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Vontobel Swiss Wealth Advisors

Investment Outlook – September 2021

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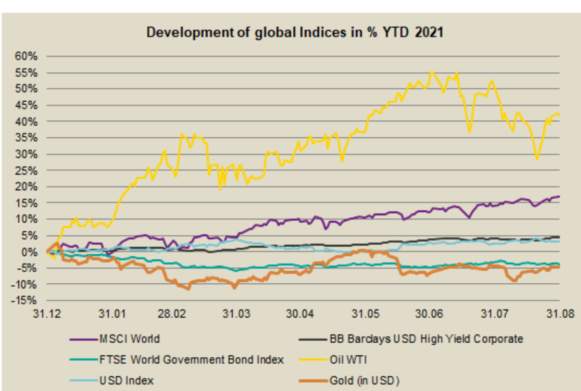
Investment Review

Driven by a very strong reporting season, the overall stock market backdrop remained positive over the summer, despite worries about the spreading Delta variant and fears of an earlier-than-expected reduction of asset purchases by the Fed. Several countries, such as Brazil, Mexico, Russia, and South Korea, already started to raise interest rates in order to counter inflationary pressures, which are more prevalent in the emerging world. Government bond yields at the longer end of the curve slightly declined, the U.S. Dollar gained against most major currencies and the price of gold moved slightly lower. Oil materially sold off since the end of July on growth concerns, following setbacks in reopening and the reduction in global fiscal support. Global growth seems to have peaked, but activity levels should remain above average over the coming months on strong consumer spending and corporate spending plans. Since the beginning of the current year, most equity markets delivered positive returns. The S&P 500 Index gained 21.6%, the Swiss SMI Index is up 14.9%, the Euro Stoxx 50 index rose 16.4% and the MSCI Emerging Markets index is up 2.9%, all on a total return basis in USD terms.



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

We decided to remain moderately overweight in equities in all multi-asset mandates at the most recent meeting of our Investment Committee. While we believe that the combination of global fiscal tightening and peak stimulus will inevitably lead to a mean-reversion of current growth rates, leading indicators still point to above average global economic activity over the coming quarters. Price pressures are temporarily high in the U.S. and several emerging economies, but less of a concern across most of the developed world. We believe that peak growth and peak stimulus will also lead to a normalization of inflation rates in countries currently suffering from higher price pressures. Stock market valuation remains above historic averages but is still reasonable if compared to the bond market. The recent reporting season for the past quarter has been strong in the U.S. and Europe as well. A strong reporting season typically leads to rising consensus estimates, which are the most important driver of stock returns. Another factor supporting stocks are share buybacks, which are at the third-highest level on record in the U.S. since the beginning of 2021.

Global Economy

We expect global growth to be close to 6% in 2021, reflecting a continued recovery driven by post-vaccination reopening, still accommodative monetary policy, pent-up demand, and high personal savings. While the Delta variant represents a key risk to global growth, we believe that rising immunity on vaccination and prior infection will allow for a continued recovery in global economic activity. This is reflected in global leading indicators, which still point to an ongoing economic rebound despite slowing momentum.

U.S. macroeconomic data peaked in the second quarter of the current year and recent releases came in below consensus expectations. Real GDP growth for the second quarter was revised up to 6.6%, as higher goods consumption growth was offset by downward growth revisions to services, residential fixed investment, and inventories. Core inflation in the second quarter was 3.38% and headline inflation 3.86% on a year-on-year comparison. Initial jobless claims ticked up to 353k, with the 4-week moving average declining to 367k, which is still slightly above normal levels. The unemployment rate fell from 5.9% to 5.4% in July, showing that the labor market recovery continues. The Philadelphia Fed manufacturing index declined in August, against consensus expectations of a for a slight increase. The underlying composition of the report was mixed, with increases in the employment and new orders components, but a decline in the shipments component.

Industrial production rose by 0.9% in July, with the capex-sensitive business equipment category even increasing by 2.8%. According to regional Fed surveys, capex spending plans remain at high levels over the coming 6 months. Retail sales decreased by 1.1% in July, which was much more than expected. Revisions were positive however, with retail sales growth revised up by 0.2% in June and by 0.4% in May. This indicates a higher pace of consumption in the second quarter but suggests a more significant drag in the third quarter from the arrival of the Delta variant. Our current estimate of U.S. real GDP growth in 2021 remains unchanged at 6.5%.

The Euro area composite PMI declined by 0.7 points to 59.5 in August, which was a touch below consensus expectations and the first decline since January. The softening was led by Germany and France, with a partial offset from further gains in the periphery, most likely driven by increased tourism activity in Southern Europe. The decline in the Euro area composite was primarily driven by the manufacturing sector, where output growth moderated more significantly than in services. Overall, the PMIs shows that activity in Europe has likely moved past its peak and that the growth moderation will be gradual. Sentiment among consumers in the Euro area declined for a second month in August on concerns that rising infections with the Delta variant may trigger new lockdowns. Vaccinations across Europe are slowing, making the more contagious Delta variant an increasing risk to the economy, which needs to be monitored closely. Nevertheless, we increase our estimate for 2021 Eurozone real GDP growth from 4.5% to 4.8%.

Switzerland's KOF Leading Indicator recently declined from record highs. The current level of the indicator still points to strong activity for the Swiss economy. Strong growth is also reflected in the Swiss Manufacturing PMI, which reached the highest level in decades. We increase our GDP growth estimate for 2021 for the Swiss economy from 3.4% to 3.6%.

Chinese activity data weakened and missed expectations in July. Industrial production growth declined from a year-on-year growth rate of 8.3% to 6.4% and the weakness appeared broad-based. Retail sales growth also decelerated to around 8.5% and fixed asset investment contracted. The current weakness reflects the impact of policy tightening and slower export growth.

Activity levels should moderate in the second half of 2021 as global growth has most likely passed its peak. Fiscal and monetary policy will likely become less supportive. However, global growth will likely remain at high levels in 2021 and into 2022.

GDP growth (in %)

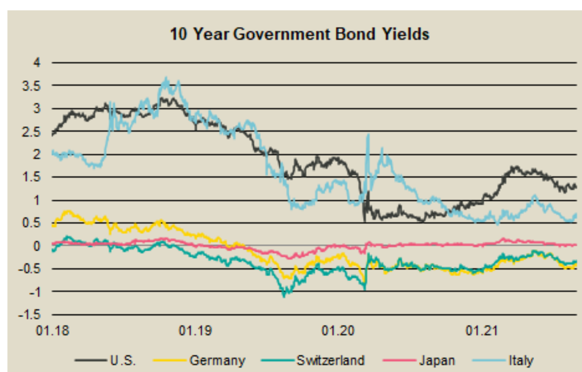
	2019	2020	Current	Forecast 2021	Forecast 2022
Eurozone	1.3	-6.8	13.7	4.8(4.5)	4.3(4.0)
USA	2.2	-3.5	12.2	6.5	4.2
Japan	0.3	-4.9	-1.5	2.6	2.1
UK	1.4	-9.9	22.2	6.1(5.2)	5.0
Switzerland	1.1	-3.5	-0.5	3.6(3.4)	2.8

VSWA Forecast; () old forecast

Bonds

Chair Powell's speech at the Fed's Jackson Hole symposium struck a balance between both, the strong employment gains in recent months, and the downside risks posed by the Delta variant. We continue to believe that the Fed's intention is to provide advance notice in September and formally announce the start of asset tapering in November. The muted market reaction after Powell's speech gives us confidence that the Fed will be able to clearly communicate its tapering plans and slow down its asset purchases without causing a tantrum in the capital markets.

Interestingly, inflation differentials between the U.S. and Europe remained high in recent months. In July, the Core Consumer Price Index (CPI) which excludes Food and Energy, rose by 4.3% year over year in the U.S., by 0.7% in the Eurozone and by only 0.2% in Switzerland. The slower vaccination path in most of Europe and hence the later easing of lockdowns offers one explanation for these diverging paths. This would suggest that inflation in Europe should mirror the developments in the U.S., albeit with a time-lag of 3-4 months. Preliminary Euro area inflation data for August points in that direction, showing an increase in core inflation to 1.6%. Another explanation of the high inflation differentials may be different labor market dynamics. Since the lockdown ended, the U.S. recorded a labor-shortage in various industries from lodging to restaurants to junior bankers. Coupled with the flexible labor-market in the U.S., this led to wage-inflation that has not been apparent in continental Europe so far. Christine Lagarde, the head of the European Central Bank, would certainly welcome a rise in inflation to the long-term goal of 2%. While the Fed talks about tapering, the ECB still seems far away from monetary tightening.



[Source: Bloomberg, VSWA]

Bond yields at the longer end of the government curve fell across the western world in July and remained flat during August. The recent rise in the Delta variant partially reversed the rise in government yields that had begun in September last year. Yields remain distorted by central bank policy and do not properly reflect the positive economic outlook. In theory, long-term government yields should offer a premium over inflation, especially during times of strong economic growth.

Despite elevated macro volatility this year, which was driven by accelerating inflation, peak growth, renewed virus fears, and the imminent reduction of monetary support, credit markets have performed quite well. Going forward, we expect investment grade credit to generate more moderate returns, as the potential for further spread tightening seems very limited given spreads close to record lows across the whole risk spectrum. Nevertheless, credit spreads continue to be well supported by the strong economic environment, rising corporate profits, and the ongoing search for yield. Thus, we regard investment grade corporate bonds as still more attractive than government bonds and favor corporate over government debt.

The eagerly awaited Fed meeting at Jackson Hole did not bring any unexpected news. Positive developments in the labor market are weighed down by uncertainty regarding the Delta variant. Our expectation is that the tapering of asset purchases will start in November and should not cause a tantrum in capital markets. 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	-0.5	-0.3(-0.2)	0.0
USD	1.9	0.9	1.3	1.5(1.6)	1.8(2.0)
JPY	0.0	0.0	0.0	0.1	0.1
GBP	0.8	0.2	0.5	0.7	1.0
CHF	-0.5	-0.6	-0.4	-0.2	0.0

VSWA Forecast; () old forecast

Equities

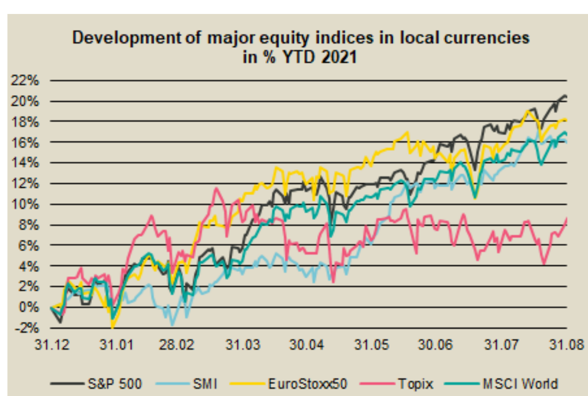
Equities continued their upwards trend in July and August, with several indices recently reaching new all-time highs. However, uncertainties about the Delta variant, economic growth, monetary policy, and the tax reform remained high. Strong index returns, the narrow return dispersion on a stock-specific level and significant sector rotations have created a challenging stock-picking environment for active managers. Nevertheless, the vast majority of our mandates outperformed their respective benchmarks since the beginning of the year on a positive contribution from stock selection and market timing.

Valuation multiples of most equity indices moved sideways in recent weeks, as rising stock prices were supported by rising earnings estimates. With a price-to-earnings ratio (PE ratio) of 22.0 for the S&P 500 index based on this year's earnings estimates and 19.5 for the Swiss SPI index, the valuation of both markets is currently around 10% above their respective average of the past 10 years. With a PE-ratio of 17.6, the valuation of the Euro area stock market is slightly below its 10-year average. Compared to bond markets, current equity valuation multiples seem justified. Despite the strong rally from March 2020 lows, the aggregated earnings yield as well as the dividend yield of major stock market indices is way above the low yields of government bonds or investment grade corporate bonds.

Consensus earnings estimates for the next 12 months continue to be revised upwards across all markets. Estimates for the Swiss and Euro area stock market are already above pre-pandemic levels and even 20% above in case of the S&P 500 Index. The reporting season for the second quarter was once again very strong, with more than 65% of Euro area companies and above 85% of U.S. large caps having reported above estimates. In aggregate, index earnings came in around 16% above consensus estimates in the U.S. and almost 32% above estimates in the Euro area. Given the strong reporting season for the past quarter we believe that earnings will continue to be revised upwards in the coming weeks.

The gradual reduction of U.S. monetary stimulus we expect over the coming quarters may not necessarily be negative for the stock market, as history suggests. Coming out of the financial crisis of 2008/2009, the Fed started to taper asset purchases in December 2013. Tapering ended 10 months later in October 2014. The Fed started to raise interest rates in December 2015 and ended the rate hike cycle three years later with the upper band of the Fed Funds Target Rate reaching 2.5%. Between December 2013 and December 2018, the S&P 500 delivered a total return of more than 50% or approximately 8.5% per year. There were minor corrections between 5% and 13%, but the general stock market uptrend was never seriously challenged. The fourth quarter of 2018 then saw a correction of around 20% in the S&P 500 index, as an inversion of the U.S. yield curve led to rising fears of an imminent recession.

Investor sentiment significantly cooled during most recent months. According to the American Association of Individual Investors (AAII) survey, around 39% of investors are currently bullish for the stock market, while 33% are bearish, which is within the neutral historical range. Since the start of the year, U.S. share buyback authorization announcements through July have totaled $683bln, representing the third largest amount on record. Strong buybacks are supportive for the market as they are a source of equity demand and lead to higher earnings per share.



[Source: Bloomberg, VSWA]

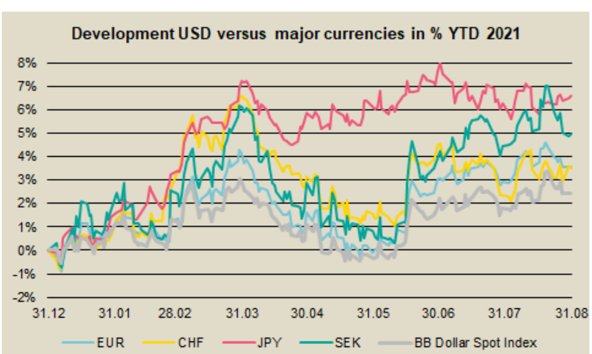
Equity market valuations					
	Price to earnings ratios			Price to Book	Dividend yield %
	Expected 2021	Expected 2022	10-year average	2021E	2021E
USA	22.0	20.1	19.9	4.4	1.4
Eurozone	17.5	16.0	19.6	2.1	2.7
Switzerland	19.5	17.8	17.6	3.1	2.5
UK	12.5	12.1	21.9	1.7	4.2
Japan	14.3	13.2	16.5	1.2	2.2

VSWA Forecast; () old forecast

Expectations regarding the tapering of asset purchases by the Fed may lead to temporary stock market volatility but will most likely not alter the current uptrend. Global growth is expected to remain strong, monetary policy remains expansionary for the time being, the reporting season for the past quarter was very strong, consensus earnings estimates continue to move higher, and the relative valuation of equities versus bonds remains attractive. Rising Delta cases and inflation pressures are risks being watched carefully. We remain moderately overweight in equities across mandates.

Currencies

In August, the U.S. Dollar gained against most other major currencies due to a deterioration of growth expectations across several countries. A peak in global growth historically tended to coincide with a stronger Dollar, as falling growth assumptions usually lead to flows into U.S. assets deemed more defensive. The likely tapering of asset purchases by the Fed, as well as potential subsequent rate hikes will also be supportive for the Dollar, given that the majority of developed market central banks will most likely not raise rates before the Fed. However, core inflation in the U.S. is currently higher compared to the Euro area or Switzerland, which negatively impacts the Dollar. The key longer-term factor, which points to a likely depreciation of the U.S. Dollar, is the persistently high twin deficit of the U.S. economy, which the U.S. administration seems not to be willing to address. We are more constructive for the Dollar in the short term, but our long-term view of a likely depreciation of the U.S. Dollar, especially against the Swiss Franc, is unchanged.



[Source: Bloomberg, VSWA]

Peak global growth and 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 reduce our 12-months forecast for the EUR against the USD to 1.16 and lower our forecast for the EUR against the CHF to 1.07 to reflect cyclical risks from rising Delta cases.

Currencies	2019	2020	Current	Forecast 3 months	Forecast 12 months
CHF per EUR	1.09	1.08	1.07	1.08(1.10)	1.07(1.10)
CHF per USD	0.96	0.88	0.92	0.91	0.92
USD per EUR	1.12	1.22	1.17	1.19(1.21)	1.16(1.20)
JPY per USD	108	103	110	106	104
USD per GBP	1.32	1.37	1.36	1.39	1.41

VSWA Forecast; () old forecast

Commodities

Oil prices have sold off over the past two months as Delta concerns as well as slowing Chinese demand have darkened the outlook. The price of WTI declined by almost 20% from a top of around $75 reached in July and recovered thereafter to close August at around $68. However, supply data continue to disappoint versus consensus expectations. The International Energy Agency (IEA) has now revised down non-OPEC ex US/Canada supply by almost 1mbpd for each of the last two quarters. We believe that the oil market will remain tight during the second half of 2021 unless output is materially increased. Storage levels in Emerging Markets are already relatively low. Most recent forecasts of the OPEC+ show that global oil supply is expected to remain in deficit for the remainder of this year. However, the oil market is projected to turn into a surplus in 2022, as halted output continues to be restored in monthly installments. We adhere to our forecast of $70 for WTI over the coming 12 months.

Despite rising growth concerns and rising real yields, gold has largely remained in a trading range in recent weeks, closely correlated to the U.S. Dollar. Large gold purchases from Brazil, Thailand, India, and Hungary show that central bank demand has picked up materially. Net long gold positions of speculative investors recently fell to the lowest level in two years. We believe that light investor positioning points to an attractive entry point for contrarians and long-term investors seeking to diversify their portfolios. Our forecast of $1800 and $1900 over the next tree and twelve months, respectively, remains unchanged.

Commodities	2019	2020	Cur-rent	Forecast 3 months	Forecast 12 months
Crude oil (WTI, USD/barrel)	61	48	63	70	70
Gold (USD/ troy ounce)	1517	1897	1'780	1800	1900
Copper (USD/ lb.)	2.80	3.50	4.11	4.00(4.20)	4.20(4.50)

VSWA Forecast; () old forecast

In the shorter term we don't see many catalysts for a materially higher gold price. Nevertheless, we remain overweight in all multi-asset mandates to diversify portfolio risks and be partly hedged against macro risks.

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