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Vontobel Swiss Wealth Advisors

Investment Outlook – October 2021

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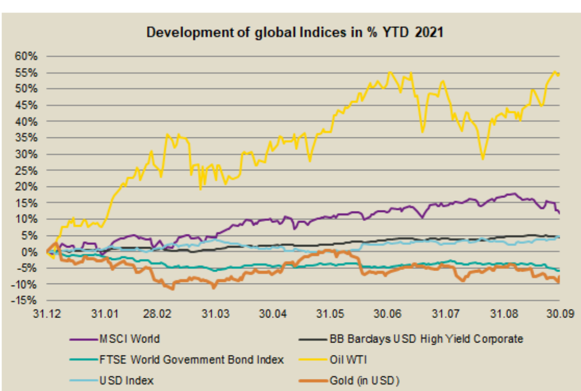
Investment Review

A combination of slowing economic growth expectations, rising inflation fears, concerns about supply bottlenecks, rising credit spreads in the Chinese property developer sector, and the guidance from central banks that they are ready to start the gradual reduction of ultra-accommodative monetary policy support triggered the switch of global financial markets into risk-off mode. As a result, global stock markets started to consolidate and bond yields across the whole risk spectrum increased particularly at the longer end of the curve. Rising bond yields led to a rotation from growth into value stocks. The U.S. Dollar appreciated against most other currencies and gold declined on rising interest rates and a stronger Dollar. Energy prices continued their upwards trend on supply concerns, adding to rising fears of a more persistent inflation backdrop and worries about the negative impact of rising input costs on company margins. Since the beginning of the current year, most equity markets delivered positive returns. The S&P 500 Index gained 15.9%, the Swiss SMI Index is up 5.8%, the Euro Stoxx 50 index rose 10.3% and the MSCI Emerging Markets index lost 1.2%, all on a total return basis in USD terms.



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

During the past two weeks, we gradually reduced the equity exposure in all multi-asset-mandates. At the most recent meeting of our Investment Committee, we decided to stay the course and keep the equity exposure relative to our benchmarks around neutral. In our view, global equity markets are already discounting a moderation in economic growth. However, a more significant downturn is certainly not reflected in current prices. It is worth noting that despite investor's worries about rising input costs negatively impacting margins, there is currently little evidence of this. In fact, many companies have reported being able to pass on higher input costs to their customers. We would be more worried about slowing demand instead of rising costs, which are a reflection of strong demand. Inflation rates may continue to increase from relatively low levels across most of the developed world over the coming months. However, various U.S. indicators already point to early signs of abating price pressures, which seems to confirm our view that current inflation spikes may be a temporary phenomenon. Investor sentiment is already pessimistic, but not yet at levels, which would indicate a heavily oversold market situation.

Global Economy

Economic momentum continues to decline from the peak levels reached between the second and the third quarter of the current year. The slowdown is especially evident in Emerging Markets and mainly driven by Chinese data releases, which continue to be reported below expectations. Activity in Developed Markets remains strong, but moderates from the unsustainably high levels of the re-opening boom. We expect global GDP growth to be around 5.8% in 2021, followed by 4.2% in 2022.

U.S. macroeconomic data releases were mixed in September, with survey-based data mainly coming in above estimates, and hard data coming in close to or slightly below consensus expectations. The ISM manufacturing survey increased to 61.1 against expectations for a decline to 59.5. The composition of the survey was mixed, with the production component decreasing, the new orders component remaining flat, and the employment component as well as the prices paid measure increasing. The consumer sentiment index published by the University of Michigan increased in the final September report. Relative to August, both the survey's current conditions and expectations components increased. The report's survey of inflation expectations slightly declined from 4.7% to 4.6% for the next year but slightly rose from

2.9% to 3.0% for the next 5 to 10 years. The August core personal consumption expenditures price index rose to 3.62%, while headline prices increased by 4.26% from a year earlier. The personal saving rate decreased to 9.4%, which is still around 2% higher compared to levels reached before the pandemic. Personal spending, which represents roughly two-thirds of U.S. GDP, increased by 0.8% from a month earlier, following a downwardly revised decline of 0.1% in July. After increases in personal spending above 10% for the first half, we expect only modest gains in the current quarter. We reduce our current estimate of U.S. real GDP growth in 2021 from 6.5% to 5.9%.

Eurozone industrial production increased by 1.5% in July after having declined by 0.1% in June. Compared to a year ago, industrial production rose by 7.7%, which was significantly above consensus expectations. The Euro area composite PMI declined to 56.1 in September. The softening in activity was broad-based across countries but primarily led by Germany, while activity levels in peripheral countries remain very high by historical standards. Across sectors, the decline was also broad-based, with services activity softening to a similar extent as manufacturing. Price pressures, rising input costs, and supply-side issues continued to be reported across industries. Germany's business climate fell for the third consecutive month in September. This points to a further slowing in activity, consistent with the PMI survey. Across sectors, manufacturing led the decline due to rising input prices and supply bottlenecks. Nevertheless, we further increase our estimate for 2021 Eurozone real GDP growth from 4.8% to 5.0%.

Above-average growth and low inflation still characterize the current macroeconomic environment in Switzerland. Core inflation increased by only 0.5% in September compared to a year ago, while headline inflation rose by 0.9%. The KOF leading indicator for September declined from unsustainably high levels, but still points to above-average activity. This is also reflected in the manufacturing PMI, which increased further in September from already strong August levels. Our current estimate for Swiss real GDP growth for 2021 remains unchanged at 3.6%.

After a strong growth rebound in the current year, we expect global growth to slow in 2022 on diminishing impulses from re-opening, much lower fiscal stimulus, and a less expansionary monetary policy. However, GDP growth will likely remain at above-average levels in 2022, especially in the developed world, which profits from high effective protection rates thanks to the combination of prior infection and vaccination.

GDP growth (in %)

	2019	2020	Current	Forecast 2021	Forecast 2022
Eurozone	1.5	-6.5	14.3	5.0(4.8)	4.3
USA	2.3	-3.4	12.2	5.9(6.5)	4.2
Japan	0.0	-4.7	7.7	2.4(2.6)	2.6(2.1)
UK	1.4	-9.9	22.2	6.5(6.1)	5.3(5.0)
Switzerland	1.3	-2.5	7.7	3.6	2.8

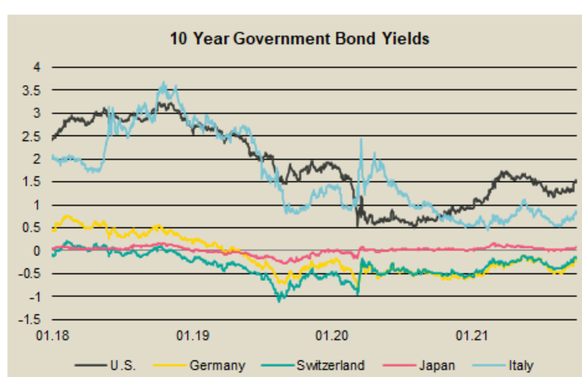
VSWA Forecast; () old forecast

Bonds

Bond markets had to digest a variety of new information in September. Evergrande, one of the largest and most highly levered property developers in China, made headlines by missing a coupon payment on its outstanding debt. The Chinese government quickly stepped in to limit potential systemic risk arising from a potential bankruptcy of $300 bn. We expect the Chinese government to orchestrate a sale of Evergrande's assets to state-owned enterprises, which can then stabilize the ongoing operations. Credit spreads outside the Chinese property market did not react in a meaningful way. We do not see Evergrande as an imminent systemic risk for global credit markets, but rather as a sign that the Chinese property market is slowing down to a healthier growth path. Fantasia, another Chinese property developer, failed to repay a maturing bond this week, adding to recent signs of stress in the property sector. We expect the government to step in as soon as more significant contagion materializes.

While a couple of months ago inflationary pressures were mostly a consequence of supply-chain bottlenecks, rising energy prices have now taken the center stage. Oil, gas, and electricity saw steep price increases during the past 12 months, which added to year-over-year inflation figures. We maintain our view regarding inflation being a transitory phenomenon but admit that a vicious cycle could play out if higher energy and food prices start to drive meaningful wage increases, which then may lead to higher prices elsewhere in the economy through second round effects.

During the September meeting of the Federal Open Market Committee (FOMC), projections for core personal consumer expenditures (PCE) prices were revised upwards from 3.0% to 3.7% for this year, and from 2.1% to 2.3% for 2022. The so-called Fed dot plot, which represents FOMC member's rate expectations, surprisingly shifted towards an earlier-than-expected start of the hiking cycle. The tapering of asset purchases will likely start in November 2021, and a first rate hike is expected for the second half of 2022. By the end of 2023 the FED expects short-term interest rates to hit 1%. However, the Fed's reaction will stay data-dependent, and a deteriorating economic outlook would certainly shift the timeline for tapering and a first rate hike further into the future. The core consumer price index (CPI) which excludes Food and Energy, rose by 4.0% year over year in the U.S., by 1.6% in the Eurozone and by 0.4% in Switzerland. While the US seems to have peaked in terms of Inflation, Europe is still on an upwards trajectory.



[Source: Bloomberg, VSWA]

Bond yields at the longer end of the government curve rose across the western world in September. The 10-year U.S. treasury yield climbed back to 1.50%, a level last reached in June. Yields in Europe and Switzerland also moved higher but remained below zero. We expect long-term yields to continue their ascent and prefer shorter maturities in the fixed income part of our portfolios. In terms of relative attractiveness, we still favor corporate debt to government debt due to the additional credit spread that can be collected at low risk. We expect the positive economic environment to persist over the coming quarters, which should keep credit risk at low levels.

Evergrande, rising energy prices and a rather hawkish Fed were the main talking points among bond investors in September. Longer dated yields rose substantially, which we expect to continue over the coming quarters. We remain underweight in fixed income in our multi-asset mandates and 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	0.25(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	-0.3	0.0
USD	1.9	0.9	1.5	1.5	1.8
JPY	0.0	0.0	0.1	0.1	0.1
GBP	0.8	0.2	0.9	0.9(0.7)	1.0
CHF	-0.5	-0.6	-0.2	-0.2	0.0

VSWA Forecast; () old forecast

Equities

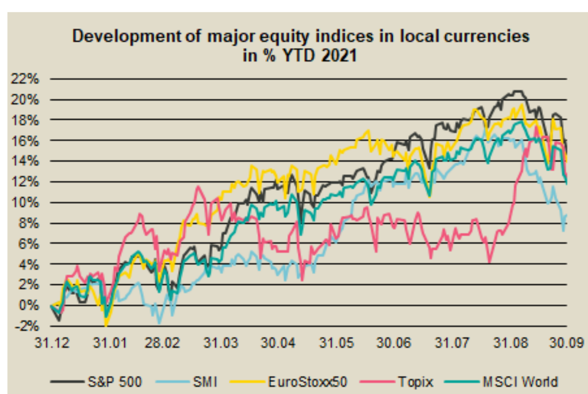
Since the beginning of the year, equity markets moved higher without any material consolidation. This is very untypical, as in most years of the past, stock markets corrected between 5% and 15% from peak to trough. During September, worries regarding signs of decelerating growth, rising inflation, supply chain issues, input cost pressures, a potentially earlier than expected Fed tapering, a worsening situation of Chinese property developers, and rising bond yields, triggered a more significant stock market correction. The current bond market sell-off has been similar to the one at the start of 2021, as in both cases the yield curve steepened, and real rates shifted higher. However, while in the first quarter rising bond yields were driven by the reflation narrative, the current increase is triggered by the prospect of monetary policy normalization. Across sectors, Energy stocks improved from a rising oil price, and Financials profited from rising yields. On the other hand, Materials, Utilities, and Communication Services stocks underperformed.

Given the background of rising earnings estimates and lower equity markets, valuation multiples moved lower across most indices, which is a healthy development in our view. As we are heading towards 2022, market participants will soon start to focus on estimates for next year. Based on estimates for 2022, most markets seem to be reasonably priced. With a price-to-earnings ratio (PE ratio) of 19.4 based on earnings estimates for 2022, the S&P 500 index is still among the most expensive markets. A PE ratio of 16.6 for Switzerland, and 14.8 for Eurozone stocks based on estimates for 2022 seems more compelling. This is especially true compared to bond markets, given that earnings yields, and dividend yields of major stock market indices are still significantly higher than bond yields.

A growing number of companies is mentioning rising input cost pressures and supply chain disruptions as factors restraining revenues and earnings. We believe that this will limit upside potential for earnings over the coming months, and probably make the forthcoming earnings season less outstanding compared to those following the first and the second quarter. Consequently, the trend of consensus earnings estimates for the next 12 months recently started to flatten but is still up. Thus, the major driver of stock market performance from the lows of March 2020 starts to be less supportive.

The prospect of an earlier-than-expected start of the Fed's hiking cycle spooked markets but may not necessarily be negative for stocks. The question is, if monetary tightening is a consequence of policy normalization in an environment of strong economic growth, or merely resulting from the need to dampen inflationary pressures against a backdrop of materially lower growth expectations. The first scenario would be positive for stocks, while the second one most likely a negative one. We currently expect the first scenario to realize, as we still see above average levels of growth and believe that current inflation pressures are resulting from the strong re-opening boom, which should soon start to normalize.

The fact that investor sentiment already fell to relatively pessimistic levels is a positive development from a stock market perspective. According to the most recent survey of the American Association of Individual Investors (AAII), only 30% of investors are currently bullish for the stock market, while 39% are bearish. This points to a better environment to add cyclical risk compared to the second quarter, where most investors were particularly bullish on stock market prospects. However, current sentiment is still not at levels signaling investor capitulation.



[Source: Bloomberg, VSWA]

Equity market valuations

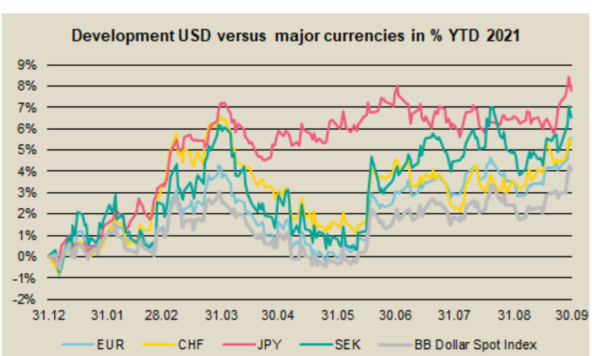
	Price to earnings ratios			Price to Book	Dividend yield %
	Expected 2021	Expected 2022	10-year average	2021E	2021E
USA	21.2	19.4	19.9	4.3	1.4
Eurozone	16.1	14.8	19.6	2.0	2.9
Switzerland	18.2	16.6	17.6	3.0	2.6
UK	12.3	11.9	21.9	1.8	4.2
Japan	14.3	13.3	16.5	1.3	2.2

VSWA Forecast; () old forecast

The current correction in equity markets reveals investor concerns on a worsening relation between inflation and growth, as well as several other negative developments. We view this as a healthy development and currently do not expect this correction to develop into a more severe drawdown. Global economic activity is still strong and estimates for 2022 remain at above average levels. Earnings estimates start to flatten but continue to move slightly higher. Stock market valuation relative to bonds remains attractive, especially based on estimates for 2022. Despite the recent more hawkish policy shift of the Fed, monetary stimulus will remain accommodative over the coming quarters. Finally, relatively pessimistic investor sentiment is already reflecting a less favorable stock market backdrop. We reduced our overweight in equities to neutral across mandates during the past two weeks and remain neutral for the time being.

Currencies

In recent weeks the macroeconomic backdrop has been driven by a slowing global growth trend, especially in the Emerging Markets, by rising inflation expectations outside the U.S., and by more hawkish Fed communication. Longer-term bond yields in the U.S. increased more than in the Eurozone or Switzerland. The above-mentioned factors led to an appreciation of the U.S. Dollar versus most major currencies in September. Dollar strengthening was also driven by weak stock markets, as risk-off-environments usually lead to flows into U.S. assets for reasons of liquidity and perceived defensiveness. We expect the Fed to start tapering and raise rates sooner than central banks in Europe. This will support the USD over the coming months on the expectation of flows into USD bonds. We increase our 12-months forecast for the USD against the CHF from 0.92 to 0.96 and lower our forecast for EUR against the USD from 1.16 to 1.11.



[Source: Bloomberg, VSWA]

Contrary to this optimistic short-term view on the U.S. Dollar, our longer-term expectation of gradual U.S. Dollar weakening, especially against the Swiss Franc, is unchanged. The key factors behind this pessimistic view are inflation differences and a high and persistent twin-deficit, the Biden administration seems to ignore.

Currencies

	2019	2020	Current	Forecast 3 months	Forecast 12 months
CHF per EUR	1.09	1.08	1.08	1.08	1.07
CHF per USD	0.96	0.88	0.93	0.94(0.91)	0.96(0.92)
USD per EUR	1.12	1.22	1.17	1.15(1.19)	1.11(1.16)
JPY per USD	108	103	111	108(106)	106(104)
USD per GBP	1.32	1.37	1.35	1.39	1.41

VSWA Forecast; () old forecast

Commodities

Oil prices strongly increased in September, reaching levels last seen in July. The price of WTI closed the month above $75 per barrel and moved higher in October on recovering demand, falling crude inventories and the OPEC's decision to stick to their plan for slow and steady supply increases. At the beginning of October, the OPEC+ cartel opted to raise daily output in November by 400.000 barrels, which was less than anticipated. OPEC+ cut output by around 10 million barrels a day at the start of the pandemic and is still withholding roughly half that amount from global markets. However, crude oil's supply/demand-balance has now moved into overproduction territory, which sooner or later will become a headwind for oil prices. Our forecast of $70 per barrel over the next 12 months remains unchanged.

The prospects of sooner-than-expected monetary tightening, rising nominal and real yields, as well as a potentially stronger USD may represent short-term headwinds for gold. During the past tightening cycle between 2013 and 2018, the gold price moved sideways in a broad trading range between around $1150 and $1350 per ounce. This does not change our positive longer-term view on gold, especially given its positive correlation to inflation. We reduce our forecast for the next 12 months from $1900 to $1800.

Commodities

	2019	2020	Current	Forecast 3 months	Forecast 12 months
Crude oil (WTI, USD/barrel)	61	48	75	70	70
Gold (USD/ troy ounce)	1517	1897	1'743	1800	1800(1900)
Copper (USD/ lb.)	2.80	3.50	4.23	4.00	4.20

VSWA Forecast; () old forecast

The current market backdrop represents a temporary headwind for gold. Thus, we do not see many short-term catalysts for a materially higher gold price. Nevertheless, gold can hedge against inflation and supply-side shocks, which might impact risk appetite. We remain overweight in all multi-asset mandates.

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