December 3, 2021

Vontobel Swiss Wealth Advisors

Investment Outlook – December 2021

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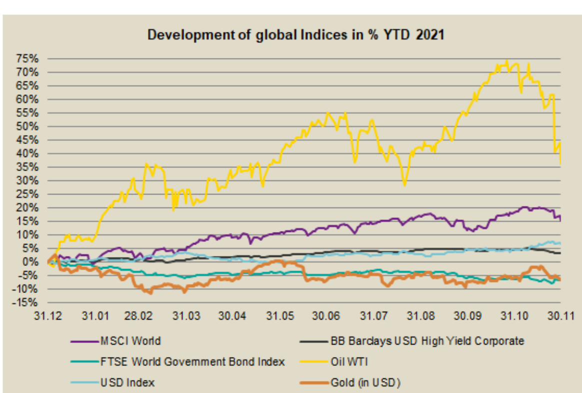
Investment Review

After a strong start into November on strong earnings results, an increasingly hawkish tone from major central banks and rising Covid cases in Europe triggered a consolidation of stock markets across the world. The Covid situation in Europe has deteriorated rapidly in recent weeks, with sharp increases in new infections primarily with the delta variant especially in Germany, Austria, and the Netherlands. Local governments re-introduced new mobility restrictions, with a primary focus on targeted regional containment measures. Given current high inflation pressures, an increasing number of global central banks are switching to a less accommodative monetary policy regime by either slowing asset purchases or starting to raise refinancing rates. Since the beginning of the current year, most equity markets delivered strongly positive returns. The S&P 500 Index gained 23.2%, the Swiss SMI Index is up 12.1%, the Euro Stoxx 50 index rose 8.5%, and the MSCI Emerging Markets index lost 4.2%, all on a total return basis in USD terms. Crude oil fell by more than 20% in October on rising demand fears related to strongly increasing Covid cases and the release of strategic petroleum reserves in several countries. Gold moved sideways, closing the month at $1774 per ounce.



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

At the most recent meeting of our Investment Committee, we decided to keep the equity exposure relative to our benchmarks around neutral in all multi-asset-mandates. While we cannot rule out volatility rising in the short-term, the medium-term prospects for equities still seem attractive. We expect global growth to decelerate but to remain above trend during 2022. Inflation should slowly normalize, as energy price effects are expected to abate in the first half. Supply bottlenecks should ease in the first half and dissolve in the second half of next year on decreasing demand and supply catching up. Central banks will continue to reduce stimulus, but the general monetary environment remains accommodative. Relative valuation of stocks versus bonds is still attractive given the low yield environment. Earnings estimates continue to go higher after a strong reporting season. Rising Covid cases are certainly a risk to watch. However, the European population has a higher effective protection rate compared to previous outbreaks. The likely approval of antiviral drugs, additional vaccines, and booster shots should limit hospitalizations and keep the hit of the fourth wave on the Eurozone economy in check.

Global Economy

For next year we expect an environment of slowing but still above average growth, moderating inflation, potentially rising bond yields, and tighter monetary policy. In our view, global growth is still supported by pent-up demand, high savings, inventory rebuilding, and medical improvements, especially new antiviral drugs from Pfizer and Merck. The fast recovery, combined with supply-side issues, has resulted in increased inflation pressures. As demand slows, and supply improves, price pressures should ease across major economies during 2022. We slightly reduced our global GDP growth forecast for this year from 5.7% to 5.6%. For the next year we expect full-year growth of 4.1% for the global economy.

U.S. macroeconomic releases further improved in November, with most releases coming in above expectations. Personal income increased by 0.5% in October, more than expected. Spending on Covid-sensitive services remains well below its pre-pandemic level. The personal saving rate fell to 7.3%, in-line with its 10-year pre-pandemic average. The University of Michigan's consumer sentiment index increased in the final November report, with both, the current conditions as well as the expectations components improving. Pending home sales rose by 7.5% in October. Sales increased in all four regions, with the largest increase compared to a month ago in the Midwest, followed by the South. Pending home sales track contract signings and tend to lead existing home sales by between 1 and 2 months. The existing home sales report shows that there is currently a strong imbalance between housing supply and demand. In October, the current supply of existing homes available for sale remained unchanged at 2.4 month, which is materially below the pre-pandemic level of 3.9 months. Regional manufacturing surveys, such as the Philly Fed Business Outlook and the Empire Manufacturing report increased in November. However, more recent surveys came in more in-line with expectations. We reduce our current estimate of U.S. real GDP growth in 2021 from 5.7% to 5.5%. For 2022 we currently expect growth of around 4.0%.

The Euro area composite Purchasing Manager Index (PMI), released on November 23, increased by 1.6 points to 55.8, which was strongly ahead of consensus expectations. Gains were broad-based across countries and sectors. Companies continued to report supply-side issues, with input and output price pressures climbing to all-time highs. Expectations of future output growth fell slightly, driven by the services sector on the back of growing worries about rising Covid cases across Europe. Business climate in Germany took another hit in November and fell for a fifth straight month to its lowest level since April. The report underscored mounting challenges for German businesses, which are currently faced by supply disruptions and inflation pressures. The resurging pandemic may weigh on services demand, which has been an important driver of the recovery. Potential Covid related weakness in the services sector would postpone activity into 2022. We leave our estimate for real GDP growth unchanged at 5.0% for this year and at 4.4% for 2022.

According to recent data, manufacturing activity in China seems to have accelerated in November on the easing of electricity shortages and normalizing raw material prices. Price indicators in the survey suggest inflationary pressures eased significantly on the input as well as on the output side. The State Council recently decided to step up policy support for small and medium enterprises (SMEs). Planned measures are related to power supply, funding, tax reductions, labor, and infrastructure. Overall economic activity is still facing headwinds from the property sector downturn, which will most likely not improve over just a few quarters.

We expect economic activity to remain above trend in 2022. Current supply shortages will partly shift GDP from this year into the next. Inflation may prove to be stickier than initially thought but should finally moderate on peak fiscal and monetary stimulus, peak growth, increasing supply, lower demand, normalizing wage growth, and lower energy prices.

GDP growth (in %)

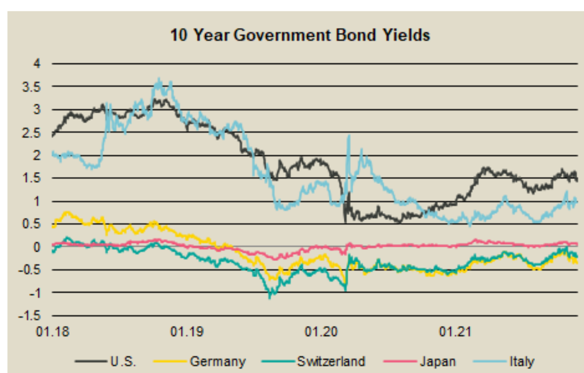
	2019	2020	Current	Forecast 2021	Forecast 2022
Eurozone	1.5	-6.5	3.7	5.0	4.4
USA	2.3	-3.4	4.9	5.5(5.7)	4.0
Japan	0.0	-4.7	7.7	2.4	2.6
UK	1.4	-9.9	6.6	6.5	5.3
Switzerland	1.3	-2.5	7.7	3.5	2.8

VSWA Forecast; () old forecast

Bonds

Given stickier inflation pressures than initially thought, major central bank officials recently switched to a more hawkish tone. Since the November meeting of the Federal Open Market Committee (FOMC), several participants have pointed to the possibility of faster than anticipated tapering plans on upside risks to inflation and the risk that long-term inflation expectations may rise above levels consistent with the Fed's target. The European Central Bank's (ECB) Executive Board member Isabel Schnabel recently pointed to sticky inflation prints in the Euro area, signaling that the ECB's Governing Council may soon start to slow down asset purchases to reduce monetary stimulus in the coming months. Rising infections and the risk of renewed mobility restrictions may prevent the ECB from being overly aggressive on normalizing monetary policy. However, we still expect central banks to switch to a less accommodative monetary regime in 2022. Reduced central bank demand for bonds and a rising Fed funds rate should result in rising bond yields over the course of next year.

According to the recent flash inflation release for November, Euro area headline inflation rose to 4.88% and core inflation, which excludes volatile components, such as energy, food, alcohol, and tobacco, increased to 2.63% compared to a year ago. October core inflation in the U.S. jumped to 4.6% year-on-year. The composition of the report was strong, with monthly shelter inflation remaining close to a multi-decade-high, a further pickup in the new and used cars category, and rising price pressure in health insurance. As for Switzerland, price pressures remain relatively contained, with the core consumer price index as low as 0.6% and headline inflation running at 1.2%. The timeframe for inflation to moderate is highly uncertain. The biggest risk remains a wage-price-spiral, which refers to rising wages being rolled over to consumers, which in turn demand higher wages, which are again rolled over to consumer prices. Such a development would likely require a more restrictive monetary policy. However, our base-case remains that of a transitory high inflation period, which we expect to level off during 2022.



[Source: Bloomberg, VSWA]

Despite the worsening Covid situation in Europe we expect government bond yields to rise over the course of next year on less policy support. We expect 10-year government bonds in Switzerland and the Euro area to cross the zero line over the next 12 months and the yield of 10-year treasuries to move towards 1.9%. Such an environment of slowing growth and gradually increasing underlying rates usually leads to a pick-up in default rates, especially among low quality issuers, and bears the risk of moderate credit spread widening. As the dispersion in performance across corporate debt rises, bond selection and risk monitoring become even more important for return generation in fixed income portfolios. We favor issuers with improving balance sheets and strong cash-flows. We still favor corporate debt to government debt due to the additional credit spread that can be collected at relatively low risk, as we do not expect default rates to materially worsen. Slowing, but still above average economic growth, easy lending conditions, and ample demand remains supportive for corporate credit in 2022.

Despite recurring Covid risks we expect bond yields to increase during 2022 on monetary policy normalization, especially at the longer end of the curve. We remain underweight in fixed income in our multi-asset mandates, keep duration relatively low, 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	0.50
JPY	-0.10	-0.10	-0.10	-0.10	-0.10
GBP	0.75	0.10	0.10	0.25(0.10)	0.75(0.50)
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	-0.3	-0.2	0.0
USD	1.9	0.9	1.5	1.7	1.9
JPY	0.0	0.0	0.1	0.1	0.1
GBP	0.8	0.2	0.8	1.1	1.3
CHF	-0.5	-0.6	-0.3	-0.1	0.1

VSWA Forecast; () old forecast

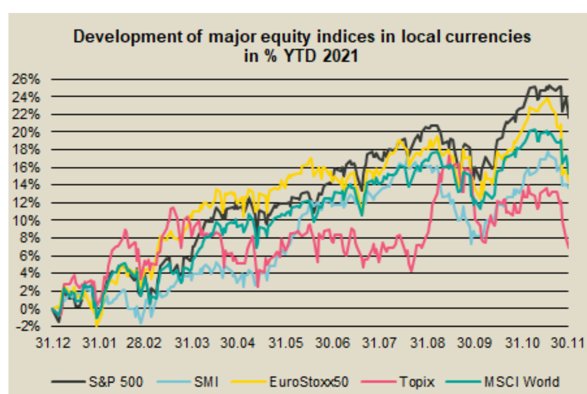
Equities

After a strong start into November on strong earnings reports, the negative newsflow around the new Covid variant, called Omicron, started to weigh on the stock market. The selloff at the end of the month was very sharp, and likely intensified by positive investor positioning and relatively low liquidity around the Thanksgiving holiday. Typical re-opening trades, such as Airlines, Hotels, and Cruise Lines were among the worst-performing stocks. The risk picture was already turning less positive in recent weeks, as declining market breath led to a falling number of stocks participating in the uptrend. This was particularly evident in the segment of super richly valued high growth stocks, which have witnessed massive drawdowns on rising interest rates.

Equity valuations have declined across most markets during 2021 due to strong earnings growth and rising consensus estimates. However, current equity valuations are elevated compared with historical post-recession environments. With a price-to-earnings ratio (PE ratio) of 20.9 based on estimates for 2022, the S&P 500 Index seems overvalued compared to history. With PE ratios of 17.6 and 14.9, respectively, Swiss and Eurozone stocks are valued roughly in line with their 10-year average. This limits the potential for further valuation expansion, so that future stock market returns should mainly be driven by rising earnings. Thus, investors should expect lower returns from here, especially if less monetary stimulus, slower growth, and rising bond yields may increasingly act as a headwind on valuation multiples. The comparison with bonds is more favorable and still speaks in favor of equities. However, the current ultra-low yield environment will likely not prevail, resulting in valuation headwinds for equities. Having said that, valuations alone are usually not a good signal for market timing, as equity markets used to remain at levels perceived to be either rich or cheap for considerable time in history. Longer-term, equities clearly remain our preferred investment on the potential for growing earnings and rising dividends.

After another strong reporting season, the analyst consensus for the next 12 months continued to move higher across most indices, which was the major driver of stock returns in the first half of November. Based on our expectation of a positive economic environment, earnings-per-share (EPS) should continue to move higher over the next years. The consensus is expecting EPS in the MSCI World to rise by 7% in 2022 and by 9% in 2023. Rising earnings compensate for the risk of potential valuation multiple compression resulting from more hawkish central bank policy and rising yields, so that any material equity market correction would, in our view, represent a compelling buying opportunity for longer-term investors. We believe that a diversified portfolio of highly profitable growth stocks and carefully selected cyclicals has the best chance to show strong performance in the economic environment we expect to prevail during most of 2022.

Driven by the sharp decline in risk appetite, volatility spiked, and investor sentiment fell from optimistic to neutral levels. According to the recent survey of the American Association of Individual Investors (AAII), 34% of respondents are currently bullish, while 36% are bearish. A continuation of the risk-off mode would move investor sentiment deeply into negative territory, likely creating a more attractive asymmetry to add risk. Buying the dip is usually the right strategy during the recovery after a deep recession. However, by just waiting for buying the dips and not being in equities, investors historically missed out on prolonged periods of strong returns without significant corrections.



[Source: Bloomberg, VSWA]

Equity market valuations

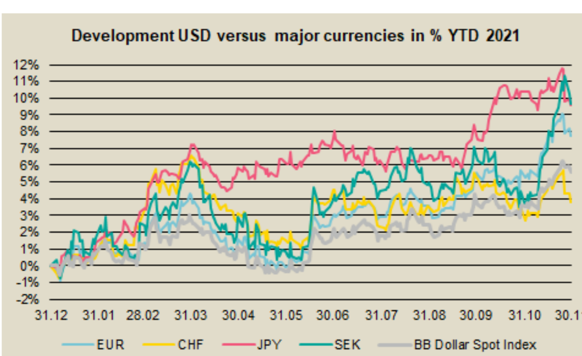
	Price to earnings ratios			Price to Book	Dividend yield %
	Expected 2022	Expected 2023	10-year average	2022E	2022E
USA	20.9	19.1	18.1	4.2	1.4
Eurozone	14.9	13.8	14.9	1.9	3.0
Switzerland	17.6	16.3	17.9	3.0	2.6
UK	11.7	11.2	14.1	1.7	4.0
Japan	13.5	12.5	15.7	1.2	2.3

VSWA Forecast; () old forecast

We decided to keep the equity quota at neutral relative to the benchmarks across all multi-asset mandates. Despite renewed Covid headwinds, the economic recovery will continue in 2022. We believe that it is too early to take a defensive stance, as the current macro backdrop is far from being late cycle. A strong reporting season shows that companies are able to protect margins by raising prices on strong demand. Earnings estimates should continue to rise by high single digits over the next few years. While being richly valued in a historic context, stock valuation remains attractive versus bonds. With less potential for a broad-based equity market rally, stock selection becomes crucial to produce strong investment returns. Quality growth stocks and cyclical stocks, which are conservatively priced remain our favorites. Key risks are related to stickier inflation, hawkish central bank action, and a more pronounced growth slowdown.

Currencies

The Euro has dropped sharply in November against the Dollar and the Swiss Franc, as well as against other major crosses. Its depreciation against the USD followed hawkish comments from Fed officials, which pointed towards a likely speed up of tapering and earlier-than-expected rate hikes. The Euro's weakness against other major currencies can be explained by specific factors, such as surging Covid cases, and the risk of further lockdowns in countries heavily hit by the current wave. We believe that the expectation of an earlier Fed move is now largely priced in, likely limiting further downside of the EUR versus the USD. While the tone of ECB officials also started to become more hawkish recently, we do not expect any rate hikes in 2022. However, a reduction of asset purchases seems likely if inflation continue to surprise to the upside. We leave our 12 months forecast for the EUR versus the USD unchanged at 1.11.



[Source: Bloomberg, VSWA]

The CHF profited from the recent decline in risk appetite, its status as Europe's safe haven, as well as from rising inflation. All these factors helped to strengthen the CHF versus the USD and other majors. However, as we expect the Fed to accelerate the pace of tapering, the USD may be well supported over the shorter term.

Currencies

	2019	2020	Current	Forecast 3 months	Forecast 12 months
CHF per EUR	1.09	1.08	1.04	1.07(1.08)	1.07
CHF per USD	0.96	0.88	0.92	0.94	0.96
USD per EUR	1.12	1.22	1.13	1.14(1.15)	1.11
JPY per USD	108	103	113	110	108
USD per GBP	1.32	1.37	1.33	1.36(1.39)	1.39(1.41)

VSWA Forecast; () old forecast

Commodities

Oil prices literally collapsed during November, with the price of WTI declining from above $84 per barrel to around $66/bbl on the release of strategic oil reserves in several countries and - more importantly - rising worries about the stepping up of travel restrictions. At current levels, oil is now priced for a significant hit on demand during the next months, without any offsetting response from the producer countries. As this seems quite unlikely, we view the recent shift in oil market sentiment as an exaggeration. One month ago, investors were worried about the risk of rising oil prices, as substitution effects and quickly shrinking crude inventories left little room in case of demand or supply-side shocks. Our forecast for WTI over the next 3 and 12 months remains unchanged at $80 per barrel.

The gold price held up well in November, despite headwinds from a rising Dollar and more hawkish Fed projections. Indian gold imports have rebounded, and Chinese demand remained strong. Overall, demand from Emerging Economies remains healthy, driven by rising price pressures and the rebound of consumer purchases on reopening. Central bank demand may increase in 2022. The Russian central bank has started to purchase gold after having remained out of the market in 2021. High commodity prices increase the currency reserves of commodity exporters, which may lead to a further rise in Emerging Market central bank demand. Our price target for the next 3 and 12 months remains at $1800.

Commodities

	2019	2020	Cur-rent	Forecast 3 months	Forecast 12 months
Crude oil (WTI, USD/barrel)	61	48	68	80	80
Gold (USD/ troy ounce)	1517	1897	1'788	1800	1800
Copper (USD/ lb.)	2.80	3.50	4.29	4.40	5.00

VSWA Forecast; () old forecast

For investors concerned about inflation risk, gold is one of the best assets to hold. Gold also offers significant diversification benefits, especially during recessions or more severe market drawdowns.

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