Light On The Horizon

Macro
One year after the first COVID-19 deaths in Europe and the US, new strains of the virus are forcing governments to keep restrictions tight for now. As a result, consumers have chosen to boost savings rather than spend and – although business confidence has recovered in manufacturing – many service businesses continue to struggle. This means that fiscal support programmes – such as President Biden’s USD 1.9 trillion plan – remain indispensable buttresses for developed economies. At the same time, vaccination programmes have accelerated – notably in the UK and the US – which offers hope that lockdowns will be eased by summer, heralding a synchronised cyclical recovery in H2.

Central Banks
Stronger demand from industry, output cuts and bottlenecks in supply chains have pushed many commodity prices to multi-year highs, kindling fears of rising inflation. Indeed, the year-on-year comparisons with last spring’s collapse in oil prices are likely to drive headline prices higher by summer. However, central banks have reiterated that they view these pressures as transitory – in his recent testimony to Congress, Federal Reserve (Fed) chair Jay Powell emphasised that inflation risks remain to the downside. In this context, we believe central banks will ensure that financial conditions remain very accommodative, keeping key rates unchanged and pursuing asset purchase programmes at current rates.

Markets
The impending cyclical upturn, the size of Biden’s fiscal plans and emerging inflationary pressures have combined to push bond yields ever higher since last summer, taking them back to pre-crisis levels. As is often the case – discounting long-term cash flows at higher rates leads to a lower net present value for equities – equity markets have come under pressure recently, particularly highly-valued growth stocks while cyclicals and value stocks have held up better. With bond and equity prices trading lower in late-February, the US dollar has seen some safe haven flows, gaining ground against both advanced and emerging market currencies.

Bottom line
Our confidence in global equity markets remains intact and we continue to hold a strong Overweight position. In terms of regions, our preferences remain those markets with greatest sensitivity to cyclical recovery, most notably emerging markets, Japan and the euro zone. Our sector allocations aim for broad diversification between growth stocks (in technology for example) and undervalued laggards which should benefit from the upturn in the cycle. Within fixed income markets, we are Underweight across the board, with the exception of emerging market bonds. Finally, our view on the US dollar is unchanged – we expect the greenback to shed further ground over 2021.

In accordance with the applicable regulation, we inform the reader that this material is qualified as a marketing document.

CA25/H1/21

Unless otherwise specified, all statistics and figures in this report were taken from the following sources on 05/03/2021: Bloomberg and Datastream.
The table below presents the latest conclusions of our Global Investment Committee.

### Summary house views

<table>
<thead>
<tr>
<th>Positioning</th>
<th>O/W</th>
<th>N</th>
<th>U/W</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overweight</td>
<td></td>
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<tr>
<td>Neutral</td>
<td></td>
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<tr>
<td>Underweight</td>
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</tr>
</tbody>
</table>

*Duration:
- Long – 7-10 years
- Intermediate – 5-7 years
- Short – 3-5 years

#### Global Equities
- United States
- Eurozone
- United Kingdom
- Japan
- Emerging

#### Global Rates
- U.S. Treasuries
- Bunds
- Gilts
- EM Govies ($)

#### Fixed Income
- U.S. IG
- U.S. HY
- EMU IG
- EMU HY
- UK IG
- UK HY

#### Duration
- USD*
- EUR*
- GBP*

#### Forex
- EURUSD
- USDJPY
- GBPUSD
- EURCHF
- EM FX (vs. USD)

#### Commodities
- Brent
- Gold

#### Alternative Strategies
- L/S Equity
- Event-Driven
- FI Arbitrage
- Global Macro / CTAs
**EQUITIES**

<table>
<thead>
<tr>
<th>Country</th>
<th>Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>We remain Neutral on US equities, which reached new all-time highs in mid-February and stress the importance of diversifying into more cyclically-sensitive, undervalued sectors.</td>
</tr>
<tr>
<td>Eurozone</td>
<td>Eurozone equities resumed the outperformance begun in November as markets reacted to excellent vaccine trial results. We continue to be Overweight the region with a preference for more cyclically-sensitive sectors.</td>
</tr>
<tr>
<td>UK</td>
<td>We remain Neutral given stringent lockdown restrictions and Brexit disruptions, which will have a strong impact on the UK economy.</td>
</tr>
<tr>
<td>Switzerland</td>
<td>The market is dominated by high-quality, defensive stocks, which should help cushion any downside.</td>
</tr>
<tr>
<td>Japan</td>
<td>We remain Overweight on Japanese equities, which recently reached levels not seen since early 1991 but this time without any exaggeration in valuations.</td>
</tr>
<tr>
<td>Emerging (EM)</td>
<td>We expect a stronger recovery in growth in Emerging countries than in advanced economies. We continue to hold a strong Overweight position.</td>
</tr>
</tbody>
</table>

**FIXED INCOME**

<table>
<thead>
<tr>
<th>Category</th>
<th>Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sovereigns</td>
<td>Government bonds remain unattractive, offering negligible or negative yields to investors. We remain at strong Underweight.</td>
</tr>
<tr>
<td>Duration*</td>
<td>We still prefer shorter-dated bonds, which are less sensitive to any rises in rates.</td>
</tr>
<tr>
<td>Inflation-linked</td>
<td>We expect a pick-up in headline inflation over the spring given the rise in energy prices since last April’s crash.</td>
</tr>
<tr>
<td>Investment Grade</td>
<td>Spreads have tightened further towards historic lows and we remain Underweight.</td>
</tr>
<tr>
<td>High Yield</td>
<td>With yields hitting new all-time lows in mid-February, HY offers insufficient compensation for default risk and we remain Underweight.</td>
</tr>
<tr>
<td>Emerging debt (in € and $)</td>
<td>We continue to prefer Asian issuers given the cyclical upswing which is well underway.</td>
</tr>
</tbody>
</table>

**CURRENCIES**

<table>
<thead>
<tr>
<th>Currency</th>
<th>Analysis</th>
</tr>
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<tbody>
<tr>
<td>EUR/USD</td>
<td>The Euro continues to carry an unjustified undervaluation in purchasing power parity terms, by some -16%.</td>
</tr>
<tr>
<td>GBP/USD</td>
<td>Sterling has been the best performing major currency YTD against USD thanks to the UK’s rapid vaccination rollout relative to other advanced economies</td>
</tr>
<tr>
<td>EUR/GBP</td>
<td>Post-Brexit disruptions may weigh on sterling against the euro in coming months.</td>
</tr>
<tr>
<td>USD/JPY</td>
<td>This optimism has pushed safe havens like JPY lower but, with USD/JPY now close to fair value, we remain Neutral.</td>
</tr>
<tr>
<td>EUR/CHF</td>
<td>Confidence has grown that 2021 would see global cyclical recovery, which has helped weaken the franc. We expect a period of consolidation in EUR/CHF.</td>
</tr>
<tr>
<td>Emerging</td>
<td>We expect the renminbi to consolidate in coming months before heading higher again.</td>
</tr>
</tbody>
</table>

**ALTERNATIVES**

<table>
<thead>
<tr>
<th>Category</th>
<th>Analysis</th>
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<tbody>
<tr>
<td>Hedge funds</td>
<td>Our preferred strategies are Special Situations, directional L/S Equity, discretionary Global Macro and CTAs.</td>
</tr>
<tr>
<td>Gold</td>
<td>Fiscal spending and hopes of easing lockdown restrictions have weakened demand for safe havens. Gold prices should recover once real rates fall again.</td>
</tr>
<tr>
<td>Oil</td>
<td>We expect oil prices to consolidate in coming months as supply cuts compensate for sluggish near-term demand.</td>
</tr>
</tbody>
</table>

Source: SGPB, 05/03/2021

* Duration: short = 3-5 years, medium = 5-7 years, long = 7-10 years
HY = High Yield bonds (higher return but greater risks), IG = Investment Grade bonds (higher quality but lower return)
Inflation expectations pressure yields

The investing world has been sent into a tailspin as it digests the possibility of renewed inflation, a paradigm shift after decades of anaemic price rises. Indeed, ever since the Great Financial Crisis (GFC), the spectre of deflation has been the overarching concern for major central banks.

This potential sea change has several currents. One, while neither quantitative easing (QE) nor deficit spending are novel, the sheer scale being used today certainly is. Most notably, the Biden administration is pushing through a $1.9 trillion fiscal package on top of the $900 billion support bill passed by his predecessor in late December – together, a staggering 13.4% of GDP. And central banks are doing their part. The European Central Bank’s (ECB) cumulative purchases have shot up from 39% of GDP to 63% over the past 12 months.

Two, money supply has shot up dramatically, particularly in the US. Nothing on this scale occurred after the GFC because much of the QE stayed on bank balance sheets. Demand for loans was muted and so the money multiplier stayed low. The difference this time is the scale of fiscal spending with much of it going straight to households via direct payments, up to $3,200 each for the poorest Americans for example if the Biden aid package gets approved. This is unprecedented.

Three, with a rapid ramp-up in vaccinations in most developed countries, expectations are that spending will surge once restrictions on mobility are lifted later in the year. Economists fear that unleashed consumer spending will overheat the global economic recovery and stoke the inflation pressures fomented by government spending and monetary excess.

Lastly, raw material prices have shot up over the past few months – the Bloomberg Commodity Spot index is up 34% over the past twelve months.

For these reasons, inflation expectations have surged from the historical lows witnessed in the throes of the pandemic last year (see chart below). This has huge market implications. Inflation fears have driven yields on government bonds around the world sharply higher as investors demand more yield to preserve inflation-adjusted incomes. This in turn has had an impact on equity markets. In recent years, investors have been tolerant of higher valuations given the negligible or negative rates set by central banks and historically low bond yields. However, discounting long-term cash flow growth at higher rates leads to a lower net present value for highly-valued equities.

It is our belief that markets have got ahead of themselves with inflation expectations, given today’s gaping wide output gaps. Unemployment levels remain high, there is huge underutilised capacity in factories and retail outlets and there are broad swathes of the economy which rely on handouts from the government simply to stay afloat. This enormous excess capacity must be worked through before wage pressure and bottlenecks begin to push underlying inflation higher. Moreover, long-term structural trends such as aging and inequality remain entrenched too – older, richer people tend to save more and spend less.

Bottom line. We expect a rise in inflation this year as the above factors work through the system but think this will be a transitory phenomenon, not structural, given the slack in the economy. Moreover, we take central bankers at their word that they have little intention to raise rates until pre-pandemic level of unemployment and economic activity are firmly in hand. It is much more likely they act to curb the increase in yields – buying long-dated bonds as part of ongoing QE programs for example – than raising rates and endangering a nascent recovery.
Many fixed-income markets saw record high prices and record low yields in January, on sustained central bank purchases. With little value left, our allocations to sovereign bonds are Strong Underweight and “credit” – i.e., investment grade (IG) and high yield (HY) corporate bonds – exposure has been cut to Underweight.

**Sovereigns**

**US.** Yields continued to surge higher in February on hopes of massive fiscal stimulus and multi-year highs in commodity prices. Moreover, strong progress in vaccination programmes has strengthened conviction that lockdown restrictions will be phased out, paving the way for a strong H2 recovery. Nonetheless, there are areas of concern, most notably the job market where the number of Americans in employment is still almost 10 million below pre-crisis levels. This suggests that the Fed is likely to keep policy easy, continuing its massive Treasury purchases which will help keep a cap on yields.

**Eurozone.** Upside in core sovereign bond yields has been relatively modest with 10-year German Bund yields at -0.34%, only 30 basis points (bps) above November’s lows. This reflects the double-dip recession caused by the continued lockdowns and curfews in place and the sluggish start to vaccination programmes across the region. Moreover, the European Central bank (ECB) has given every indication that asset purchase programmes are likely to continue at the current rapid pace. Nonetheless, with cyclical recovery looming in H2, there is little scope for core bond yields to fall much lower.

**UK.** 10-year sovereign (“gilt”) yields shot higher in February, gaining almost 50 bps as world-leading progress in vaccinations raised hopes of rapid economic recovery. And with core inflation at 1.4% in January, many investors feel yields can only rise. Nevertheless, the economy remains mired in recession and restrictions are only due to fully lifted in June. Moreover, although the Bank of England has ruled out negative key rates, it is unlikely to tighten monetary policy in the foreseeable future. All said, further upside in gilt yields should be limited for now.

**Credit**

**US.** IG yields have tracked Treasury yields higher since year-end, leaving “spreads” (i.e., yield differentials) very close to 2018’s decade lows. Speculative grade HY bond yields hit all-time lows in mid-February and, with spreads close to multi-decade lows, offer little protection against default risk. We see little change in the outlook for USD corporate bonds and – with low yields and tight spreads – we remain Underweight.

**Eurozone.** After reaching an all-time low in mid-December at 0.0%, yields on euro IG bonds have tracked core sovereign yields modestly higher. However, spreads over Bunds are only 74 bps – just 20 bps more than Spanish government bonds – and offer little value for investors. Yields on HY bonds are little changed in recent weeks and still only just above the 2017 all-time lows. The economic environment is likely to worsen under the weight of lockdown restrictions, which is likely to place weak balance sheets under great pressure. In all, we remain Underweight euro-denominated credit.

**UK.** Sterling-denominated credit holds little more promise. IG spreads over gilts hit all-time lows in mid-February and have barely widened during the recent sharp rise in sovereign yields. HY spreads at 275 bps are tighter than for comparable credit in euros or dollars. In part this may reflect optimism about vaccine-fuelled recovery but such spreads fail to compensate for default risk.

**Emerging Market (EM) debt**

EM sovereign bonds tracked Treasuries lower in February leaving spreads virtually unchanged over the month at an attractive 300 bps. EM economies are set to register a sharp acceleration in growth as the global economy recovers from the pandemic – the International Monetary Funds expects +6.3% this year and +5.0% in 2022. Nonetheless, yields remain close to all-time lows and we have capped our allocation at Neutral.

**10-year Treasury yield hits highest level in a year**

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EQUITIES

Still bullish

We maintain a strong Overweight allocation to global equities, with a regional focus on emerging markets (EM), Japan and the euro zone. In terms of sectors, investors should aim for a balance between quality growth and undervalued cyclical sectors. In a context of rising bond yields, we expect the recovery in “value” stocks to continue.

US. Recent rises in bond yields have put downward pressure on equity markets, in particular those with the highest valuations. Nonetheless, US stocks remain only around 3% below their all-time highs reached in mid-February. At the same time, there has been a switch in market leadership – smaller stocks have outperformed large caps (the Russell 2000 index of smaller companies has outstripped the larger stocks in the Russell 1000 by almost 24% since the first vaccine announcements in early November) and cheaper “value” stocks have done better than more pricy “growth” companies (the Russell 3000 Value index has surpassed its Growth equivalent by almost 11% over the same period).

US equities remain expensive on many measures – the price to forward earnings ratio is currently at 23 times, a level only exceeded during the tech stock bubble in early 2000. With higher rates putting pressure on multiples, we remain Neutral on US equities and stress the importance of diversifying into more cyclically-sensitive, undervalued sectors.

Eurozone. In February, euro zone equities resumed the outperformance begun in November as markets reacted to excellent vaccine trial results and investors began to rotate portfolios towards laggard markets with relatively cheap valuations and high sensitivity to the economic cycle. The initial ramp-up of vaccinations across the EU has disappointed and new virus mutations have kept restrictions and curfews in place, a combination which is likely to keep the region in recession until spring. However, government fiscal support remains generous and the ECB shows no sign of abandoning its commitment to easy monetary policy.

With vaccination programmes beginning to accelerate, we remain confident that the euro zone will join the US and the UK in cyclical recovery in H2, perhaps with a two-month lag. Analysts have already begun to revise earnings expectations higher (see chart) and we remain Overweight with a preference for more cyclically-sensitive sectors.

UK. Business confidence surveys improved sharply in February, encouraged by world-leading progress on vaccinations, and the government has announced a detailed roadmap to lift all restrictions by late June. However, sterling has strengthened appreciably against USD and EUR, unwelcome news for UK exporters as they adjust post-Brexit red tape and a headwind for large-cap groups with substantial overseas earnings. All in all, we remain Neutral.

Switzerland. Since last November, Swiss equities have lagged their peers as investors have switched focus to more cyclically-sensitive markets like the euro zone. The market is dominated by high-quality, defensive stocks – which should help cushion any downside – but is unlikely to resume outperformance for now.

Japan. Japanese equities recently reached multi-decade highs, finally rising to levels not seen since early 1991 in the aftermath of bursting of Tokyo’s stock market bubble. This time however, the rise in Japanese equities has come without any exaggeration in valuations as shown by the price to cyclically-adjusted earnings ratio (a measure of current market levels compared to trend earnings) which remains 6% below its 20-year median. With a solid 2% dividend yield, we remain Overweight.

Emerging Markets. Emerging markets lagged global equities in February as investors locked in some profits after several months of strong outperformance. Looking ahead, we expect a stronger recovery in growth than in advanced economies, helped by the pick-up in trade flows and emerging supply bottlenecks which should help improve EM exporters’ pricing power. In this context, earnings growth should be solid this year while valuations remain cheaper than in the US and Europe. We expect EM equities to recover from the recent bout of weakness and remain bullish for 2021.

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**CURRENCIES**

**Consolidation likely**

The global reserve currency – in a sustained downtrend for a year – has been performing better over recent weeks despite looming US stimulus, mainly driven by rising US Treasury yields. However, the Euro continues to carry an unjustified undervaluation in purchasing power parity terms.

**Dollar Index.** The global reserve currency – in a sustained downtrend for a year – has been performing better over recent weeks despite looming US stimulus, mainly driven by rising US Treasury yields. However, it is prudent to remember that US yields themselves are rising in part due to increased inflation expectations, which will limit US dollar upside. Moreover, the sheer size of fiscal stimulus – current plans represent some 13% of GDP – could raise fears of currency debasement.

**EUR/USD.** The euro has been held in a 1.19-1.24 trading range against USD since the start of January. We are currently at the lower end of that range and with EUR/USD trading close to the 100-day moving average, we expect the consolidation to continue in the short-term. Trading is likely to reflect swings in risk appetite, with the dollar rising on risk aversion and the euro benefiting from rising optimism. However, of the major currency pairs, EUR/USD is the only one which is notably undervalued in purchasing power parity terms, by some -16%.

**GBP/USD.** Investors have been bullish on sterling largely due to the speed of the vaccination rollout and the fact the Bank of England appears to have ruled out negative rates for now. Reflecting these factors, it has been the best performing major currency against USD this year. However, the pound reached overbought levels at 1.42 recently and was due a correction. We expect the GBP/USD rally to slow and are downgrading our view to Neutral for the time being.

**USD/JPY.** The US dollar has shot past the 107-mark versus the Japanese yen, its highest level since July 2020. The move – the yen is 4% lower YTD – has been fuelled by the strong pace of US COVID-19 vaccinations and Biden’s massive spending plans, which have boosted dollar yields and hopes for a robust economic recovery. This optimism has pushed safe havens like JPY lower but, with USD/JPY now close to fair value, we remain Neutral.

**EUR/CHF.** The Swiss franc has long been overvalued but keenly sought after as a safe haven in times of trouble, an uncomfortable combination for a small, open economy. Through much of last spring, the Swiss National Bank was forced into currency intervention to prevent EUR/CHF breaking below 1.05. Since then however, confidence has grown that 2021 would see global cyclical recovery, which has helped weaken the franc. From here, we expect a period of consolidation in EUR/CHF.

**EM currencies.** JP Morgan’s index of emerging currencies has eased 2% lower since end-2020, having rallied almost 11% from April’s lows. Recent weakness has been driven by outflows – many investors shy away from EM assets in times of rising dollar rates. However, one side effect of the pandemic has been to improve many countries’ current account balance. Mexico, for example, moved from a modest deficit in 2019 to a 2.4% surplus, the highest since the 1980s. Moreover, global cyclical recovery should favour EM assets, attracting new inflows.

**USD/CNY.** China’s pandemic management during 2020 enabled the country to reopen much earlier than advanced economies, avoiding the need for the massive fiscal support doled out by western governments. As a result, China’s debt ratios have suffered less than in the US or EU. Moreover, 10-year CNY government bond yields are well above western counterparts, making it one of the most attractive sovereign bond markets. This has fuelled a 7% CNY rally over the last year or so. However, it appears to be petering out – only 1% of that gain has occurred in 2021 – and the Chinese will be wary of allowing their currency to appreciate much further from here.

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Alternatives

OPEC+ keeps supply tight

We expect oil prices to consolidate in coming months as supply cuts compensate for sluggish near-term demand. Gold prices should recover once real rates fall again. In hedge funds, our preferred strategies are Special Situations, directional L/S Equity, discretionary Global Macro and CTAs.

Commodities

Oil

Oil prices have trended steadily higher, gaining over 70% since November’s vaccine announcements sparked hopes that cyclical recovery this year would push oil demand back to pre-crisis levels. These hopes have since been reinforced by massive US fiscal spending plans and rapid progress in vaccinations. Moreover, supply has contracted. US output has tumbled from an average 13.0 million barrels per day (mb/d) last February to 10.4 this year as extreme cold weather disrupted many oilfields in Texas. And OPEC and its allies (OPEC+) decided in early March to postpone a planned 500’000 b/d increase in output, with Saudi Arabia maintaining its voluntary 1 mb/d production cuts for another month.

This dynamic should help mop up excess inventories over coming months. However, measures of mobility in the US and Europe suggest that current demand for oil remains well below pre-crisis highs and – with oil prices back at January 2020 levels – US shale producers may soon be able to attract more investment capital to finance increased output.

Oil prices now look set to trade between $60 and 70 per barrel of Brent in coming months.

Gold

Gold prices have been pushed lower by a number of factors. Fiscal spending and hopes of easing lockdown restrictions have weakened demand for safe havens while pushing global equity prices to all-time highs in mid-February. Fears of a looming spike in inflation have driven inflation-adjusted (or “real”) 10-year yields higher – as shown on the chart, when real yields are rising, gold prices tend to come under pressure. And lower prices tend to fuel selling pressure in gold ETFs – total ETF gold holdings are down almost 6% from October’s highs.

However, physical demand for gold is showing tentative signs of improvement. Chinese retailers built up inventories ahead of the expected Lunar New Year bounce in and retail demand has also picked up in India, pushing imports up 113% year-on-year. In both countries, local prices have moved back to a premium over the international benchmark.

In sum, lower gold prices and rapid progress in vaccination programmes should bolster jewellery demand while we expect the impending bounce in inflation to bring real yields lower again, thereby putting a floor under price weakness.

Hedge funds

Long/Short (L/S) Equity

Within a Neutral allocation to L/S Equity, we still prefer managers who keep some exposure to rising prices over Market Neutral strategies. The latter tend to struggle with the sector and style rotations that this year’s cyclical recovery is likely to bring. And among more directional funds, we find more opportunities in the US than in Europe.

Event Driven

We have downgraded Merger Arbitrage to Neutral and prefer more directional strategies like Special Situations. The latter have a bias towards value stocks which is an advantage in today’s environment. As noted last month, many merger specialists have increased their allocations to SPACs (Special Purpose Acquisition Companies) which may suggest diminishing opportunities in their core strategy.

Fixed Income Arbitrage

L/S Credit managers in the US have struggled recently, many having been caught out by rallies in HY energy driven by rising oil prices. Moreover, recent rises in Treasury yields may prove a challenge for “carry” strategies such as Fixed Income Arbitrage which we have moved to Underweight.

Global Macro / CTAs

We have upgraded trend-followers (known as Commodity Trading Advisors, or CTAs) to overweight. CTA managers are running well diversified portfolios, having increased exposure to commodities and currencies recently and scaled back positions in rates. Conversely, we have downgraded Global Macro EM funds to Neutral, given the recent rises in US yields.

Gold declines when real yields are rising

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