ○
• USD bonds	● ● ● ○ ○
• Emerging Markets	● ● ● ○ ○
equities	● ● ● ○ ○
• Switzerland	● ● ● ○ ○
• Europe	● ● ● ● ○
• USA	● ● ● ○ ○
• Japan	● ● ● ○ ○
• emerging countries	● ● ● ○ ○
• World and Themes	● ● ○ ○ ○
Alternative	● ● ● ● ○
• Hedge funds	● ● ● ○ ○
• ILS	● ● ● ● ○
• Convertible Bonds	● ● ● ○ ○
• Gold	● ● ● ● ○

Our View on the **Economy**

- **US fiscal stimulus** supports the economy
- The medium-term **recovery scenario** remains intact
- The **shortage of materials** improves the economic outlook for the coming year

- The **shortage of materials**, however, is holding back economic recovery in the short term
- **Delta variant** of corona virus again restricts travel
- The service sector has a **catching-up effect**

Shortage of material once thought differently

The economic outlook allows for two different perspectives. In the short term, the lack of material is a significant economic risk. Without supply, production suffers and, further down, employment suffers. This also shows the view of the camps. The latter are empty as rarely before. But it is precisely the low stock of materials in the companies that promises a robust economic development for the coming year. As soon as pre-products are available again, the warehouses will be refilled. At the same time, the remaining orders must also be processed. The production outlook is therefore a very favorable one. So, as much as the material shortage is currently painful, the outlook for the coming year has benefited so much.

Our View on **Monetary Policy**

- **Fed is preparing to exit,** but there is no abrupt change
- **ECB** shows that **no rate hikes** occur in the foreseeable future

- Difficult discussion about **the right monetary policy measure** intensifies
- In our view, the Fed will announce a reduction in its bond purchases in November
- A change of direction in monetary policy could lead to **nervousness in financial markets**

Central bankers are nervous

As much as the current level of inflation and that of the coming months can be predicted, so much uncertainty for the coming year is likely. Inflation rates will probably fall at the beginning of 2022, that much is certain. But the question is how much is going backwards? Recently, a new momentum has been added to the gas price rise. The latter will not be fully effective until next year. That is why central banks will have to keep their inflation projection upward for the coming year. If higher consumer prices were to be reflected in employee pay, there would be a risk of a wage-price spiral. That would be the much-feared second-round effects. There is no sign of this yet, but central bankers are no longer as relaxed as they were a few weeks ago. In any case, the Fed will probably announce a reduction in its monthly bond purchases in November.

Our View of **Government Bonds**

severely
underweighted

- The **shortage of materials** is currently putting the brakes on economic development and thus also argues against an abrupt rise in yields
- Government bonds **diversify** a portfolio

- The **Fed** opened the door for a gradual reduction of government bond purchases in the second half of 2021.
- The **ECB** will also have to reduce its **securities purchases** somewhat in view of significantly higher inflation rates.
- Government bonds carry a high **interest rate risk**

Yields are on the rise again

Yields in the eurozone recently rose again. The noticeable rise in inflation rates, even if they are of a temporary nature in our view, and the prospect of the expiry of the ECB's Pandemic Emergency Purchase Programme (PEPP) in the coming year can be seen behind the increase. The financial markets are thus preparing for a gradual adjustment of the ECB's monetary policy stance. A moderation of the ultra-expansive monetary policy course, whether on the part of the Fed or the ECB, continues to argue for higher yields on both sides of the Atlantic. However, as short-term economic risks increase at the same time in view of the shortage of materials, the markets will be cautious with a significant sale of government bonds. The rise in yields is therefore likely to continue, but a spike in interest rates at the long end of the yield curve is unlikely.

Our View on **Emerging Market Bonds**

neutral

- **Yield advantage** over developed countries supports asset class
- The **vaccination campaign** is now also making headway in the major emerging markets
- **Higher prices** for oil & co basically help commodity-exporting emerging markets

- **Emerging market bonds** may suffer briefly from rise in USD yields
- **High political risks** in a number of emerging markets
- **Long maturity** of emerging market bonds entails **high interest rate risk**

Solid hard currency bonds, weak currencies

The rise in commodity prices is both a blessing and a curse for emerging countries. On the one hand, the export economy of the countries benefits from the lucrative sales prices, but on the other hand, the more expensive prices for oil, but also food, are causing inflation rates to skyrocket. The inflation rate in Turkey, for example, is currently almost 20%, in Brazil it is around 10%. This is putting pressure on the central banks to tighten the monetary reins. This is despite the fact that the consequences of Corona have not yet been fully overcome. In the financial markets, emerging market bonds denominated in USD are now performing relatively robustly. Many emerging market currencies, on the other hand, remain at historic lows against the US dollar.

Our View on **Equities**

neutral

- **Rising interest rates** in the US also support the financial sector in Europe
- The **labor market** continues to improve and signals a stable and growing economic situation
- European companies signal **increased equity buybacks**, a signal of good business performance

- Market sentiment worsened, **hedging tendencies** burden equity prices
- Sharp rise in **energy prices** and continuing **shortage problems** weigh on profit margins

The markets on the touchstone

The recent price corrections on the stock markets represent a consolidation. Since May, only the US has been able to post notable price gains, with fundamental valuations already pricing in positive growth expectations. In other regions, valuations now look more attractive again. Japan, the UK and Latin America stand out. These regions tend to be more dependent on increased demand for commodities. This situation is accentuated by the high pressure towards climate neutrality. October is still marked by increased price fluctuations. A difficult market environment, but one that could also create an interesting window of opportunity for tactical repositioning.

Our View on **Japanese Equities**

included in themes

- The **growth outlook** for the next two financial years is above average
- The **Japanese economy** is industrially oriented and offers attractive investment prospects, especially for value investors
- In particular, the **basic industry** and the **financial sector** are being assessed at high haircuts

- The Fed's **high stock levels** in Japan (BOJ) remain worrying
- The new Prime Minister plans to **increase the capital gains tax** by 5-10% (currently 20%)
- The **technology sector** is also highly valued by international companies

Stable growth at fair valuations

With the election of Fumio Kishida as prime minister, the political establishment in Japan is betting on stability. Initially, market participants reacted with disappointment and the anticipatory price gains with the expectation of a significantly more expansive economic policy were immediately corrected. Nevertheless, the medium-term potential of Japanese equities should not be underestimated. Among the industrialised countries, Japan has the highest potential for value recovery and benefits equally from an infrastructure programme that has already been adopted and offers planning security. The fundamental valuation in Japan offers additional plus points for investors, especially in comparison to the USA and Switzerland.

Our View on **Alternative Investments - Gold**

overweighted

- **Consumers** support demand
- Low interest rates provide an **opportunity dividend**
- **Protection** against higher inflation

- **Stronger USD** reduces purchasing power
- **headwinds**, if bond yields rise
- Prospects for **more restrictive monetary policy** have a damaging effect

Higher interest rate weighs on gold price

Volatility on the gold market has increased significantly in recent weeks. This is due to concerns about a more restrictive monetary policy by the Fed and the resulting interest rate hikes. In addition, the appreciation of the US dollar has had a negative impact. The rise in inflation could only support the price to a limited extent. Permanently higher inflation rates would be necessary for a sustained rise in prices in the current environment. Listed gold funds were also unable to record significant net inflows recently, which shows that concerns about rising interest rates prevail. Consumer demand from emerging markets remains positive, as gold continues to trade at a premium, especially in China. Since our tactical overweight, gold has been able to deliver a positive relative contribution against the equity market, contributing to the stability of the portfolio.

Our View on **Currencies**

- Defensive currencies such as **USD, CHF, EUR** are currently in demand
- **EUR** is weaker than CHF and USD, but it is also higher than most other currencies

- **High-beta currencies** in the running water of risk-on and risk-off lose current, as the **SEK**
- Nor can **emerging-market currencies** now stand up to major currencies

USD Current on the winning page

The dollar is currently a currency in demand. The reasons are manifold. The movement can still be seen also on the previous significant price losses of the greenback. Forward sales of the USD by speculative investors, which built up to record levels at the time, are still being unwound in view of the gains in the US currency. In addition, defensive currencies are in demand in view of global uncertainties, supply bottlenecks and the increased inflation risks. But the prospect of the Fed withdrawing from its expansionary monetary policy is also currently leading to dollar gains. In our view, the latter could continue in the coming weeks. If the global recovery continues, as we expect, we still expect a weaker US dollar in the medium to long term.

Authors and disclaimer

Authors:

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

Important legal advice

This documentation was produced by VP Bank AG (hereinafter the bank) and distributed by the companies of the VP Bank Group. This documentation does not constitute an offer or an invitation to purchase or sell financial instruments. The recommendations, estimates and statements contained therein reflect the personal views of the relevant analyst of VP Bank AG at the time of the date stated on the documentation and can be changed at any time without prior notice. The documentation is based on information that is considered reliable. This documentation and the assessments or assessments made therein are prepared with the utmost care, but their accuracy, completeness and accuracy cannot be guaranteed or guaranteed. In particular, the information contained in this documentation may not include all relevant information on the financial instruments covered or their issuers.

For more important information on the risks associated with the financial instruments in this documentation, the proprietary business of the VP Bank Group or the management of conflicts of interest in relation to these financial instruments, and for the distribution of this documentation, see http://www.vpbank.com/legal_notes