

»FischView

Monthly Update – June 2021

As at 25 May 2021

Summary

- **Loose monetary policy together with high fiscal stimuli continue to drive solid global economic growth**
- **However, various leading indicators signal a slight slowdown in economic momentum in the US and China**
- **The reasons for the slowdown in growth are weakening consumer sentiment due to fears of inflation, as well as a slowdown in the real estate market reflecting higher interest rates**
- **The Chinese central bank is pursuing a moderately more restrictive monetary policy, thus additionally dampening growth and inflation in China but also globally**
- **The current slowing economic environment allows for a continued expansionary monetary policy without risks for inflation and long-term interest rates**
- **The positive "goldilocks" environment for equity and credit markets persists**
- **High valuations, however, dampen the upside potential**
- **Long-term interest rates are under slight upward pressure**

Significant changes compared to the previous month

- Compared to the previous month, a slight but clearly discernible slowdown in economic momentum is noticeable in the US and China. In the US, on the one hand, there are base effects. The high growth rates coming out of the pandemic low are beginning to normalise and, at the same time, there are supply bottlenecks for important products (e.g. semiconductors, building materials, containers) due to the rapid reopening of the economy. In addition, US consumers are increasingly focused on potential future problems, such as higher inflation and tax increases.
- In China, on the other hand, a more restrictive monetary policy from the Chinese central bank (PBoC), which has been in place for some time, is having an increasing impact. The Chinese economy recovered much earlier than other economies. The authorities are therefore aiming for a sustained upswing without symptoms of overheating. In particular, an excessive wave of lending ("leveraging") within the private banking system is to be prevented.

- China's more restrictive monetary policy is also having a dampening effect globally. In the US, some leading indicators (ISM Manufacturing Index, housing market, consumer confidence, Chicago Fed National Activity Index) are beginning to confirm the loss of momentum in the US economy. In China, the pace of bank lending is slowing significantly. In addition, money supply growth is slowing and the PBoC's balance sheet and Chinese foreign exchange reserves are falling.
- The economic slowdown has been evident in recent weeks in the form of a stabilisation of long-term interest rates, despite a very sharp rise in inflation in the US. In addition, the economically sensitive copper price corrected downwards. Market participants realise that the inflation threats are only temporary. The equity and credit markets are benefiting from this non-overheating and balanced environment.

Current situation and positioning

- The economic slowdown in the US and China is extremely positive for financial markets. Inflationary risks and the rise in long-term interest rates are being dampened and a globally well-balanced upswing is emerging.
- The Chinese central bank and government are currently doing a good job, skilfully steering through a potential danger zone between too much and too little growth. This policy also has a stabilising effect globally.
- Despite the economic slowdown, we do not expect a recession. The money supply remains very generous and the fiscal stimuli are still having a noticeable effect going into the third quarter, and this will probably last beyond Q3 (albeit to a lesser extent).
- In addition, consumers in the US and Europe still have high cash reserves, some of which will be used for consumption in the coming months, thus ensuring stable demand at a high level. However, consumer sentiment is currently somewhat dampened due to inflation fears. Possible tax increases in the US are also creating a need for more savings and putting pressure on consumers' purchasing power. The current dampener is healthy, however, spreading the consumption potential more evenly over the coming quarters.
- In the current environment, central banks thus retain full control over the economic cycle, inflation and the long-term interest rate level. The hitherto very loose monetary policy can be continued risk-free for the time being. Markets are currently reacting very positively to statements by central banks and also to ongoing economic data releases. This signals a high level of confidence in monetary policy and is a favourable signal for the market.
- However, the positive market conditions can change at any time due to potential disruptive factors. Supply bottlenecks for various goods due to the rapid economic opening could also lead to an inflationary push in the longer term, which has not yet been priced into the market. In addition, we expect second-round effects (acceleration effects) in inflation in the medium term due to rising wages. As soon as this is the case, the situation will become extraordinarily difficult for central banks. However, no immediate danger is evident here yet. Wages are rising in both the US and Europe, but in a very controlled way and only in certain sectors. Moreover, labour markets are still too far from full employment to trigger major inflationary pressure.
- Thus, the environment for equity and credit markets (especially high yield) remains favourable. The trends in economic activity, inflation and long-term interest rates remain moderately upwards and under the control of central banks. The continuing loose

monetary policy and the further increase in money supply form an extremely strong support.

- However, markets are expensively valued in terms of P/E ratios and the Fed model, as well as historical credit spreads, and are thus vulnerable to disruptions. In addition, there is negative seasonality in equity markets for the months of May to October. Therefore, we see only limited upside potential combined with rising volatility. Interest rate-sensitive securities and growth stocks should perform somewhat better again due to only moderate upward pressure on interest rates. However, we continue to prefer cyclical stocks that benefit more from a global normalisation of the economy, especially in Europe.
- The US dollar remains under pressure due to the Fed's aggressive monetary policy and a strongly negative US trade balance. The previously very strong trends in many commodities (copper, oil, soft commodities) are likely to weaken slightly due to the economic slowdown. However, major setbacks are not to be expected from a fundamental perspective.

Topics “on the radar”

Chart: Consumer sentiment in the US is slightly weakening



Source: TradingEconomics/University of Michigan

Consumer sentiment in the US continues to recover from the pandemic low in the medium term, but is taking a break in the short term. Moreover, the pre-crisis level is still far away. Base effects, consumer restraint due to inflation fears and the threat of higher taxes, the recent rise in long-term interest rates and the economic slowdown in China are having a dampening effect.

However, the dampener is moderate. Moreover, consumption is likely to take off again in the foreseeable future, as there are currently still very high savings balances for future purchases and investments. A probable easing on the inflation front from the third quarter onwards should then provide an additional boost.

In Europe, consumer confidence is currently still clearly on the rise. Overall, Europe is benefiting more than the US from the global economic recovery and still has significant re-opening steps of the economy ahead of it as Covid-related restrictions are lifted.

Summary of *FischView* model outputs

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

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible Bonds	<ul style="list-style-type: none"> – Reopening beneficiaries – Cyclical 	<ul style="list-style-type: none"> – Growth (software/e-commerce) – Covid-19 winners
Global High Yield	<ul style="list-style-type: none"> – 'B' rating segment – Telecoms – Basic industry 	<ul style="list-style-type: none"> – Banking – Transportation
Emerging Market Corporates – Defensive	<ul style="list-style-type: none"> – Colombia – China – United Arab Emirates 	<ul style="list-style-type: none"> – South Korea – Qatar – Russia
Emerging Market Corporates - Opportunistic	<ul style="list-style-type: none"> – Africa – China 	<ul style="list-style-type: none"> – Argentina – Oman
Global Corporates	<ul style="list-style-type: none"> – Energy – TMT – 'BB' rating segment 	<ul style="list-style-type: none"> – Real estate – Banking – 'B' rating segment

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

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