MARCUARD
HERITAGE

# Quarterly investment letter – 3rd quarter 2021

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### Summary points

- Governments and central banks remain committed to generous stimulus measures. This in combination with consumer pent-up demand and a strong wave of capital expenditures form a robust backdrop for the global economy.

- GDP growth in the US is particularly strong and the service sector recovery is now driving the rebound and labor market recovery. The US Fed’s ultimate goal is to reach “maximum employment” before any interest rate hikes are envisaged.

- European GDP growth is lagging the US by around six months. The overall environment is characterized by economic reopening with uncertainties to the summer holiday season in Southern Europe. The ECB continues to dictate the yield curve.

- China’s economic data have been moderating lately and a soft outlook remains the base case, despite strong absolute growth numbers. On July 1, China’s Communist Party will celebrate its 100th anniversary under the slogan “follow the Party forever”.

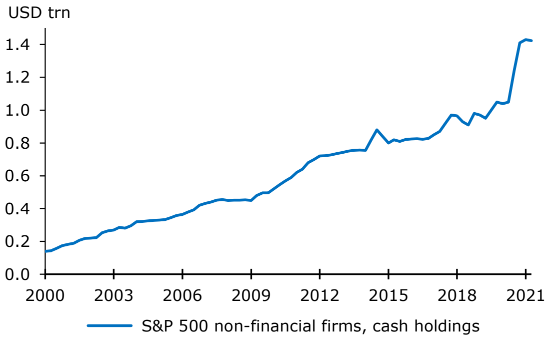
- Conclusion: We expect equities to outperform bonds over the next three to six months. That said, the equity market has likely run ahead of itself and to keep the rally alive, valuations need to be confirmed by the upcoming Q2 earnings season and/or driven by the current emerging capital expenditure cycle. The next market phase or “new normal” will be determined by slightly higher inflation, moderate rate hikes and tempered GDP growth numbers. Looking beyond 2022, the economy might enter into a stagnation or even stagflation phase. With so many inflection points, capital markets are about to enter a riskier and more volatile spot.

## 1 Regional macro-economic backdrop

### The best is behind us unless…

… the **new capex cycle** lasts and acts as **a catalyst** for global capital markets. While uncertainties persist, the global economy is bouncing back stronger than expected and the IMF expects **global GDP to grow by 6%** in 2021 (fastest since 1970s) and 4.5% in 2022. Governments and central banks around the world remain committed to generous fiscal stimulus measures and keeping the cost of capital at historic lows. This combination has initiated a new investment cycle (besides M&A) as **companies have the cash to add new capacity** (chart 1). In the end, investment in new products, technologies and business practices is, after all, the foundation for higher company earnings. A US investment bank reckons that global investment will soar to 121% of pre-recession levels, while Oxford Economics, a consultancy, argues that "the time looks right for a boom in capex". True, the bull market in global **equities** is entering a **riskier** spot and its frequency and intensity of drawdowns is likely to rise. Nevertheless, risky assets may enjoy another three to six months of positive momentum.

**Chart 1: US firms have the cash to invest**



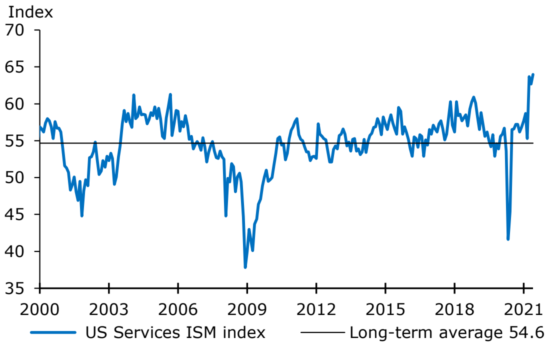
Source: Bloomberg Finance L.P., Alpinum Investment Management

### United States

Market consensus expects **US GDP growth** to rise **+6.6%** in 2021 and +4.1% in 2022. While the positive news flow and US growth is slowing from exceptionally strong levels, the Eurozone is still accelerating. Although the US equity market is expensive, this is supportive for the S&P 500 index as 43% of its revenues is derived from abroad. In the near term, **valuations can easily overshoot**, as financial repression (negative real rates) continues and sentiment is overly positive. People are in the mood to spend thanks to the fiscal stimulus that has led real disposable income to be 27% higher than it was in February 2020.

The US **Services ISM** (chart 2) increased to a fresh **all-time high of 64** and indicates that the service sector recovery is now driving the rebound. The acceleration in service activity will in turn support the **labour market recovery**, which is **the key figure** for the US Fed's interest rate policy (besides their minimum 2% inflation target). The Fed's "maximum employment" goal, which is around 3.5%, will ultimately determine the timing of interest rate hikes. For now, the bond market has priced in the first rate hikes for early 2023. To achieve the Fed's "maximum employment" goal by the end of 2022, the average monthly nonfarm payroll numbers (new hires) must be around 420'000. An indicator we watch closely. Although **inflation** has increased (also thanks to year-over-year base effects), it is still very much **under control**. That said, signs of a wage-price spiral would change the whole equation and force the Fed to shift to a less dovish policy stance sooner than expected. This besides a disappointing Q2 earnings season are the biggest **imminent threats** to equity valuation multiples to contract and equity markets to correct meaningfully.

**Chart 2: The US service sector is driving the economic rebound**



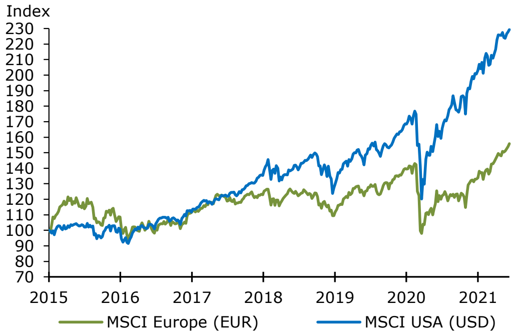
Source: Bloomberg Finance L.P., Alpinum Investment Management

## Europe

Economic growth in the Eurozone is **expected to peak with a six months lag to the US**. For 2021 market consensus expects Eurozone GDP growth to reach +4.3% and +4.2% in 2022. The large growth difference to the US in 2021 is already well reflected in stock market prices (chart 3) and Europe has the potential to outperform the US should rate hikes become more concrete and a drag on the US IT sector. In Germany, federal **elections** will be held on **September 26** and determine the successor to Chancellor Angela Merkel of the ruling Christian Democratic Union (CDU). To raise the chances to oversee the government for another term, the CDU has already shifted to pro-environmental and fiscally proactive policies. This is important as the election promises will likely be positive for German and European equities in general. Further support comes from the **German ZEW Economic Sentiment** indicator, which stands at 79.8 after reaching a **21-year high** in May. Although Covid-19 measures have been extended in several European countries, the overall environment is characterized by economic reopening and pent-up demand, while the global manufacturing sector is still well underpinned. The **fly in the ointment** could be Southern Europe as the summer holiday season may be well below pre-Covid levels and dampen the recovery.

In 2020, the European Central Bank **(ECB) bought 95% of new bonds issued** by Euro member states through the so-called PEPP program. The program is set to last until March 2022 and investors can expect the ECB to implicitly **manage the yield curve**. Inflationary pressures are still way too weak for the ECB to begin even hinting at any form of monetary tightening. Although headline inflation crossed the ECB's 2% target in May, core inflation is still at a low 1% and **5-year inflation expectations are at 1.6%**. This is still well **below the ECB's target**. Market expectations for the first rate hike are not before mid/end of 2023. The ECB will probably be the ultimate laggard in the global monetary policy normalization process.

**Chart 3: Performance MSCI USA versus MSCI Europe since 2015**

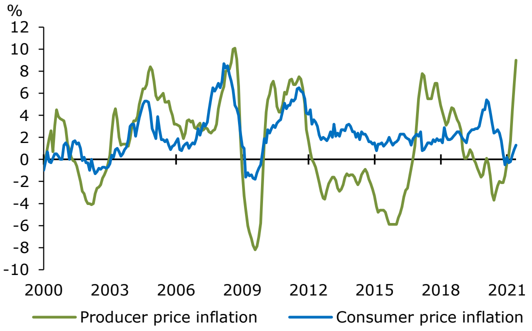


Source: Bloomberg Finance L.P., Alpinum Investment Management

## China and emerging markets

**Economic numbers** have been **moderating lately** but China's underlying strength is still intact. For 2021, market consensus expects **GDP to grow +8.5%** and +5.5% in 2022. The lower than expected economic data is the result of a relatively sharp pullback in total social financing (essentially government supported credit growth). That said, policymakers' pullback was intentional, as **capacity utilization** runs at **77.2%** versus 75.9% two years ago (most relevant pre-Covid 19 comparison). In addition, companies' capital spending (capex) has increased as the financial case for **investing in new capacity** is strong because of high global pent-up demand and low borrowing costs. This is also reflected in **producer price inflation** (chart 4), which increased to 9% on the back of tight supply and higher commodity prices. The quarterly reports of China's 4170 listed non-financial firms show an **upswing in capex** of an annualised 12.9% in Q1 2021 compared to 7.9% two years ago. Unless housing construction and/or exports weaken considerably, the level of capex is well underpinned. One of the **major challenges** for Chinese policy makers remains to spur domestic consumption as retail sales and household spending remain largely below their pre-pandemic levels. On July 1, China's Communist Party will **celebrate its 100th anniversary** under the slogan "follow the Party forever". The celebrations will give Xi Jinping a forum to present himself as the leader in China's transformation to a global power. On the other side of the Atlantic, US President Biden continues to rebuild alliances to curb Beijing's influence. Chinese and EM equities have been underperforming Western stock markets year-to-date and have largely discounted downside risks. This may change in the **second half of 2021** as global capital flows follow profitability and attractive valuations.

**Chart 4: China producer versus consumer price inflation**

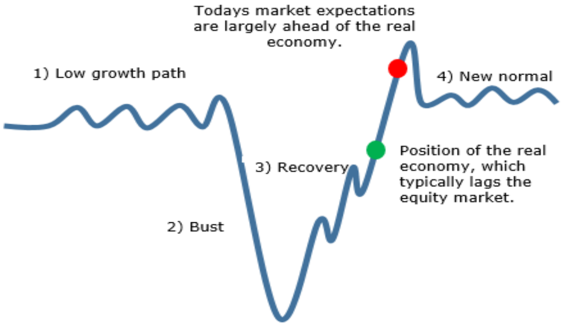


Source: Bloomberg Finance L.P., Alpinum Investment Management

## Investment conclusions

High expectations of economic re-openings and pent-up consumer demand have driven **risk asset prices and valuations** to **lofty levels**. While the real economy is about to play catch-up with the equity market (chart 5 – green dot), the equity market has likely run ahead of itself (chart 5 – red dot). To justify elevated valuation levels, the upcoming **Q2 earnings season** should not disappoint and/or a **new catalyst is needed** to keep the stock market rally alive. Such a catalyst could come in the form of a new cycle in capital expenditure as many companies' balance sheets are "cash rich" and financing conditions remain very favourable. For the **next phase or "new normal"**, equity markets will have to find a new balance factoring in higher inflation, interest rate hikes, stagnation or even stagflation. With so **many inflection points**, capital markets are about to enter a riskier and more volatile spot. Despite the uncertainties, **we expect equities to outperform bonds** over the next three to six months.

### Chart 5: The "new normal" determined by inflation and growth


Todays market expectations are largely ahead of the real economy.
1) Low growth path
4) New normal
3) Recovery
Position of the real economy, which typically lags the equity market.
2) Bust

**Bonds:** Western monetary stimulus continues to support credit-sensitive assets and keeps short-term rates lower for longer. Market consensus does not expect US rate hikes to start before early 2023 and, hence, financial repression will continue. In such an environment, we avoid long duration assets and our focus remains on selective credit risk in European loans, US and Scandinavian short-term high yield and structured credit.

**Equities:** The combination of strong economic growth and accommodative monetary policy could easily cause valuations to overshoot in the near-term. With the many inflection points and their different impacts on regions (US/Europe/emerging markets) and style (value/growth), we favour a well-balanced and diversified equity exposure. Tactical opportunities have yet to open up.

## 2 Market consensus forecasts

| GDP growth % | 2019 | 2020 | 2021e | 2022e |
|---|---|---|---|---|
| World | 2.8 | -3.3 | 6.0 | 4.5 |
| United States | 2.2 | -3.5 | 6.6 | 4.1 |
| Eurozone | 1.3 | -6.5 | 4.4 | 4.2 |
| Germany | 0.6 | -4.8 | 3.4 | 4.2 |
| France | 1.8 | -7.9 | 5.7 | 4.0 |
| Italy | 0.3 | -8.9 | 4.7 | 4.2 |
| United Kindom | 1.5 | n.a. | 6.7 | 5.4 |
| Switzerland | 1.2 | -2.7 | 3.4 | 2.8 |
| Japan | 0.0 | -4.7 | 2.6 | 2.4 |
| Emerging economies | n.a. | n.a. | 5.3 | 5.2 |
| Asia Ex-Japan | 5.4 | 1.4 | 5.7 | 5.7 |
| Latin America | 1.3 | -6.1 | 5.6 | 2.9 |
| EMEA region | 2.5 | -2.9 | 4.1 | 3.5 |
| China | 6.0 | 2.3 | 8.5 | 5.5 |
| India | 6.5 | 4.0 | -7.5 | 9.6 |
| Brazil | 1.4 | -4.1 | 4.9 | 2.3 |
| Russia | 2.0 | -3.0 | 3.4 | 2.5 |

| Inflation % | 2019 | 2020 | 2021e | 2022e |
|---|---|---|---|---|
| World | 3.5 | 3.2 | 3.3 | 3.0 |
| United States | 1.8 | 1.2 | 3.5 | 2.5 |
| Eurozone | 1.2 | 0.3 | 1.8 | 1.4 |
| Germany | 1.4 | 0.4 | 2.5 | 1.6 |
| France | 1.3 | 0.5 | 1.5 | 1.3 |
| Italy | 0.7 | -0.2 | 1.3 | 1.0 |
| United Kindom | 1.8 | 0.9 | 1.6 | 2.0 |
| Switzerland | 0.4 | -0.7 | 0.3 | 0.5 |
| Japan | 0.5 | 0.0 | 0.1 | 0.6 |
| Emerging economies | 3.9 | 3.1 | 3.4 | 3.6 |
| Asia Ex-Japan | 2.6 | 2.6 | 1.6 | 2.6 |
| Latin America | 9.5 | 2.8 | 10.2 | 8.1 |
| EMEA region | 6.0 | 5.2 | 7.1 | 5.6 |
| China | 2.9 | 2.5 | 1.5 | 2.3 |
| India | 3.7 | 6.6 | 6.2 | 5.0 |
| Brazil | 3.7 | 3.2 | 6.0 | 4.0 |
| Russia | 4.5 | 3.4 | 5.5 | 4.0 |

| Central bank rates % | 2019 | 2020 | 2021e | 2022e |
|---|---|---|---|---|
| US Fed Funds | 1.75 | 0.25 | 0.25 | 0.35 |
| ECB Main Refinancing | 0.00 | 0.00 | 0.00 | 0.00 |
| China 1yr Best Lending | 4.35 | 4.35 | 4.30 | 4.30 |
| Bank of Japan Overnight | -0.07 | -0.03 | 0.00 | 0.00 |
| UK Base Rate | 0.75 | 0.10 | 0.10 | 0.20 |
| Swiss 3mth CHF Libor | -0.75 | -0.75 | -0.75 | -0.75 |

| Commodities | 2019 | 2020 | 2021e | 2022e |
|---|---|---|---|---|
| NYMEX WTI oil USD/barrel | 54 | 48 | 67 | 66 |
| ICE Brent oil USD/barrel | 59 | 51 | 69 | 68 |
| Iron Ore USD/metric ton | 91 | 159 | 190 | 73 |
| Copper USD/metric ton | 6174 | 7766 | 9357 | 9389 |
| Gold USD/troy oz | 1518 | 1899 | 1783 | 1791 |
| Silver USD/troy oz | 17.9 | 26.4 | 26.3 | 26.4 |

| Major interest rates % | 2019 | 2020 | 2021e | 2022e |
|---|---|---|---|---|
| USA 3mth rate | 1.9 | 0.2 | 0.3 | 0.4 |
| USA 10yr Gov't Bond | 1.9 | 0.9 | 1.9 | 2.2 |
| Eurozone 3mth rate | -0.4 | -0.5 | -0.5 | -0.4 |
| Eurozone 10yr Gov't Bond | -0.2 | -0.6 | 0.0 | 0.2 |
| China 3mth rate | 3.0 | 2.8 | 2.8 | 2.8 |
| China 10yr Gov't Bond | 3.1 | 3.1 | 3.2 | 3.2 |
| UK 3mth rate | 0.8 | 0.0 | 0.1 | 0.2 |
| UK 10yr Gov't Bond | 0.8 | 0.2 | 1.0 | 1.3 |
| Swiss 3mth rate | -0.7 | -0.8 | -0.7 | -0.8 |
| Swiss 10yr Gov't Bond | -0.5 | -0.6 | -0.1 | 0.1 |

| Exchange rates | 2019 | 2020 | 2021e | 2022e |
|---|---|---|---|---|
| EURUSD | 1.12 | 1.22 | 1.21 | 1.24 |
| EURCHF | 1.09 | 1.08 | 1.12 | 1.14 |
| USDCHF | 0.97 | 0.89 | 0.92 | 0.92 |
| EURJPY | 122.2 | 126.16 | 132.00 | 131.00 |
| EURGBP | 0.85 | 0.89 | 0.85 | 0.85 |
| USDJPY | 108.72 | 103.2 | 109.00 | 110.00 |
| GBPUSD | 1.33 | 1.37 | 1.42 | 1.45 |
| USDCNY | 6.96 | 6.53 | 6.40 | 6.30 |
| USDBRL | 4.02 | 5.19 | 5.12 | 5.30 |
| USDRUB | 62.49 | 74.03 | 71.00 | 72.00 |

Source: Bloomberg Finance L.P., Alpinum Investment Management

Note: Q2 = data as of June 28, 2021 / PE=price-earnings / PB=price-book / EPS=earnings per share / YtW=yield-to-worst

## 3 Performance table

| | | Performance | | |
|---|---|---|---|---|
| **Global equity markets** | **Price** | **Q2** | **Ytd Q2** | **Div.yld** |
| MSCI World (USD) | 3025 | 7.8% | 12.6% | 1.8 |
| MSCI World (USD) hedged | 1470 | 7.9% | 14.5% | n.a. |
| HFRX Global Hedge Fund | 1433 | 2.6% | 4.0% | n.a. |
| S&P 500 | 4291 | 8.4% | 15.0% | 1.4 |
| Russell 1000 | 2419 | 8.6% | 14.7% | 1.3 |
| Nasdaq 100 | 14525 | 12.6% | 13.1% | 0.7 |
| Stoxx Europe 600 | 455 | 5.6% | 13.7% | 2.9 |
| MSCI Emerging Markets | 1381 | 4.7% | 7.1% | 2.4 |
| Nikkei 225 | 28813 | -2.1% | 5.0% | 1.7 |
| China CSI 300 | 5195 | 2.0% | 1.6% | 1.9 |

| | Forward | | EPS growth | |
|---|---|---|---|---|
| **Equity market valuations** | **PE** | **PB** | **2021e** | **2022e** |
| MSCI World (USD) | 20.7 | 3.1 | 79% | 10% |
| MSCI World (USD) hedged | n.a. | n.a. | n.a. | n.a. |
| HFRX Global Hedge Fund | n.a. | n.a. | n.a. | n.a. |
| S&P 500 | 22.7 | 4.3 | 54% | 12% |
| Russell 1000 | 23.5 | 4.3 | 57% | 12% |
| Nasdaq 100 | 29.6 | 8.2 | 47% | 12% |
| Stoxx Europe 600 | 17.7 | 2.1 | 197% | 11% |
| MSCI Emerging Markets | 14.6 | 1.9 | 61% | 9% |
| Nikkei 225 | 19.3 | 1.9 | 70% | 9% |
| China CSI 300 | 16.0 | 2.2 | 17% | 13% |

| | | Performance | | |
|---|---|---|---|---|
| **Global gov't bonds** | **Yield** | **Q2** | **Ytd Q2** | **YtW** |
| 10yr US Treasury | 1.49 | 2.2% | -3.4% | n.a. |
| 10yr Euro gov't bond | -0.18 | -0.7% | -2.5% | n.a. |
| 10yr German gov't bond | -0.18 | -0.4% | -2.3% | n.a. |
| 10yr Italian gov't bond | 0.88 | -1.0% | -2.1% | n.a. |

| | | Performance | | |
|---|---|---|---|---|
| **Global bond indices** | **Price** | **Q2** | **Ytd Q2** | **YtW** |
| Barclays Global Corporate IG | 302 | 2.9% | -1.7% | 1.6 |
| Barclays US Corporate IG | 3507 | 3.4% | -1.4% | 2.1 |
| Barclays Euro Corporate IG | 265 | 0.3% | -0.5% | 0.3 |
| Barclays Emerging Market USD | 1281 | 3.1% | -0.5% | 3.8 |
| Barclays US Corporate HY | 2418 | 2.8% | 3.5% | 3.8 |
| Barclays Pan-European HY | 435 | 1.5% | 3.7% | 3.0 |

| | | Performance | |
|---|---|---|---|
| **Commoditites and currencies** | **Price** | **Q2** | **Ytd Q2** |
| Brent oil | 75 | 16.2% | 45.2% |
| US Energy Services | 63 | 18.4% | 42.8% |
| Copper | 9372 | 6.7% | 19.5% |
| Gold | 1777 | 5.4% | -6.2% |
| EURUSD | 1.19 | 1.7% | -3.1% |
| EURCHF | 1.10 | -0.7% | 1.1% |

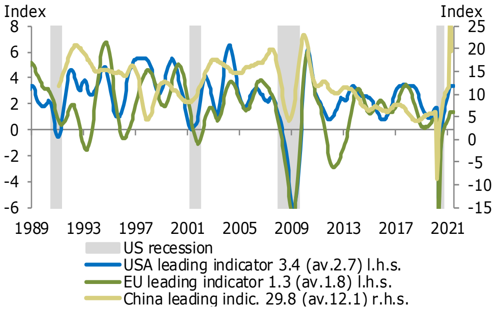
Source: Bloomberg Finance L.P., Alpinum Investment Management

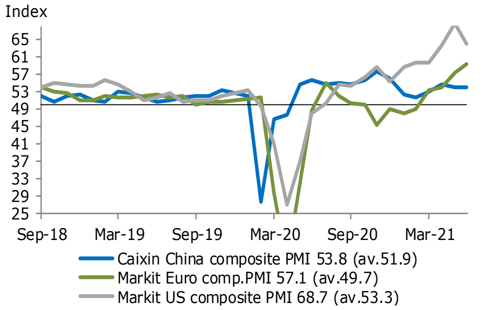
Note: Q2 = data as of June 28, 2021 / PE=price-earnings / PB=price-book / EPS=earnings per share / YtW=yield-to-worst

## 4 Key Charts

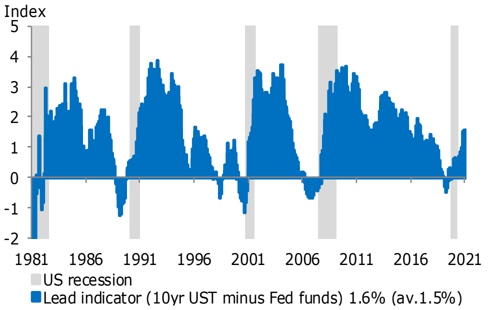
### Leading indicators and manufacturing

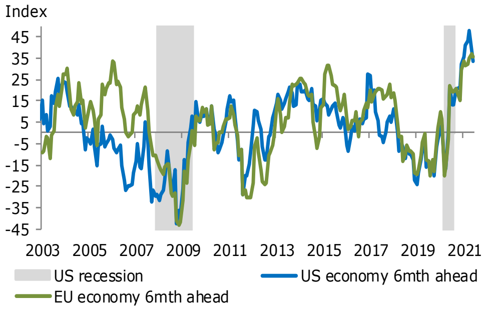
Source: Bloomberg Finance L.P., Alpinum Investment Management



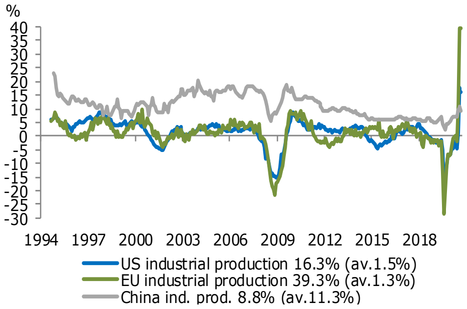


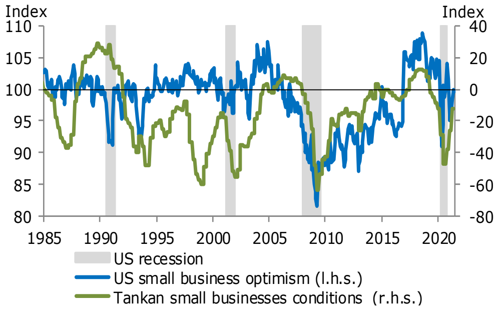
### Recession indicator



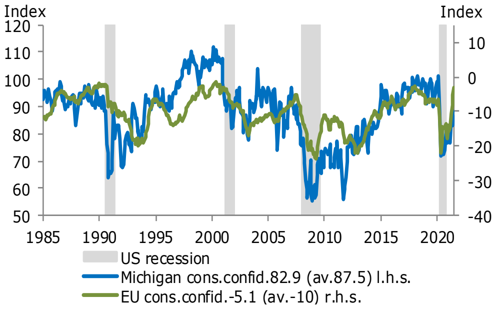


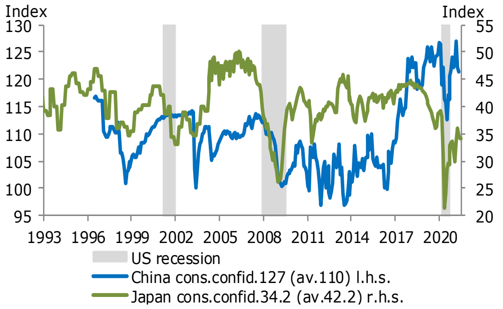
### Industrial production and small businesses





### Consumer confidence





## 5 Scenario overview 6 months

### Base case 70%

- **US:** U-shaped GDP recovery from -3% in 2020 to +6-7% in 2021. US is in the midst of a strong cyclical recovery. Vaccination efforts are paying off and shielding off from large new infection break-outs. On top of unprecedented government and Fed support, we experience reviving personal consumption and infrastructure spending and boosting of business investments.
- **Eurozone** GDP collapsed -7% in 2020 and recovers +~4-5% in 2021. Lagging US recovery, but momentum is on the rise. Southern Europe is still in bad shape as the tourism season will not reach pre-Covid levels. However, huge fiscal stimulus (and solidarity payments from north to south) and unprecedented ECB-actions are a strong support.
- **China:** Avoided recession in 2020 and heading for +8-9% growth in 2021.
- **Oil:** Prices have rallied and keep upward bias with unfolding global economic recovery.

### Investment conclusions

- **Equities:** Experienced a V-shape recovery and trade on 2021/22 earnings expectations. Equities are vulnerable with P/E 2021 multiples >20. If vaccines lose their efficacy vs. new variants a market correction would be the consequence. Otherwise, on-going ultra-loose monetary policy provides continued support to equities. Cyclical stocks remain well bid. We recommend a balanced approach in terms of equity “style”.
- **Interest rates:** Negative stance on rates exposure as upward pressure on yields remains. (US) Duration exposure serves only as a diversifier and tail hedge. Less effective at these levels.
- **Credit:** Credit spreads are fairly priced and corporate default rates are falling. We prefer European loans, Asian high yield (HY) & investment grade (IG) bonds and structured credit exposure.
- **Commodities/FX:** Relative interest advantage favours USD and commodities keep upward bias.

### Bull case 15%

- **US:** V-shaped recovery with GDP growth >+7%. Vaccination roll-out is a big success, social dis-tancing measures are fully lifted and regional lockdowns are avoided. Fiscal stimulus pro-grammes, consumer pent-up demand and capex spending fuel an already “hot” economy.
- **Europe:** Thanks to a strong recovery in 2021 and the immense fiscal (incl. recovery fund) and mone-tary stimulus, peripheral countries find a halt.
- **China/EM:** Strong cyclical recovery as export markets recover (EU/USA) and interest rates in developed markets remain low. This helps easing the pressure on local EM FX depreciation.

### Investment conclusions

- **Equities:** Having already priced in a V-shaped economic recovery, markets start to discount a “Keynesian Golden Age” economy, namely a goldilocks environment for equities and potentially an exaggeration of equity multiples.
- **Interest rates:** Rates remain low, but curve steepens. Avoid duration as inflation revives.
- **Credit:** Corporate default rates have peaked. Credit in general and loans in particular benefit the most.
- **Commodities/FX:** Support for commodity bloc and precious metals. EUR accelerates and selective emerging market FX rates recover.

### Bear case 15%

- **US:** Recovery gets distracted to <+5% in 2021 as infections spike again due to new variants of the virus. Social distancing measures will be re-introduced and new local/regional lockdowns are required. Unemployment rates soar again.
- **Europe:** Peripheral countries recover very slowly and a renewed fallout of international tourism takes its toll. Investors lose faith and Italian long-term yields rise. Germany’s recovery gets meaning-fully interrupted (EU confidence crisis 2.0).
- **China/EM:** Domestic China remains intact, but softer growth numbers and deteriorating exports. Rest of EM does poorly as global trade remains at low levels and currencies depreciate.

### Investment conclusions

- **Equities:** Equities fall but avoid making new lows. Highly priced US equities will lead the correction, followed by Europe.
- **Interest rates:** Rates will go lower, but limited potential out-side of the USD. Support for high quality as-sets (US Treasuries, A and AA corporate bonds or agency bonds). Cash is king!
- **Credit:** Corporate default rates will climb again, but thanks to unprecedented monetary and fiscal spending a collapse of the financial system is avoided. Favour short dated/high quality bonds.
- **Commodities/FX:** Negative for the commodity bloc; USD, CHF & JPY act as a safe haven.

### Tail risks

- Equity (Tech) bubble bursting, liquidity shock.
- An Italian sovereign debt crisis, Euro break up.
- US/China military conflict in the South China Sea.
- Vaccines loses their efficacy/new virus variants.
- Stagflation (reversion of disinflationary era).
- Emerging market meltdown similar to 1998.

## 6 Asset class assessment

### Equities

- We keep our positive bias on equities. Equities get support from the cyclical recovery while inflation is not yet a dominant concern. In addition, equities get natural support due to a scarcity of investment alternatives.
- Overall, we believe equity multiples can stay elevated as we pay low attention to current distorted earnings reports. Our focus is on 2021/22 earnings and a multiple of 18-20 can be well justified.
- We believe in the co-existence of "cyclicals" and structural innovation winners (i.e. big tech). Operating leverage will be a boost for cyclical sectors in 2021 and beyond.
- Non-US equities could finally outperform. This is especially true if the USD stops strengthening. We hold limited overweight positions in Asia/EM and to a small degree in selective European equities.

### Comment

- US equities incorporate advanced valuations compared to other regions. However, the economy is also more resilient with a 2021/22 perspective and also supported by "Big Tech" earnings, which provide a robust floor. Hence, a valuation premium is justified.
- With ultra-loose central banks, high equity multiples are justified, but the air is getting thin at levels >20. i.e. a U.S. P/E ratio of 22 results in an earnings yield of 4.5% and still compares well with a yield of 1.5% for 10 year government bonds. In Europe, this comparison leads to an earnings yield of 5.8% (P/E ratio of 17) compared to negative government bond yields.
- If the vaccine roll-out gains further momentum, so will the cyclical recovery and export-led stock markets; EM/Asia/EU will benefit the most.

### Credit / Fixed Income

- **Rates**: The near-term outlook for interest rate duration risk remains negative. On a structural basis, duration risk is unattractive, especially in Europe and we hold minimal exposure only. Instead, we consider duration exposure as a portfolio diversifier, whereas we favour US Treasuries.
- **IG**: We hold minimal US investment grade bonds and only selective European IG bonds. Asian IG bonds trade at much more attractive valuations.
- **High Yield:** Loans and high yield bonds offer still relative and absolute attractive yields, whereof we prefer loans. Overall, we favour selective US short-term bonds, European loans and EUR CLOs of all risk categories.
- **Emerging Debt:** Emerging market bonds offer a relative value advantage, whereas we favour hard currency bonds as spreads are still relatively wide. We currently hold only very limited selective local currency bonds.

### Comment

- Markets are flooded with liquidity by central banks on a global basis and this will not change any time soon. On the contrary, with the FED's introduction of the "Average Inflation Targeting" framework, the outlook for low rates got further confirmation, while inflation pressure will stay.
- The ECB is committed to keeping rates low for longer to support the economic recovery.
- With "lower for longer", credit spreads remain supported on a broad basis. The general market remains benign for credit, although, selective credits and sectors face some headwinds.
- We like the structured credit market such as US non-agency RMBS or European CLOs.
- Consider harvesting the illiquidity premium from direct loans (corporate/mortgage backed loans).
- We identify also attractive yield in "new" alternatives, but selection and a proper liquidity management are paramount.

### Alternatives

- Credit long-short strategies identify plenty of relative value trades, both long and short.
- Equity long-short strategies benefit from higher volatility and increasing performance dispersion.
- Alternative lending as an asset class is in the spotlight in a "low for longer" rates environment.

### Comment

- The current crisis produces many losers and winners, which is a great hunting ground for active managers. Moreover, the "innovative disruption" also leads to more price dispersion among single securities, industries, as well as asset classes.
- Global macro managers benefit from sharp market movements in either direction.

### Real assets

- Gold benefits when real interest rates fall and vice versa. Hence, it is a complex situation for gold in the short term, while rising inflation and a halt of the USD strength are supportive for gold.

### Comment

- The cyclical recovery is beneficial for commodity prices. Moreover, a weaker USD is beneficial for the whole commodity FX bloc. Gold suffers when (real) rates increase.

## 7 Asset Class Conviction Levels

| **Equities** | Underweight | ← | Neutral | → | Overweight |
|---|---|---|---|---|---|
| North America | □ | □ | ■ | □ | □ |
| Europe | □ | □ | ■ | □ | □ |
| Switzerland | □ | □ | ■ | □ | □ |
| China | □ | □ | ■ | □ | □ |
| Japan | □ | □ | ■ | □ | □ |
| Asia – Emerging Markets | □ | □ | ■ | □ | □ |
| Others – Emerging Markets | □ | □ | ■ | □ | □ |
| **Fixed Income** | | | | | |
| US - Treasury Bonds | □ | □ | ■ | □ | □ |
| Euro - Government Bonds | ■ | □ | □ | □ | □ |
| US - Investment Grade Bonds | □ | ■ | □ | □ | □ |
| Europe - Investment Grade Bonds | ■ | □ | □ | □ | □ |
| US High Yield | □ | □ | ■ | □ | □ |
| US Short Term High Yield | □ | □ | ■ | □ | □ |
| US Loans | □ | □ | □ | ■ | □ |
| US Municipal Bonds | □ | □ | ■ | □ | □ |
| European High Yield | □ | □ | ■ | □ | □ |
| European Short Term Hiegh Yield | □ | □ | ■ | □ | □ |
| European Loans | □ | □ | □ | □ | ■ |
| US/EUR Preferred Securities | □ | □ | ■ | □ | □ |
| US/EUR Asset Backed Securities | □ | □ | □ | ■ | □ |
| Emerging Market Local Currency | □ | □ | ■ | □ | □ |
| Emerging Market Hard Currency | □ | □ | ■ | □ | □ |
| Emerging Market High Yield | □ | □ | □ | ■ | □ |
| **Commodities** | | | | | |
| Gold | □ | □ | □ | ■ | □ |
| Oil (Brent) | □ | □ | ■ | □ | □ |
| **Hedge Fund: Strategies** | | | | | |
| Equity Long-Short | □ | □ | □ | □ | ■ |
| Credit Long-Short | □ | □ | □ | □ | ■ |
| Event-Driven Corporate Actions | □ | □ | □ | □ | ■ |
| Global Macro | □ | □ | □ | □ | ■ |
| **Hedge Fund: Regional Focus** | | | | | |
| Hedge Fund: North America | □ | □ | ■ | □ | □ |
| Hedge Fund: Europe | □ | □ | ■ | □ | □ |
| Hedge Fund: China/Japan | □ | □ | ■ | □ | □ |
| Hedge Fund: Emerging-Markets | □ | □ | ■ | □ | □ |

Note: The above conviction table reflects on the one hand our view of the relative expected return of an asset class versus well-recognized benchmarks such as BarCap Global aggregate (for bonds) and MSCI World (equities), but does on the other hand also partly incorporate our view of the absolute expected return versus "cash".

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