Perspectives

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IN SHORT

- Talks regarding tapering by the end of the year intensified, but this did not surprise the markets
- Yields have remained stable at their low levels, but could gradually resume their upward trend
- Cyclicals have come under pressure recently, but we still see an additional leg of performance towards the end of the year

Looking past the risks

Inflation, tapering, Chinese regulation, delta variant,... - the list is long but has failed to derail the recovery and Equity markets. The Fed minutes released mid-month indicated that tapering could take place by the end of the year as they “saw the Committee’s substantial further progress criterion as satisfied with respect to the price-stability goal and as close to being satisfied with respect to the maximum employment goal”. We do not think this will be a real problem, as it does not come as a surprise to the markets: the adjustments will be gradual and widely anticipated. Rate hikes are not expected until late 2022 or early 2023. The U.S. economy remains on a strong recovery path thanks to abundant liquidity and fiscal support. The Democrats' infrastructure ambition has moved in the right direction as the Democrat-controlled U.S. Senate has passed both the bipartisan $1 trillion infrastructure package and the $3.5 trillion budget plan that focuses on "soft" infrastructure. While the infrastructure plan moves forward, the need for an increase in the public debt limit looms at the end of September. In Europe, countries have received their first tranches of money from the €800 billion European recovery fund designed to help them recover from the pandemic and make their economies greener and more sustainable.

Covid cases have surged worldwide due to the spread of the delta variant. Hospitalizations have remained under control so far, but we will be watching them closely as they have begun to rise again, particularly in the U.S. where we are approaching 100,000 hospitalizations per week, a level not seen since January. We do not expect this to lead to additional restrictive measures, as the proportion of fully vaccinated people continues to increase and vaccinated people appear to be more resistant.

Chinese regulation continues to make headlines and weigh on markets, especially Asian equities or China-sensitive sectors like luxury stocks. While it started with Ali Baba and Jack Ma, it now extends to antitrust, productivity, data control, inequality and education. It is still too early to assess the scale and scope but it is likely China's regulatory crackdown still has room to go. However, valuations have retreated, creating opportunities to enter the market at a good level.

Against this backdrop, equity markets have experienced increased volatility in recent weeks. Chinese equities continue to suffer and cyclical stocks have come under pressure, while growth stocks have made a comeback. We remain on the bullish side: we expect continued economic growth globally with ample support from central banks and government spending. The second quarter earnings season has shown historical results with increasing revenues and improving margins, leading to stunning earnings growth. While valuation remains at elevated levels, we believe earnings growth will continue to support the market in the following month.

As rising commodity prices, supply chain bottlenecks and the base effect continue to drive high inflation prints, markets seem confident that central banks will keep inflation under control. Yields have remained steady at their low levels. But we may have gone too far and their upward trend could resume towards the end of the year.

Asset class details

Equities

Tapering talk, rising Covid cases due to the delta variant, Chinese regulations have caused market volatility in recent weeks. Growth stocks have returned to the forefront, overshadowing the rally in cyclicals. The economic backdrop remains positive however, as vaccination campaigns in develop markets should avoid further stringent measures and the accommodative stance on fiscal and monetary matters should be maintained.

The economic positive surprises have slowed, highlighting we may be past the growth peak. However, we still expect strong economic data in the coming quarters and sustained elevated growth, supporting risky assets. Companies continue to show increasing revenues as pent-up demand is released and margins improves. Valuations remain elevated, but strong earnings growth should continue to drive the market higher.

We therefore continue to be positive on Equity, keeping a preference for cyclicals. Sustained high growth and lower valuation should help sectors like financials, energy and materials. The landscape is not black and white, however, and we are starting to look more at a barbell positioning as a select portion of growth sectors show strong earnings resilience. The Chinese regulatory crackdown may create opportunities to enter at an attractive level.

Fixed Income

U.S. 10-year Treasury yields rebounded somewhat to 1.30%. Tapering talks dominated the headlines, with Fed minutes released mid-month indicating the tapering could begin by year-end. Despite this, yields behaved and remained capped as investors assessed variants concerns and growth fears. We believe that yields may be too low and should gradually resume their upward trend.

Monetary policy should remain accommodative and forward guidance will be cautious so as not to catch the market off guard. We do not expect a Fed rate hike until late 2022 or early 2023, and the ECB should normalize policy later, at an even slower pace, to continue supporting its banking sectors and peripheral countries.

In this context, we remain cautious on duration as yields remain low and we see more upside risk. We favour credit risk, as default levels have declined and spread levels have offset the risk taken. The longer duration of IG indices and tight spread levels leave less room to compensate potential losses from rising rates. Despite a slight widening recently, corporate spreads have held up and selective high yield opportunities may present themselves.

We remain positive on emerging hard currency corporate debt, as the carry level remains attractive compared to developed markets, we see additional room for spread conversion, and corporate balance sheets are strong. However, selection remains key in this area.

Currencies

The dollar has reached the bottom of its trading range, as inflation fears and a more hawkish Fed has led to dollar strength. We do not expect additional upside, as strong growth and risk taking should eventually detract from further strengthening. The broad range trading witnessed over the last months should continue against major currencies. EM and commodity-linked currency may benefit from such environment.

Commodities

As the recovery continues and pent-up demand is released, oil prices continue to receive some support. Production cuts are still in place and properly managed to maintain a sustainable price recovery. Most of the rebound has probably already taken place as supply remains plentiful, but continued strong growth should keep a floor on oil prices.

Gold prices have retreated since the beginning of the year from last year's highs, but the reopening of emerging economies and increased central bank reserves could lead to higher physical demand, as well as low real yields and high medium term inflation expectations.

Alternatives

Alternatives continue to provide diversification and de-correlation opportunities. We believe that real assets can also help provide income in a world where interest rates will remain lower for longer.

Asset Classes	Negative	Neutral	Positive
Equities			●
Fixed Income		●	
Equities			
US		●	
Europe			●
Japan			●
Asia ex Japan			●
Emerging Markets		●	
Asia		●	
Latam		●	
Europe		●	
Fixed Income			
Sovereign US	●		
Sovereign EUR	●		
IG US		●	
IG EUR		●	
HY US		●	
HY EUR		●	
EM Hard Ccy		●	
EM Local Ccy		●	
Commodities			
Oil		●	
Gold		●	
Base Metals		●	

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