



Monthly Update - November 2021

As at 26 October 2021

Summary: "Goldilocks light"

- A combination of globally solid economic growth, loose monetary policy and controlled inflation trend persists
- This is a "Goldilocks light" environment, with no stagflation scenario in sight for the time being
- Inflation continues to be driven by different factors: short- to medium-term cushioning, but with structural upward pressure in the longer term
- Central banks currently still have the situation well under control but a tightening of very loose monetary policy is imminent
- The environment for equity and credit markets remains positive: but upside potential is limited and short-term corrections are possible
- The trend in long-term interest rates remains upward in the medium term,
 but could plateau in the short term
- The US dollar could come under pressure in the medium term but no clear trend is evident at present

Significant changes compared to the previous month

- Global economic growth remains very solid. However, global supply-chain problems and and the effect of declining consumer confidence, due to higher inflation, have recently started to have a dampening impact. Nevertheless, both factors should be temporary and might not lead to a major slump in growth or, worse still, stagflation.
- A negative exception is China, where the economy is being slowed by a real estate crisis.
 However, this slowdown is desired by the Chinese authorities and will therefore continue for some time at a measured level. In the medium term, this is likely to have a dampening effect on global growth.
- However, an escalation of the problems in China is not to be expected. The central bank (PBoC) has already been moderately easing monetary policy for some time and appears to have the situation under control.
- Due to the aforementioned combination of growth-dampening factors (supply chain problems, consumer confidence and the Chinese deceleration), the room for manoeuvre is also becoming somewhat larger once more for the Fed and the ECB. Although a tightening of monetary policy remains likely, it is likely to be more moderate than previously expected.

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— This means that there is still a Goldilocks environment for financial markets, albeit with slightly weaker upside potential (i.e. "Goldilocks light").

Current situation and positioning

- Global economic growth remains robust and is further supported by an inventory rebuilding cycle, high household cash balances and rising real estate prices. However, the above-mentioned issues are weakening the upswing somewhat.
- Due to this dampening of the growth momentum, the potential continuation of very loose monetary policy will again be attuned to the fundamental environment, rather than a tightening by historical precedent. A shift towards a more hawkish stance remains necessary, albeit to a lesser extent given a drop in euphoric sentiment. The central banks will therefore again have a little more room for manoeuvre in continuing their support measures. The danger that the central banks "fall behind the curve" and are forced by markets to take more stringent measures is diminishing.
- Overall, this combination of solid but moderate economic growth, loose monetary policy and a controlled inflation trend results in a classic Goldilocks environment, which in view of the dampening factors has been lowered to "Goldilocks light".
- However, the economic slowdown is likely to be only temporary and a resurgence in the foreseeable future seems likely. At the same time, inflation momentum is likely to slow down again temporarily. Thus, the danger of a currently much-discussed stagflationary scenario is very small for the time being. However, the situation can change quickly, in which case timely early warning signals from economic and inflation indicators should be expected.
- Overall, the general environment for equity and credit markets thus remains positive.
 However, the risk of a temporary correction in the equity market is increasing. High
 valuations, somewhat less momentum in monetary policy as well as a possible decrease
 in the momentum of corporate earnings would constitute a sound rationale for such a
 market correction.
- The trend in long-term interest rates remains upwards. But here, too, a temporary consolidation with slightly lower rates is possible at any time for the reasons mentioned. The US dollar currently remains an important reserve and safe-haven currency in a sideways trend. In the longer term, however, there are potentially weakening factors (US trade balance and a lower purchasing power parity).
- Various short-term and long-term or structural factors are at work in terms of inflation, which makes it difficult to accurately assess future developments. In the short term, inflation should ease due to the obsolescence of ultra-low base effects on emerging data, a calming of energy and real estate prices as well as the aforementioned slight loss of economic momentum. In the longer term, however, rising wages, dried-up labour markets, partial deglobalisation, high consumer cash holdings and still rising money supply will ensure an inflation potential that is likely to exceed the central banks' target of 2%. However, this increased inflation potential is already included in the majority of consumers' and investors' expectations and should not cause any major negative surprises for financial markets.

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Topics "on the radar"

Chart: Inflation expectations for US consumer prices rise



Source TradingEconomics / Federal Reserve Bank of New York

The danger of "stagflation" is currently being discussed intensively among participants in financial markets. Stagflation is a combination of decelerating growth and rising inflation, which would be a very difficult problem for central banks to solve. To combat inflation, a more restrictive monetary policy would have to be implemented, which would further increase recessionary pressures.

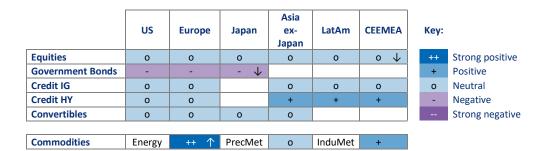
Expectations regarding the development of inflation play a decisive role in the emergence of stagflation: Especially at present, the expectation of higher consumer price inflation (see chart above) is causing consumer sentiment to deteriorate, and thus harbours potential dangers for consumption, and a consequent disruption in economic equilibrium.

Rising inflation expectations can additionally amplify actual inflation via second-round effects on wages, and thus increase the risk of stagflation. Further developments must therefore be closely monitored.

On the positive side, the momentum of inflation expectations is already declining slightly. Other factors and base effects are currently providing a temporary easing of the actual inflation situation. Thus, at least for the moment, the danger of stagflation is limited. However, expectations can change quickly and are difficult to predict. Consequently, a certain residual risk of a deterioration in the prevailing symmetry remains for the time being.

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Summary of FischView model outputs



Notes regarding the table: Changes from prior month are indicated with \downarrow or \uparrow . i.e. "O \downarrow " 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	Cyclicals (industrials, materials)	Interest rate sensitives (real estate)
Global IG Corporates	Banking, energySpread duration 5-10"Rising Stars"	Real estate, utilitySpread duration > 15'AA-A' rating segment
Global Corporates	Banking, energySpread duration 5-10"Rising Stars"	Real estate, utilitySpread duration > 15'AA-A' rating segment
Global High Yield	'B' rating segmentTelecomsBasic industryEnergy	BankingTransportationReal estate, especiallyChina
Emerging Market Corporates - Defensive	IndonesiaRussia	SingaporeTaiwan
Emerging Market Corporates - Opportunistic	High yield commoditiesIndiaSub-Sahara Africa	BahrainQatar

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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