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INVESTMENT OUTLOOK 05.2021

08 May 2021

Almost all macro-economic indicators remain exceptionally strong. The US manufacturing ISM index, for example, reached a historical high of 64.7 in March. The vaccination campaign is progressing. In the US 70% of the population will be fully vaccinated by the end of June. A vaccination rate of 70% is considered to be the threshold for herd immunity. While Europe is still lagging behind, the pace of the rollout is accelerating there too. It can be assumed that Europe will reach herd immunity by the end of Q3.

As a result, lockdown measures will be eased over the course of the next few months. This will boost consumer demand and, in turn, capital expenditure as companies will need to expand capacity to meet pent-up demand.

Since fiscal and monetary policy continues to be accommodative, risky assets are poised to outperform bonds.

We remain neutral in equities but have overweighted cyclical sectors. Especially industrials and financials should benefit from accelerating economic growth and do not look as overvalued as other sectors.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

REFLATION IS IN FULL SWING

Financial markets

In April most equity markets rallied. The MSCI World rose 4.5%. The leaders in vaccination, the US and the UK, outperformed, while the laggards, Europe, Japan, and the emerging markets, underperformed. Year-to-date the cyclical sectors, like energy, finance, materials and industrials performed best.

Central banks reiterated their accommodative stance and inflation expectations continued to rise, albeit at a slower pace than in previous months. Despite rising inflation expectations, nominal yields stabilized in April. While German 10-year government bond yields rose slightly, by 9 basis points, US yields fell 11 basis points. As a result, real yields fell and inflation-linked bonds performed well. Credit spreads tightened across the board. Especially emerging market bonds rallied strongly.

Commodity prices continued to surge. Many years of low investment in the commodity sector created supply shortages. At the same time, demand for commodities is expected to rise very sharply as the economy opens up and strong pent-up demand is set free. Furthermore, the trend to decarbonization is greatly benefiting metals, copper being an important example. The price of gold recovered somewhat, as real interest rates plunged.

The USD sold off in April, losing value against most major currencies. Despite Chinese growth concerns and some volatility, the CNY remained on the strong side; the USD-CNY is currently trading around 6.5. The CHF strengthened in April, with EUR-CHF falling below 1.10.

Macroeconomics

In April the US manufacturing ISM index fell to 60.7 after 64.7. The Markit manufacturing PMI rose to 62.9 after 62.5. Though most leading indicators have been strong, the April US non-farm payrolls disappointed vastly. While economists had expected a figure as high as 1 million, the pace of hiring actually fell to 226,000 after 770,000. Most jobs were created in the hospitality sector. However, many companies are still faced with virus-related restrictions and fears. Furthermore, supply chain disruptions, like the global semiconductor shortage, also held companies back from hiring.

In many countries, tax increases are being discussed to finance the massive build-up of debt. President Joe Biden, for example, wants to raise corporate taxes from 21% to 28% and to double the top rate for capital gains and dividends. Some countries, including the US, are considering introducing a wealth tax. It remains to be seen how tax systems will emerge, given the major funding needs of governments, and how this will impact economic growth and capital flows.

Covid-19

The total number of cases reached 159 m, with 3.3 m deaths. In many countries the pace of the vaccination roll-out accelerated. The US is expected to have 70% of the population fully vaccinated by the end of June. This figure of 70% is believed to be the threshold for herd immunity. The UK and the US already started to relax lock-down measures on the back of falling new case numbers. In the EMEA region, where the vaccination campaign is lagging, the number of new cases is still rising. Still, it can be assumed that Europe will reach herd immunity by the end of Q3.

Meanwhile, the covid infection rate in India is surging rapidly with 400,000 new cases daily. This shows how precarious the fight against the pandemic remains.

Central banks

In its April meeting the ECB reiterated its accommodative stance, although it expressed confidence that the eurozone economy will rebound strongly later this year. ECB chairwoman Christine Lagarde expects that we have a long way to go for the economy to become sustainable.

A week later, during its two-day policy meeting, the US Fed also concluded that it is far away from withdrawing monetary support for the US economy. The path to recovery would be highly dependent on the further course of the viral pandemic.

Very remarkably, in contrast to the ECB and the US Fed, the Bank of Canada was the first central bank to announce its intention to taper off its asset purchases, reducing its buying target from CAD 4 bn to CAD 3 bn per month.

Outlook

In our view, global growth will rebound strongly this year. Especially developed countries will be able to open their economies in Q3 and Q4, which will unleash pent-up demand. This may lead to supply shortages and rising inflation.

After such a strong rally in risky assets – the MSCI world index for example has risen by 85% since its trough on 23 March 2020 – we clearly expect lower returns in the coming months. Nevertheless, stocks are likely to outperform bonds. But we also think bond yields could rise further, especially in the second half of this year when markets start anticipating the first US rate hikes.

We therefore remain neutral in equities and prefer inflation-linked bonds over nominal government bonds. We also expect that cyclical sectors, like financials and industrials will outperform the broad market indices. As a result, we have initiated overweight positions for those sectors. We also remain constructive on the outlook for commodities. Especially the prices of industrial metals have further upside potential in our view.

ECONOMICS

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Fig. 1: PMIs

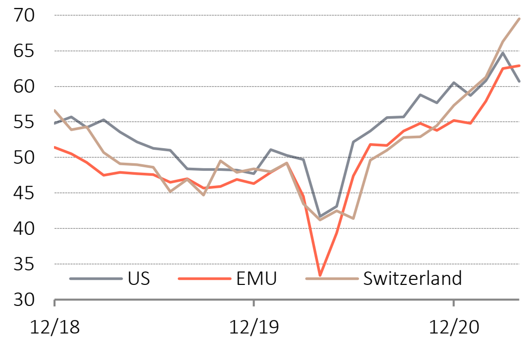


Fig. 2: PMIs

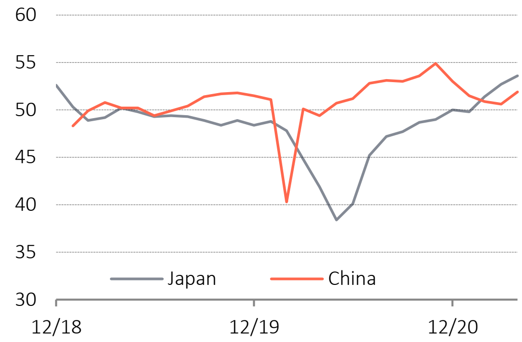


Fig 3: Consumer price inflation, in % YoY

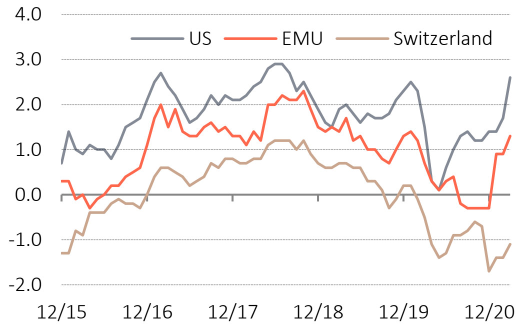


Fig. 4: Consumer price inflation, in % YoY

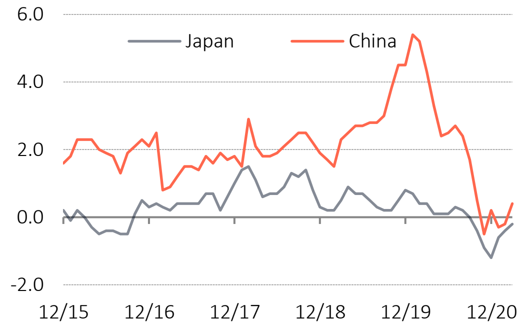


Fig 5: Unemployment rates, in %

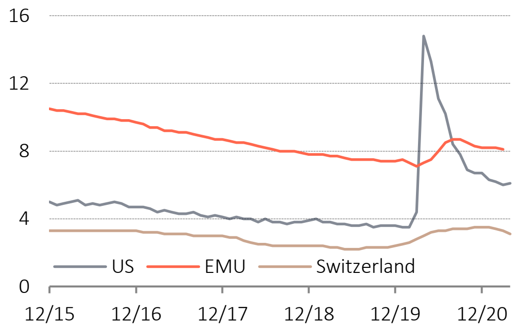
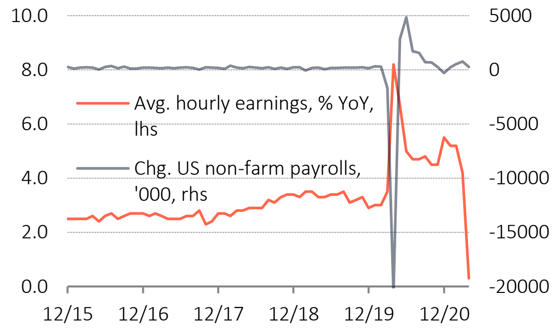


Fig 6: US labor market



FIXED INCOME

Central banks reiterated their accommodative stance and inflation expectations continued to rise, albeit at a slower pace than in previous months. Despite rising inflation expectations, nominal yields stabilized in April. While German 10-year government bond yields rose slightly, by 9 basis points, US yields fell 11 basis points. As a result, real yields fell and inflation-linked bonds performed well. Credit spreads tightened across the board. Especially emerging market bonds rallied strongly.

Fig.7: 2Y government bond yields

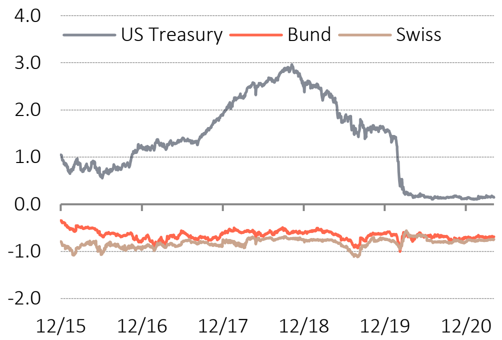


Fig. 8: 10Y government bond yields

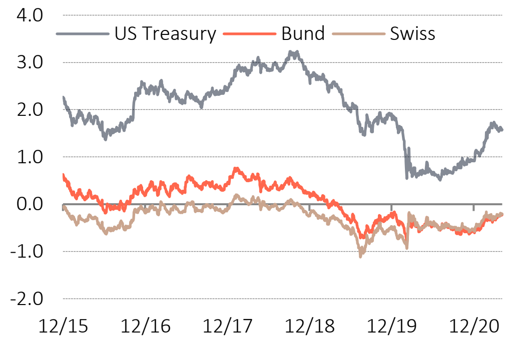


Fig 9: 10Y break-even inflation

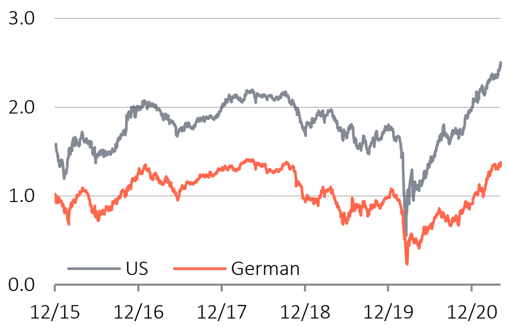


Fig. 10: Credit spreads, 5Y credit default swaps

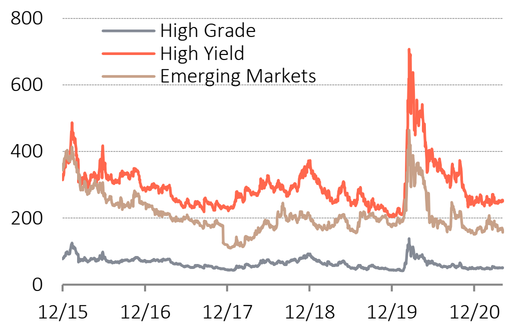


Fig 11: Money market spreads (3M-2Y)

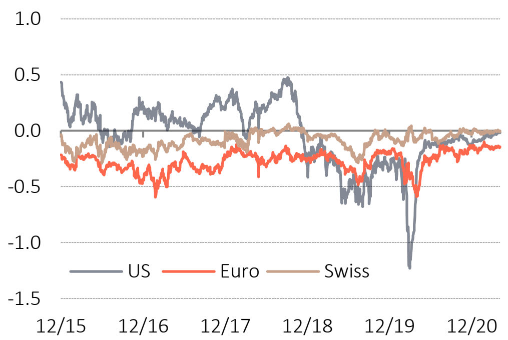
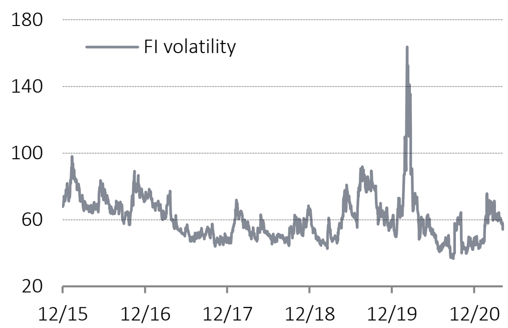


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

In April most equity markets rallied. The MSCI World rose 4.5%. The leaders in vaccination, the US and the UK, outperformed, while the laggards, Europe, Japan, and the emerging markets, underperformed. Year-to-date the cyclical sectors, like energy, finance, materials and industrials performed best.

Fig. 13: MSCI equity indices – major regions

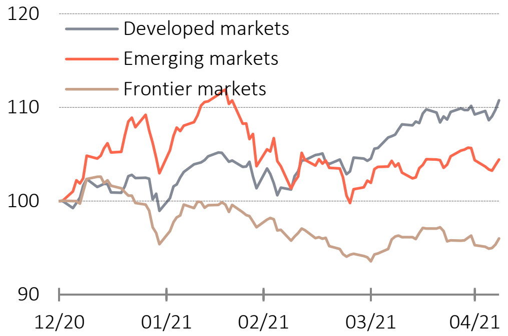


Fig.14: Equity indices – major developed markets

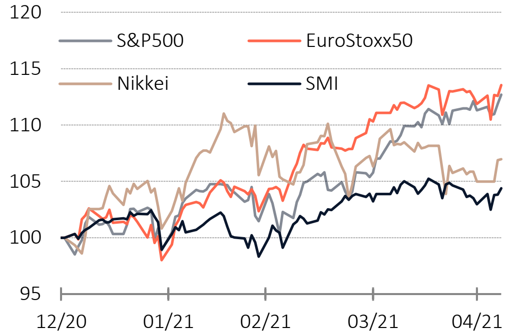


Fig 15: Equity indices – major emerging markets

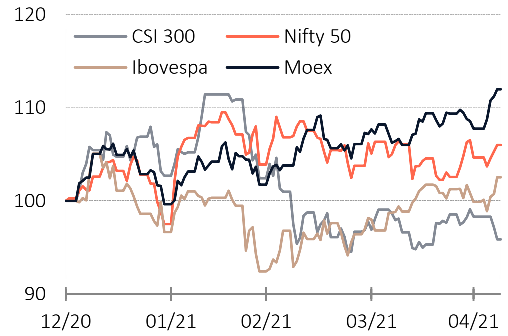


Fig. 16: Sector performance, MSCI Europe, YTD

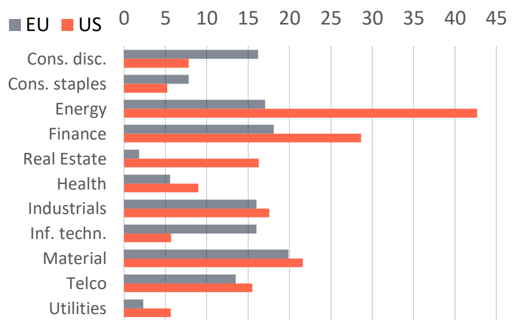


Fig 17: Price-earnings ratios

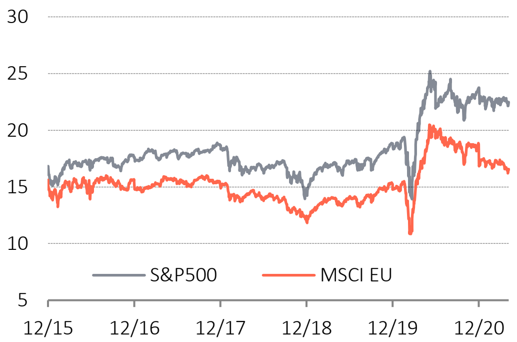
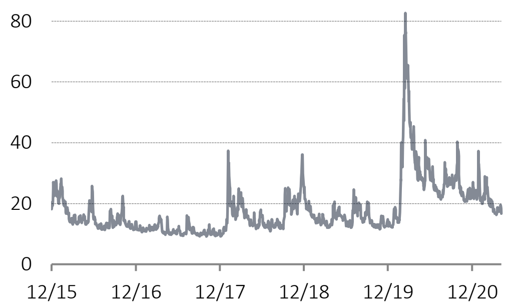


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

Commodity prices continued to surge. Many years of low investments in the commodity sector created supply shortages. At the same time, demand for commodities is expected to rise very sharply as the economy opens up and strong pent-up demand is set free. Furthermore, the trend to decarbonization is greatly benefiting metals, copper being an important example. The price of gold recovered somewhat, as real interest rates plunged.

Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

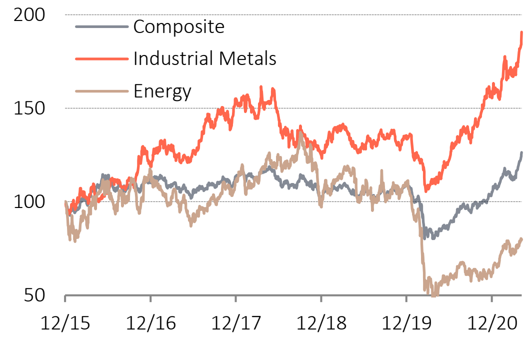


Fig. 22: HFRU hedge fund indices

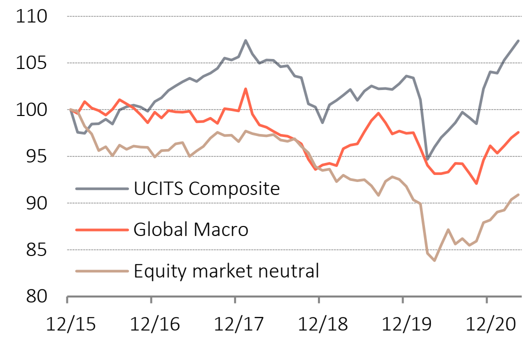
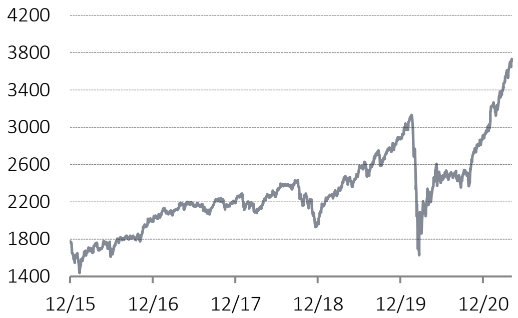


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: LPX global listed private equity



CURRENCIES

The USD sold off in April, losing value against most major currencies. Despite Chinese growth concerns and some volatility, the CNY remained on the strong side; the USD-CNY is currently trading around 6.5. The CHF strengthened in April, with EUR-CHF falling below 1.10.

Fig. 25: EUR-USD exchange rate

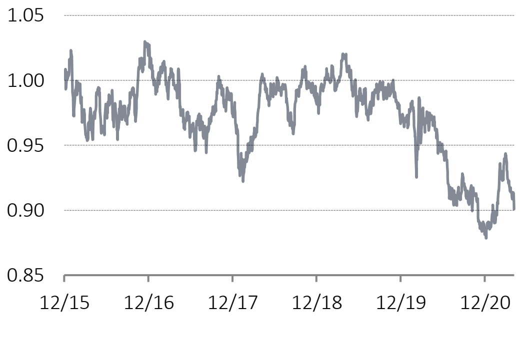
Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

Fig 30: USD-CHF exchange rate



COVID-19

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Fig. 31: Total Covid-19 cases (x 1000)

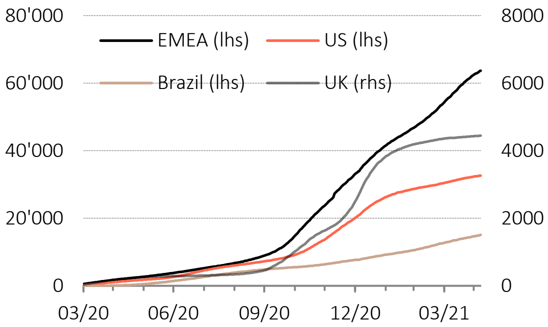


Fig. 32: New cases per day (7-day average)

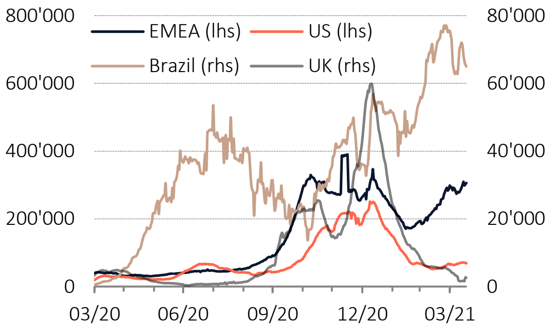


Fig 33: Global vaccination campaign (doses per 100 people)

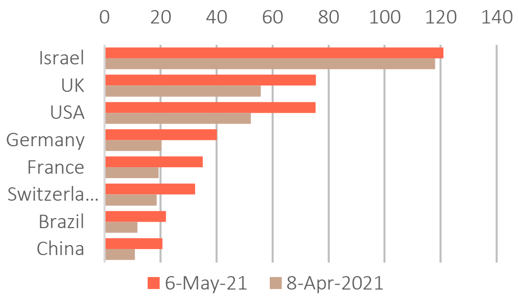


Fig.34: Central bank total assets (indexed)

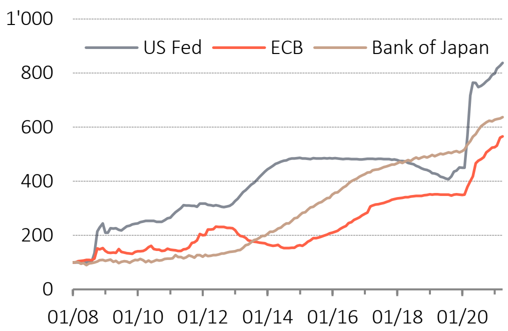
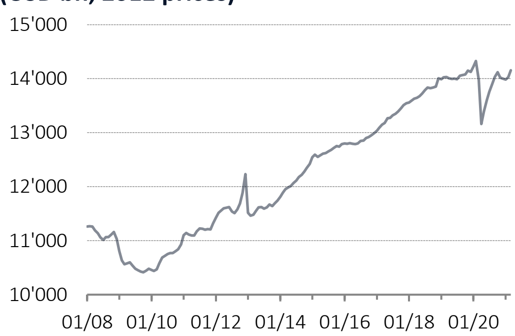


Fig 35: US bankruptcy index

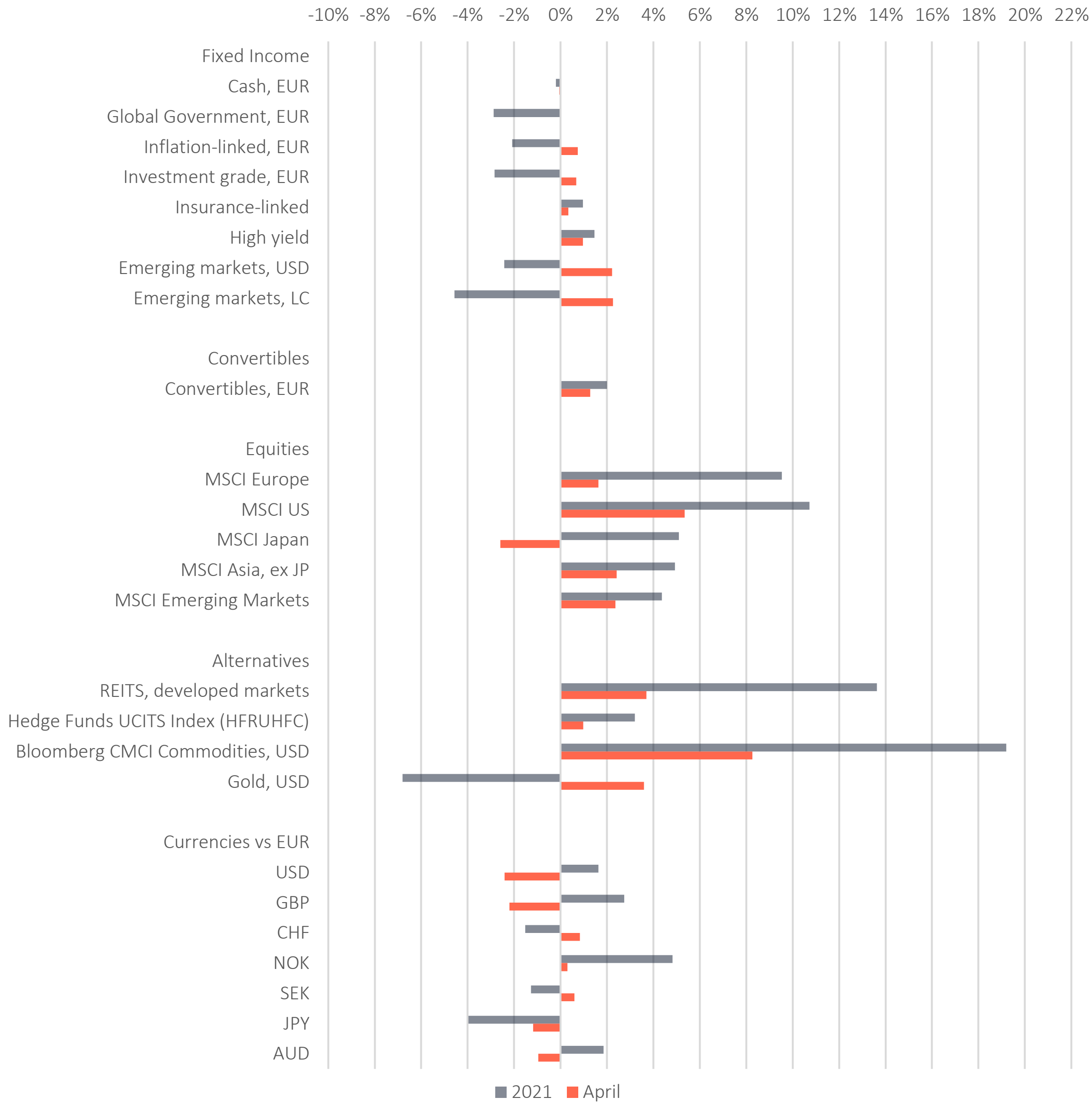
Fig 36: US personal income, excl. transfers (USD bn, 2012 prices)



ASSET ALLOCATION

Risky assets continued to perform strongly in April. This included the riskier bond segments, like high-yield and emerging markets. As bond yields stabilized, nominal bonds were flat. Real yields fell, however, which translated into a positive performance for inflation-linked bonds. The US stock market outperformed as the US vaccination campaign continued to outpace those of most other countries. The slowing of the Chinese economy and the brutal re-emergence of the pandemic in India weighed on Asian stocks. Virus-related concerns led to a negative performance of the Japanese equity market.

Fig. 37: Performance of major asset classes, based on our EUR portfolio strategy

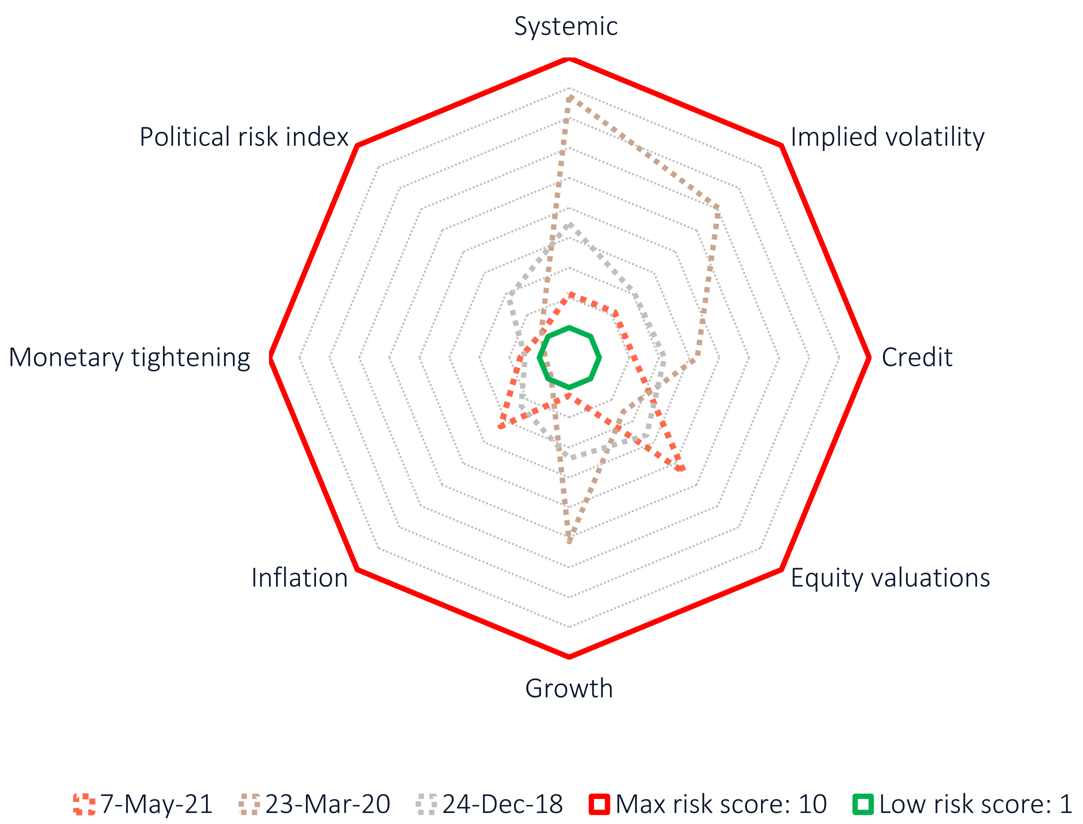


RISK MONITOR

Our risk monitor shows minimal growth and monetary tightening risks, while inflation risks are rising. Furthermore, risks in relation to elevated equity valuations are high. Implied volatilities, the price for hedging, remain low across asset classes. Overall, the benign risk environment continues.

Fig. 38: IMT Risk Monitor

23-Mar-2020: Global pandemic
24 Dec 2018: Growth and monetary tightening fears



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