

NEWSLETTER

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“The race for vaccines: a sprint or a marathon?”

The markets were driven in January by hopes for the rapid rollout of vaccination campaigns and by the double Democratic victory in Georgia. The new Biden administration has announced additional stimulus plans – a short-term one to combat Covid-19 and a longer-term one to fund infrastructures and green energies. Late in the month, business and consumer confidence figures disappointed, particularly in Germany, as did purchasing manager surveys in Europe and the UK, thus suggesting that social distancing measures are still having an impact on economic activity, albeit a smaller one than last spring. What’s more, the massive deployment of vaccines is running into limits in both production and logistics. Having warmed up for a sprint, many governments will now have to run a marathon. Despite these obstacles, we are still convinced that economies are still on the way to a robust recovery in 2021.

Market trends

Global equities fell by 1.0% last month. Emerging equities (MSCI EM +3.1%) outperformed other regions. In the US, the Nasdaq ended in positive territory (+1.4%), while the S&P 500 declined by 1.0% and the rotation into small caps continued (with the Russell 2000 up by 5.0%). The short squeeze late in the month (with GameStop up by 1625% and AMC up by 525%) triggered a sudden spike in volatility (with the VIX soaring past 37 pts) and forced a number of market participants to unwind their positions. Emerging markets fell by 4.5% in the last week of the month, and the S&P 500 by 3.3%. That said, this phase of stress was confined to equities. Credit market spreads were unchanged, while the rally continued in government bonds, with the 10-year US yield up 15bps to 1.07%. The dollar gained (DXY +0.7%, EUR/USD -0.7% to 1.2136), while gold fell by 2.7%.

In Switzerland, the LPP pension fund indices (*indices de la prévoyance professionnelle*) began the year in slightly negative territory at -0.5% for the LPP25+ and -0.3% for the LPP40+.

Market performance as of 31 January 2021

| STOCKS MARKETS | LEVEL | CHANGE SINCE | CHANGE SINCE | BONDS & ALTERNATIVES MARKETS | LEVEL | CHANGE SINCE | CHANGE SINCE |
|-------------------------|------------|--------------|--------------|------------------------------|------------|--------------|--------------|
| | 29.01.2021 | 31.12.2020 | 31.12.2020 | | 29.01.2021 | 31.12.2020 | 31.12.2020 |
| Index | | | | Rates | | | |
| MSCI World | 2661.7 | -0.99% | -0.99% | Germany 10 y | -0.52 | 5 Bps | 5 Bps |
| USA | | | | France 10 y | -0.28 | 6 Bps | 6 Bps |
| Dow Jones Ind | 29982.6 | -1.95% | -1.95% | Italy 10 y | 0.64 | 10 Bps | 10 Bps |
| S&P 500 | 3714.2 | -1.01% | -1.01% | US 10 y | 1.07 | 15 Bps | 15 Bps |
| Nasdaq Comp | 13070.7 | 1.44% | 1.44% | Debt | | | |
| Europe | | | | Investment Grade US | 341.49 | -0.55% | -0.55% |
| Euro Stoxx 50 | 3481.4 | -1.88% | -1.88% | Investment Grade Europe | 265.89 | -0.12% | -0.12% |
| SPI (Switzerland) | 13192.9 | -1.01% | -1.01% | High Yield US | 2345.78 | 0.33% | 0.33% |
| CAC 40 (France) | 5399.2 | -2.64% | -2.64% | High Yield Europe | 422.63 | 0.58% | 0.58% |
| DAX (Germany) | 13432.9 | -2.08% | -2.08% | Emerging Debt | 922.35 | -1.21% | -1.21% |
| FTSE 100 (UK) | 6407.5 | -0.79% | -0.79% | Currencies | | | |
| Japan + Emerging | | | | EUR/USD | 1.21 | -0.65% | -0.65% |
| Nikkei 225 | 27663.4 | 0.80% | 0.80% | EUR/CHF | 1.08 | -0.02% | -0.02% |
| CSI 300 (China) | 5352.0 | 2.70% | 2.70% | USD/CHF | 0.89 | 0.58% | 0.58% |
| MOEX Index (Russia) | 3277.1 | -0.34% | -0.34% | Commodities | | | |
| S&P BSE Sensex (India) | 46285.8 | -3.05% | -3.05% | Crude Oil (WTI) | 52.20 | 7.58% | 7.58% |
| Ibovespa (Brazil) | 115067.6 | -3.32% | -3.32% | Gold | 1847.65 | -2.67% | -2.67% |

Pandemic situation: the number of pandemic deaths exceeded 2.3 million early in the year, but data from the past two weeks suggest that the number of new cases has peaked. Against this backdrop, **vaccination campaigns are the focus of newsflow** for two reasons: they are still essential for eradicating the pandemic, and they offer hope for reopening economies.

Some 130 million vaccine doses have now been administered worldwide, one quarter of which in the US. In per capita terms, Israel is leading the sprint, just ahead of the Gulf states. In contrast, vaccine shortages and logistical bottlenecks are forcing Europe, including Switzerland, to dial back their vaccination campaigns. **As a result, many countries will miss their 2021 targets** and risk running out of breath. Even the US, which is distributing the largest number of daily doses (1.3 million), will need more than six months to administer a first dose to 80% of its population.

Economic environment: restrictions on mobility and economic activity are being kept in place. Even so, economic indicators show that **managing the pandemic is having far less of an impact than many observers feared**. In the fourth quarter of 2020, GDP shrank by 1.3% in France, for example (vs. -4.0% forecast) and by 2.0% in Italy, while it actually expanded by 0.1% in Germany, by 0.4% in Spain, and by 1.0% in the US.

A similar message is being sent out by consumer confidence surveys (at 89.3 in the case of the US Consumer Board Confidence Index, vs. 131.6 in January 2020), unemployment indicators and small business optimism, meaning that **there is still much concern over the economic outlook**. In Germany, for example, business climate fell to a six-month low and dragged down the equity markets late in the month.

After the shutdown in economies last spring, followed by the run-up in precautionary savings in view of the crisis-related downturn in the job market, **the household savings rate is at historically high levels**, at almost 14% in the US and more than 17% in the euro zone. Potential spending of these savings on consumer goods and services is a relay that backs our positive scenario. The key issue is when, and how much, these savings will flow into the real economy.

Role of public authorities: “orthodox” central bankers (such as Greenspan and Trichet) are a species of the past. So is the age of fiscal austerity. In the post-Covid world, monetary and fiscal policies are no longer self-contained, but coordinated. **Biden, Powell, Yellen, Lagarde and Draghi are the starting line-up for taking economies out of recession**, and they will continue to do their utmost to restore consumer confidence.

For example, the announcement of the new 1900 billion dollar emergency stimulus plan comes at the right time. It includes a new 1400 dollar cheque for households (up from the 600 dollars approved in December), an extension of unemployment benefits until September, and backing for local governments and for revving up anti-Covid measures and vaccinations. We are accordingly forecasting real growth of between 4.5% and 5% in 2021 in US.

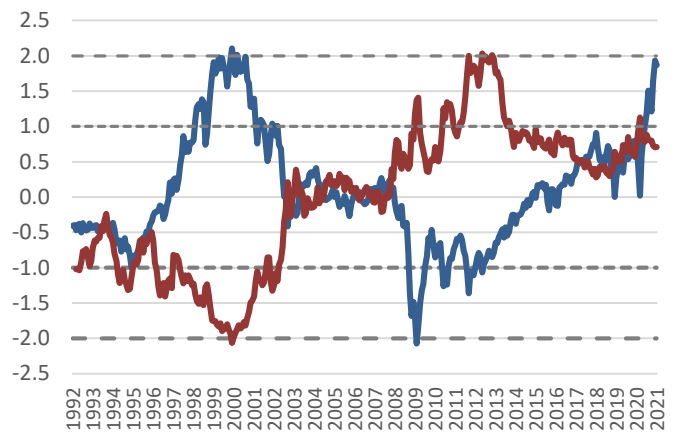
The US Federal Reserve stuck to its status quo on key rates and asset purchases (at 120 billion dollars per month, split into 80 billion in Treasury bonds and 40 billion dollars in mortgage-backed securities). **Powell’s cautious tone aimed to dismiss expectations of a tapering in asset purchases**, perhaps with one eye on the “taper tantrum” that the market threw in 2013 under Bernanke.

Yellen, who is now US Treasury secretary, stressed that, in dealing with the crisis, we would have to “think big” and justified her policy stance by the need to prevent “a longer and more painful recession”. She suggested that **no expense should be spared, as the plan’s benefits would outweigh its costs**. Management of debt can wait. The ECB pledges to maintain ample monetary stimulus on the grounds that Lagarde, its president, expects the recovery to come in the second half of the year. Since March 2020, it has released a total package of 2500 billion euros for a period that runs until March 2022. Ultimately, **Draghi was brought back to save Italy**. With Super Mario’s hero status and determination make him, once again, the man of the hour? His return sent risk premiums down on European assets, in particular for banks. Italy has been bled dry – in 2020 it suffered one of the euro zone’s worst drops in GDP, at -8.3%. It is now counting on more than 200 billion euros from the European plan (equivalent to 12% of its GDP).

The inflation story: inflows into “inflation assets” are already significant and far higher than previous episodes in energy, industrials, materials, real estate, raw materials, and inflation-linked bonds. Within a few months, **deflation fears have given way to reflation hopes and, now, inflation fears.** How did that happen? Through aggressive stimulus plans, the economic rebound, the upturn in commodities prices, the restocking of inventories, higher shipping costs and hourly labour costs, and a weaker dollar. These have pulled inflation figures out of their 2020 doldrums. At 2.2%, five-year US inflation expectations are at a high since 2013. They are nonetheless still within the Fed’s targeted range. **We expect the post-pandemic surge in unemployment and overcapacities to keep inflation in check this year.** Inflation will accordingly remain the key focus for investors in the coming years.

Financial markets: corporate results continue to surprise on the upside. By early February, 59% of S&P 500 companies had reported their results for the fourth quarter of 2020. Of these, 81% beat forecasts (higher than the five-year average of 74%). Companies’ aggregate earnings actually beat analysts’ forecasts by 15%! The top performers were in technology, communication services and financials, while materials, energy and real estate brought up the rear. **The acceleration in earnings dynamics is the good surprise of early 2021** and could continue unless it is slowed by the spread of the pandemic. **The risk factor for the markets has thus shifted from earnings towards valuations that, overall, are stretched in all asset classes.** Equity markets are increasingly expensive, interest rates are very low and premiums for listed Swiss real estate funds are at record levels.

Trend in US equity valuations. In blue: a set of indicators in absolute terms. In orange: valuations relative to interest rates. The dotted lines are deviations from the mean.



Source: Banque Pâris Bertrand

Investment decisions

The consensus reflation scenario has already come to pass, in January. Our conviction is that the recovery will continue to unfold in the coming quarters, although it will come later than expected at the end of 2020, as vaccinations are behind schedule in several parts of the world.

Without yet constituting a major risk, preliminary signs of speculation are buffeting the markets, which makes us even more careful in maintaining diversified portfolios, particularly as asset valuations are demanding, on the whole, in equities, bonds and listed Swiss real estate.

In equities, we continue to recommend exposure to emerging markets, Japan and Europe, as well as to mid and small caps exposed to the cycle upturn. In bonds, we are maintaining a good balance between high-quality credit risk and the quest for higher-yielding paper. We are cautious on the long end of the curve, which is likely to continue to rise. Lastly, we are supplementing our portfolio construction with real assets such as gold and real estate, in the expectation of a more inflationary scenario.

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