

»Fisch View

Monthly Update – February 2021

As at 26 January 2021

Summary

- Our macro model continues to deliver positive signals for the global economy as well as for equity and credit markets. The underlying catalysts remain the extensive monetary and fiscal stimulus programmes, the robustness of money supply, high cash levels and positive wealth effects among private households, in addition to the Covid-19 vaccination programmes that are being launched worldwide.
- However, owing to the very successful reflation of the financial system by the central banks so far, there will be upward pressure on inflation and long-term interest rates in the medium term. This trend is still weak at the moment and should only strengthen in the second quarter of this year.
- Potential dangers are the currently high equity market valuations, a very high positive market consensus (susceptible to negative news) and markets' growing dependence on monetary policy. This increases the sensitivity of markets to the smallest temporary fluctuations in monetary dynamics. And there is still the risk of US dollar weakness with a chain reaction in the form of rising commodity prices, higher inflation and higher interest rates. In addition, the global economic recovery could slow down if there are delays in vaccinations.
- However, as the positive forces currently outweigh the potential dangers, we remain positioned with slightly increased risk exposure and neutral on interest rate duration.

Highlights and key changes

- The current main risk for the further advancement of financial markets is the great dependence of the system on monetary impulses, and, thus, the high sensitivity to the smallest changes in liquidity supply or monetary (e.g. velocity and multiplier) dynamics.
- One reason for the current positive environment is the expansion of government stimulus. In addition to the US government's very extensive new aid package (American Rescue Plan (ARP)), additional infrastructure programmes are planned for later in the year. The ARP has not yet been approved by the US Congress and could be scaled down. In the event of a reduction, however, a further easing of US monetary policy can be expected as compensation. And very strong fiscal stimulus is also taking effect in Europe. The EU states

have so far launched aid packages amounting to around 24% of GDP and there is still the EUR 1.75 trillion programme at EU level to come.

- Monetary policy remains extremely expansionary. The US Federal Reserve is currently buying USD 120 billion of securities on the market every month (QE), thereby further increasing its balance sheet. The ECB is buying EUR 80 billion per month. The M1 and M2 money supply, which are important for economic growth, are increasing accordingly, thus demonstrating that monetary policy is still effective, and the money created by the Fed and the ECB is reaching the banking system.
- The cash holdings of private households, as well as companies, are at record highs in both the US and Europe. Together with the strong rise in US house prices, the wealth effects that are important for the coming months are having a positive impact on goods consumption.
- There are slight delays in the global vaccination of broad sections of the population. Nevertheless, a lasting effect should become visible in the foreseeable future. In addition, there is the immunity of all those people who have already contracted Covid-19. Here, a worldwide population share of 10 to 15 percent is estimated. Another positive development is the creation of modified vaccines that target the new Covid-19 mutations.
- The global economic upswing is running relatively synchronously. However, the most important impulses are coming from China, which are generating positive global feedback.
- However, there are a number of dangers that are not yet acute: The high absolute valuation of the stock markets (P/E ratios of 30 and higher) is becoming increasingly problematic. According to Fed President Jerome Powell, this is put into perspective by the low interest rates. Nevertheless, markets are very susceptible to the smallest disturbances in the form of rising interest rates or temporary monetary air pockets. In contrast, corporate bond markets are in a neutral valuation territory, and the emerging market segment is even slightly cheap.
- Monetary disturbances can be triggered without central bank intervention, for example by falling velocity of circulation of money, falling dollar exchange rates, rising inflation expectations or the markets' anticipation of a change in monetary policy (tapering discussions). The latter has been ruled out by the Fed and the ECB for the time being. Nevertheless, fears of tapering can arise at any time.
- Various factors are currently having a negative impact on the development of the US dollar. On the one hand, the US currency is overvalued in terms of its purchasing power parity (PPP) and the Fed is increasing the money supply via securities purchases (QE) more strongly than the ECB. In addition, historically stronger economic growth in the US with higher inflation and higher interest rates have often been a drag on the US currency.
- Other dangers include the prevailing very high consensus among market participants that stock markets will rise as long as the stimulus flows. Retail investors are already in a state of euphoria that could turn into panic at any time. Triggers for this could be the announcement of corporate tax increases in the US or regulatory interventions at major corporations, as well as an economic slowdown due to possible delays in vaccinations (double-dip recession).
- Nevertheless, the positive drivers still predominate at present. The potentially dangerous trends in the US dollar, inflation and long-term interest rates are still very moderate and even desired by the central banks. In the event of a double-dip recession or tax increases in the US, the ECB and Fed would once again initiate massive countermeasures. And experience shows that overheated market sentiment or fears of tapering only lead to

temporary market slumps. Tapering only has a strong negative impact once it is actually implemented.

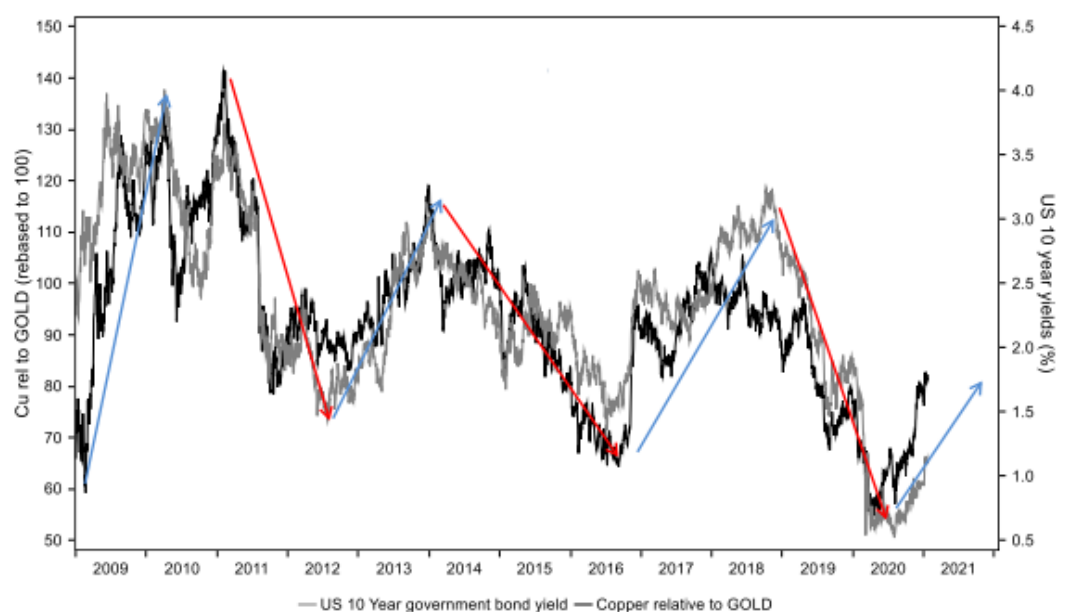
- The overall positive environment is directly confirmed by some of our macro model indicators (yield curve, copper price and M1 money supply dynamics). The cycle sub-model also signals still intact growth potential. However, the input consistency (=model confidence level) is currently relatively low, as the various input parameters partly contradict each other. This is a confirmation that the global financial system could react very sensitively to potential disruptions. We are therefore slightly reducing the risk exposure in our strategies, but remain overweight compared to the respective benchmarks. Duration is in a neutral range.

Topics “on the radar”

The current positive drivers of financial markets (monetary and fiscal stimuli, money supply growth, high cash holdings and wealth effects) have for some time been resulting in a reflation of the financial system, as desired by central banks. As a medium-term consequence of this, various forces are driving long-term interest rates upwards, especially in the US, because of the added effect of a weaker US dollar.

The chart shows a comparison of the development of interest rates on ten-year US government bonds with the copper/gold ratio. Historically, a (relative) rise in copper against gold has always led to a rise in interest rates. We are currently in such an upward phase, which confirms the successful reflation of the system. According to this indicator, US interest rates could rise into the 1.5–1.7% range by the middle of the year.

Chart: Ten-year US government bond yield vs. copper/gold ratio



Source LongView Economic Research

Summary of *FischView* model outputs

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA	Key:
Equities	+	+	+	+	+ ↓	+	++ Strong positive
Government Bonds	o	o	o				+ Positive
Credit IG	+	+		+	+	+	o Neutral
Credit HY	+	+		+	+	+	- Negative
Convertibles	+	+	+	+			-- Strong negative

Commodities	Energy:	+	Prec. Met	+	Indu. Met	++
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Notes regarding the table: Changes from prior month are indicated with ↓ or ↑. i.e. "O ↓" means that the output has weakened from a prior value of + or ++.

The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained [here](#).

Within government bonds, we consider the most important bonds for each region, e.g. German Bunds in Europe, and a representative group of countries for Latin America, Asia ex-Japan and CEEMEA (Central and Eastern Europe, Middle East and Africa).

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