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Vontobel Swiss Wealth Advisors

Investment Outlook – July 2021

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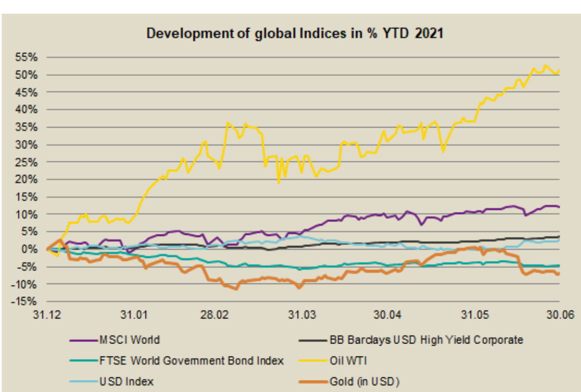
Investment Review

Global equity markets continued their uptrend in June, despite the most recent FOMC meeting minutes pointing to a more hawkish projected policy path. Following the meeting, markets started to reprice expectations of monetary tightening in 2023 and the probability of an inflation overshoot in the coming years. As a result, the U.S. yield curve flattened significantly, the U.S. Dollar appreciated, and several commodities sold off. Lower yields at the longer end of the U.S. curve boosted long-duration growth stocks while value-stocks sold off sharply. This is in sharp contrast to the first quarter of 2021, when a much more reflationary backdrop, strong growth momentum, and higher commodity prices benefitted cyclical and value stocks. Since the beginning of the current year, most equity markets delivered positive returns. The S&P 500 Index gained 15.2%, the Swiss SMI Index is up 9.4%, the Euro Stoxx 50 index rose 11.8% and the MSCI Emerging Markets index is up 7.4%, all on a total return basis in USD terms. Credit spreads continued to move sideways and remained close to their historic lows. The price of gold closed the month below $1800 per ounce on a stronger U.S. Dollar and a repricing of inflation expectations.



[Source: Bloomberg, Vontobel Swiss Wealth Advisors (VSWA)]

At the most recent meeting of our Investment Committee we decided to remain moderately overweight in equities in all multi-asset mandates. U.S. growth will likely peak during the second quarter of the current year but should remain strong in the second half. Economic activity in Europe continues to accelerate, with growth likely peaking in the third quarter of 2021. Emerging Markets momentum is slowing, but we still expect a solid growth backdrop during the remainder of the year. Our base case scenario is still for a temporary inflation overshoot on base effects, with consumer prices starting to moderate in the second half. We consider more hawkish policy expectations of FOMC members as positive because they confirm the Fed's determination to stay ahead of the curve regarding inflation pressure. Earnings forecasts for the next 12 months are rising across all markets. This is very important, as rising earnings forecasts are generally supportive for equities and may even overcompensate for potential valuation multiple contraction in the medium term.

Global Economy

Globally, we expect real GDP growth of around 6% for the full year, primarily driven by the U.S. and China on the back of pent-up demand, significant fiscal stimulus, and widespread immunization. Economic momentum in developed countries seems quite toppish, while Emerging Markets momentum already started to decelerate. On a global scale, we expect economic growth to peak during the second quarter, but to remain strong during the second half of 2021 and into 2022. We still see catch-up potential in Europe on the relaxation of restriction during the coming months. Decent consumer confidence across major countries and the likely return to more normal spending habits of the population should result in strong consumer spending growth in the second half.

Macroeconomic data for the U.S. started to rebound lower from very high levels. Sales of new single-family homes decreased by 5.9% in May to an annualized rate of 769 thousand units. Existing home sales declined by 0.9% to an annualized rate of 5.8 million units. The Philadelphia Fed manufacturing index moved lower in-line with expectations in June. The underlying composition was mixed, with the new orders component decreasing and shipments as well as employment rising. The University of Michigan's index of consumer sentiment rose by 3.5 points to 86.4 in the June preliminary report, which was above consensus expectations. Both the survey's current economic conditions, as well as the expectations component increased. The report's measure of inflation expectations for the next year and for the next 5 to 10 years declined but remained close to previous highs. The May core personal consumption expenditures (PCE) index rose by 0.48% month-over-month, and by 3.39% year-over-year. Headline prices increased by 0.48% month-over-month and by 3.91% from a year earlier. The personal saving rate fell to 12.4%, still roughly 5 percentage points above its level from before the pandemic. Industrial production rose 0.8% in May, reflecting a rebound in motor vehicle output 6.7% on a waning but still existing drag from microchip shortages. We further increase our estimate for U.S. real GDP growth in 2021 from 6.3% to 6.5%.

Germany's Ifo business climate index moved back into the expansion zone in June and was well ahead of consensus expectations. On a sector level, services and trade saw the strongest improvement in activity, whereas strong momentum in manufacturing continued. Similarly, the Insee survey of French business conditions increased in June, with strongest gains in services and retail. The Ifo and Insee surveys are based on a large sample, which also includes smaller firms. The recent strength of both surveys is consistent with our view of a significant rebound in economic activity during the next months. The Governing Council of the European Central Bank lifted its projections for Eurozone growth to 4.6% for 2021 and to 4.7% for 2022. The Governing Council sees current inflation pressures as temporary in the context of significant economic slack, which will need considerable time to be gradually absorbed. We increase our estimate for 2021 Eurozone real GDP growth from 4.1% to 4.5%.

Mirroring April releases, key Chinese activity indicators also missed expectations in May. Industrial production increased by just 8.8% year-over-year in May, as car manufacturing continued to be a drag on semiconductor shortages. Retail sales growth slowed to 12.4% compared to a year ago. Fixed asset investment growth missed expectations as well, as property and infrastructure investment slowed. Broad credit growth accelerated in May from a dip in April, roughly back to the average of recent months. Government bond issuance picking up is a sign that infrastructure spending will likely rise in the next months. On the other hand, corporate financing slowed, reflecting the Peoples Bank of China's bias towards tightening liquidity conditions as it reduces stimulus.

The global economic recovery broadens, and economies make more progress toward the goals of central banks. As fiscal and monetary stimulus reached their peak, we should expect economic momentum and inflation to slow in the second half of the year. However, global growth will likely remain at high levels in 2021 and into 2022.

GDP growth (in %)

	2019	2020	Current	Forecast 2021	Forecast 2022
Eurozone	1.3	-6.8	-1.3	4.5(4.1)	4.3(4.0)
USA	2.2	-3.5	0.4	6.5(6.3)	4.2
Japan	0.3	-4.9	-1.5	2.6	2.1(1.8)
UK	1.4	-9.9	-6.1	5.2	5.0
Switzerland	1.1	-3.5	-0.5	3.4	2.8

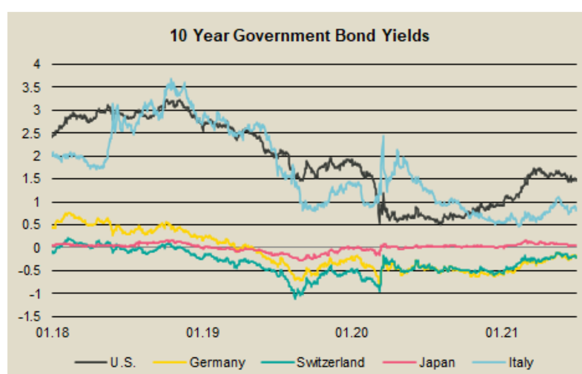
VSWA Forecast; () old forecast

Bonds

The most recent meeting of the Federal Open Market Committee (FOMC) resulted in a more hawkish monetary policy outlook than investors had anticipated. For the first time since the COVID pandemic hit, the FED finds itself on opposing sides regarding its two mandates: Full employment and price stability. Throughout the pandemic, both high unemployment and disinflation negatively impacted the American economy. Hence, the FED's ultra-accommodative stance in terms of low short-term interest rates as well as asset purchases was a logic text-book reaction. Over the last months inflation has increased sharply but the labor market is still far away from pre-COVID employment numbers. Higher inflation, even though it will likely be a transitory phenomenon, would theoretically demand a more restrictive monetary policy, while the slack in the labor market speaks in favor of prolonged accommodation.

During the FOMC meeting, all voting committee members are asked to indicate where they would like to see short term interest rates over the coming years. The result is the so-called "Dot-Plot" that gives investors a good indication of how fast the FED will move from a very accommodative policy stance into a potential rate-hike cycle. The most recent "Dot-Plot" shows that the median committee member expects 2 rate hikes already in 2023, which is earlier than markets had anticipated. We think it's a positive sign that the FED is taking inflationary pressures seriously and prepares the market for a gradual withdrawal of monetary stimulus as the economy strongly recovers. A significant slowdown of asset purchases is expected to start well before the first rate hike will happen, and the next FED meeting, which traditionally takes place in August in Jackson Hole will likely bring a clearer timeline regarding the Fed's tapering plans.

According to preliminary estimates, Eurozone core inflation will come in at around 0.9% in June, whereas Switzerland is expected to report 0.3%. Given the time-lag in terms of reopening between the U.S. and Europe we expect inflation in Europe to trend higher over the coming months, mirroring the developments we have seen in the U.S., but on lower levels. We still do not expect Eurozone and Swiss inflation to return close to central bank targets anytime soon.



[Source: Bloomberg, VSWA]

Government bond yields at the longer end of the curve fell across the western world in June, as inflation fears receded after the FOMC meeting increased the likelihood of rate hikes in 2023. Falling yields at the long end led to a yield curve flattening from relatively steep levels. Credit spreads continued to move sideways close to historic lows across the risk spectrum, driven by an improving global economic picture. We expect credit spreads to stay at current levels over the coming quarters, as we live through a period of strong growth where credit risks seem to be non-existent, especially with regards to high quality investment grade corporate bonds. We continue to underweight fixed income given the unattractive real returns, which the asset class currently offers. Within fixed income we favor corporate over government debt to profit from the additional spread at very low risk.

By signaling two rate hikes in 2023 the FED signaled its intention to stay ahead of the curve and gradually reduce its accommodative monetary policy if the economy continues to recover strongly. We remain underweight in fixed income in our multi-asset mandates and still favor corporates over government bonds.

Key interest rates (in %)

	2019	2020	Current	Forecast 3 months	Forecast 12 months
EUR	-0.50	-0.50	-0.50	-0.50	-0.50
USD	1.75	0.25	0.25	0.25	0.25
JPY	-0.10	-0.10	-0.10	-0.10	-0.10
GBP	0.75	0.10	0.10	0.10	0.10
CHF	-0.75	-0.75	-0.75	-0.75	-0.75

VSWA Forecast; () old forecast

10-year government bond yields (in %)

	2019	2020	Current	Forecast 3 months	Forecast 12 months
EUR (Germany)	-0.2	-0.6	-0.2	-0.2	0.0
USD	1.9	0.9	1.5	1.6	2.0
JPY	0.0	0.0	0.1	0.1	0.1
GBP	0.8	0.2	0.8	0.7	1.0
CHF	-0.5	-0.6	-0.2	-0.2	0.0

VSWA Forecast; () old forecast

Equities

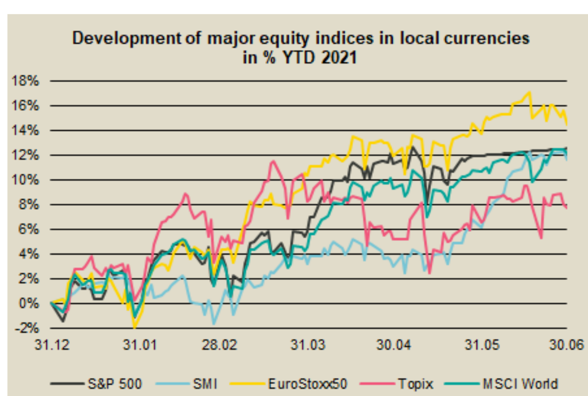
Most equity markets continued to increase in June despite the hawkish surprise delivered during the most recent meeting of the Federal Open Market Committee. Bipartisan agreement on the infrastructure package increases the likelihood of the deal becoming law and certainly helped equities moving higher. According to the plan, $1.2 trillion will be injected over eight years, providing $312 billion to transportation projects, $65 billion to broadband, and $55 billion to waterways. As a result, the S&P 500 index posted its largest weekly gain since February.

As U.S. growth will likely peak in the second quarter, one of the main drivers of stock market returns in recent quarters will likely abate. In order to assess the implications of peak growth for stocks, we analyzed historic phases of a declining global purchasing manager index (PMI) and compared them to times the global PMI was moving higher. Generally speaking, a rising PMI resulted in higher stock market returns, smaller drawdowns, and lower volatility. Since 1998, there have been eight instances, when the global PMI moved higher over several months and seven instances when it moved lower. During periods of a rising global PMI, the MSCI World index generated a median return of 35%, it had a median drawdown of 4.5% and an average volatility of 12.4%. Periods of a falling global PMI, on the other hand, resulted in relatively meager median returns of 0%, much bigger drawdowns of more than 20%, and a higher volatility of around 17%. However, returns of the MSCI World were clearly positive if a declining PMI didn't finally result in a recession, as was the case between 5/2004 and 5/2005 as well as between 4/2010 and 8/2012. Thus, a likely peak in the PMI does not necessarily mean that equities will perform negatively over the following 12 months.

Valuation multiples didn't move much during the past few months, as rising stock prices have been accompanied by rising earnings estimates. Based on estimates for 2021, the price-to-earnings ratios of U.S., Eurozone, and Swiss stocks are 22.1, 18.5, and 19.1, respectively. This doesn't seem cheap compared to history but is still attractive compared to ultra-low bond yields. Buying 10-year treasuries at current levels offers around 1.5% yield. Buying the S&P 500 at current levels offers 1.4% dividend yield and the prospect of high single digit earnings growth over the next 10 years. Even when factoring in a significant valuation multiple compression buying the S&P 500 should clearly be the much better deal in the longer term.

Following a strong reporting season and positive company outlooks, consensus earnings estimates continued to move higher in June. We believe that this trend will continue over the next months, driven by another strong reporting season for the past quarter. Economic growth positively surprised during the second quarter and corporates should have profited from the strong economic activity. However, this doesn't necessarily mean that the earnings season will be a trigger for further price increases. As seen during the previous reporting season, even strongly positive surprises may lead to a relatively muted price reaction.

According to the American Association of Individual Investors (AAII) survey, around 41% of investors are currently bullish for the stock market, while 26% are bearish. We would consider current investor optimism to be within the normal historical range. However, the pro-cyclical positioning of institutional investors didn't materially change in recent weeks according to Bank of America's most recent fund manager survey, with many institutional investors still overweight in commodities and equities, and underweight in bonds.



[Source: Bloomberg, VSWA]

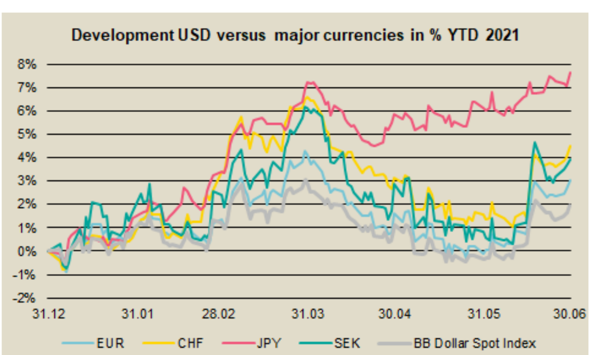
Equity market valuations					
	Price to earnings ratios			Price to Book	Dividend yield %
	Expected 2021	Expected 2022	10-year average	2021E	2021E
USA	22.1	19.8	19.9	4.2	1.4
Eurozone	18.5	16.5	19.6	2.1	2.7
Switzerland	19.1	17.4	17.6	3.1	2.5
UK	13.6	12.6	21.9	1.8	3.9
Japan	15.4	13.9	16.5	1.3	2.1

VSWA Forecast; () old forecast

The peak growth theme shouldn't worry equity markets too much, at least if growth remains at healthy levels. However, macro uncertainty regarding growth, inflation, bond yields, and the Fed's reaction function may remain elevated over the next months. Given relatively high equity valuations, rising uncertainties may spill over to risky assets, potentially leading to a consolidation period. To reflect these short-term concerns, we are only slightly overweight in equities across mandates and would use a potential market correction to add positions and increase our equity overweight.

Currencies

The FOMS meeting's hawkish surprise resulted in a repricing of inflation risks and stronger U.S. Dollar, which appreciated against all G10 currencies in June. This is not surprising and reminiscent of major periods of rising tapering expectations in the past. We believe that the Fed's determination to stay ahead of the curve and keep inflation risks under control limits the risk of an inflation-driven depreciation of the U.S. Dollar. The impact of inflation on currency markets depends on the central bank's policy response. If inflation rises without a change in the monetary policy path, this should theoretically lead to currency depreciation. However, if the central bank responds to rising inflation with monetary tightening, this should result in currency appreciation driven by investment flows. It is highly probable that the Fed starts monetary tightening much earlier than the ECB or the SNB, which will support the U.S. Dollar in the shorter term. However, this will not alter our view of a likely depreciation of the U.S. Dollar in the medium and longer term, especially against the Swiss Franc.



[Source: Bloomberg, VSWA]

Prospects of a more restrictive monetary policy in the U.S. limit the downside risks for the U.S. Dollar in the shorter term. We increase our 12-months forecast for the USD against the CHF to 0.92 and lower our forecast for the EUR against the USD to 1.20 to reflect these recent developments.

Currencies					
	2019	2020	Current	Forecast 3 months	Forecast 12 months
CHF per EUR	1.09	1.08	1.09	1.10	1.10
CHF per USD	0.96	0.88	0.92	0.91	0.92(0.89)
USD per EUR	1.12	1.22	1.19	1.21	1.20(1.23)
JPY per USD	108	103	110	106	104
USD per GBP	1.32	1.37	1.39	1.39	1.41

VSWA Forecast; () old forecast

Commodities

The price of WTI has increased by more than 50% this year as the recovery in demand from pandemic lows outpaced production growth by far. However, the recent spike in crude prices will most likely be transitory, as the OPEC member countries can't be interested in hurting Emerging Market oil demand too much. The market has been experiencing a supply deficit for most of this year as the OPEC maintained its production cuts even as demand strongly recovered. We believe that the oil market will remain tight during the second half of 2021 unless output is materially increased. The OPEC countries and its allies are already in the process reviving crude supplies halted last year to balance weak demand. The coalition increased production by about 2 million barrels per day from May to July and is expected to keep going. We increase our 3-months and 12-months forecast for WTI to $70 per barrel.

The price of gold declined from above $1900 to below $1800 per ounce in June on a stronger U.S. Dollar and the repricing of inflation risks after the most recent FOMC meeting. Over the next months we expect the Dollar to remain firm against major currencies, inflation to moderate, and bond yields at the longer end of the yield curve to slightly increase. This is not an ideal environment for gold, and we see only limited upside potential during the third quarter. Consequently, we reduce our 3-months forecast for gold to $1800 per ounce, as we view a sideways move as the most likely outcome. Our 12-months forecast remains unchanged at $1900 per ounce.

Commodities					
	2019	2020	Current	Forecast 3 months	Forecast 12 months
Crude oil (WTI, USD/barrel)	61	48	73	70(65)	70(65)
Gold (USD/ troy ounce)	1517	1897	1'780	1800(1900)	1900
Copper (USD/ lb.)	2.80	3.50	4.18	4.20(4.50)	4.50(4.80)

VSWA Forecast; () old forecast

Irrespective of our conservative short-term view on gold we remain overweight in all multi-asset mandates to diversify portfolio risks and partly hedge against the risk of more persistent inflation pressures or a potential resurgence of growth concerns.

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