Vontobel

Investors' Outlook

An economy reborn (to be wild)

June 2021

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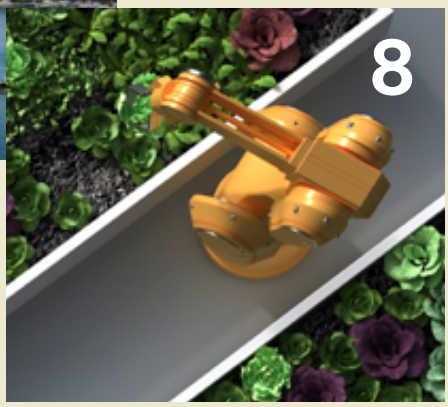

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Bank Vontobel AG
Gotthardstrasse 43
8022 Zurich

Editor
Martin Gelnar

Authors*
Reto Cueni, PhD
Chief Economist,
Vontobel
Pascal Dudle
Head of Listed Impact,
Portfolio Manager,
Vontobel
Stefan Eppenberger
Equity & Commodity Strategist,
Vontobel
Matthias Fawer
Senior ESG & Impact Analyst,
Vontobel
Frank Häusler
Chief Investment Strategist,
Vontobel
Michaela Huber
Economist,
Vontobel
Marco Lenfers
Client Portfolio Manager,
Vontobel
Mario Montagnani
Senior Investment Strategist,
Vontobel
Sandrine Perret
Senior Economist,
Fixed Income Strategist,
Vontobel
Sven Schubert, PhD
Head of Strategy Currencies,
Vontobel
Dan Scott
Chief Investment Officer,
Head of Impact & Thematics,
Vontobel

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An economy reborn (to be wild)

Dear readers,

Fiscal and monetary policy measures leave me humming the Steppenwolf song "Born to be wild", which helped propel the Easy Rider film to global fame.

It's not just because the economy has "got its motor running", like Peter Fonda and his hippie buddies on their Harley-Davidson choppers. It's also because they financed their wild trip across the American southwest with drug money, a fitting parallel to the global economy of today. After all, it was reborn thanks to stimulating stuff from central banks and governments.

Apart from the economy, vaccination campaigns are running at full steam. Bars, restaurants, museums and gyms are slowly but surely opening up across Europe and the US after months-long closures. The easing of restrictions and the rapid decline in new Covid-19 cases have lifted our spirits. Financial markets are thriving and leading economic indicators have been ticking higher for months. Purchasing managers' indices have climbed to multi-year highs and seem to be as good as they can get. Companies have recovered from last year's pandemic shock. The reporting season that just ended smashed expectations. Around three quarters of the S&P 500 companies managed to beat the already optimistic analyst forecasts, leading to further upgrades of their estimates.

In a nutshell: the economy seems to be reaching peak growth. Does this mean the highway stretching before our motorcycles is sloping downwards? Some experts warn that central banks are about to limit their extraordinary roadside assistance. Some have already started to discuss how to wean markets off stimulus programs.

—
Dan Scott
Chief Investment Officer,
Head of Impact & Thematics,
Vontobel

We still prefer equities but brace for lower returns
We acknowledge concerns that the economic motor is now nearing maximum speed. But while equity returns will in all probability come down, they will hardly turn negative. And it's worth noting that despite inflation worries, the readings still oscillate around historical lows. Stocks are likely to continue to be more attractive than bonds in terms of returns, so we still prefer equities to fixed income overall.

As for commodities, the rally since the beginning of the year is yet to reach its end. Some of the tailwinds that have been driving it have indeed started to wane: China's so-called credit impulse, an indicator that tracks changes in new public and private credit as a share of GDP, has now dropped below zero. Furthermore, the most acute short-term supply issues owing to the near global lockdown in 2020 are mostly resolved. But commodities will be in demand as long as the world economy continues to expand. The ongoing efforts to mitigate climate change should also translate into strong interest for metals. We thus reiterate our favorable view on this asset class.

As you notice, the Covid-19 pandemic already seems to be a remnant of the past for the capital markets. With some luck, this will be the case for us as well in the near future. And the economy may still enjoy the high while it lasts.

→ Webcast
To view our webcast on recent market developments, click:
vonto.be/macro-en-jun21

—
Frank Häusler
Chief Investment Strategist,
Vontobel

—
Mario Montagnani
Senior Investment Strategist,
Vontobel

A great view, but will it last? We reiterate our preference for equities

On June 16, Switzerland will host a summit in Geneva (pictured) where Joe Biden and Vladimir Putin will meet for the first time as presidents. The two leaders surely won't overcome their differences, but the mere fact that they convene on neutral ground is welcome. The world may be more polarized, but it is about to put the pandemic behind it, and the global economic vigor sends a hopeful signal. With central banks and governments drowning the economy in liquidity, "peak growth" is around the corner.

But while enjoying a fantastic view from a mountaintop, we know that it's hard to go significantly higher from here. Among the risks we see are sudden spikes in inflation rates, if only temporary. For the time being, we are comfortable with our current positioning and our views on asset classes. In a nutshell, it's overweight equity, underweight bond, stay neutral on cash. Hedge funds are still an underweight, whilst gold and commodities remain an overweight.

True, some investors may think twice before paying a premium price for a stock, but other options they may be contemplating are hardly better. While equity returns will come down, they won't turn negative and will continue to beat those of bonds, we believe. As regards bonds, we maintain our overall negative take on the fixed income segment. We expect rates to move higher over the next twelve months, albeit only gradually. For details, see the overview page 5 or read the asset class focused items on pages 12 to 15.

	UNDERWEIGHT significantly	UNDERWEIGHT slightly	NEUTRAL	OVERWEIGHT slightly	OVERWEIGHT significantly	
1 Liquidity			→			We retain our neutral stance on liquidity. This weighting was recently increased after we moved proceeds from an equity transaction into cash.
2 Bonds		→				We reiterate our negative view on the fixed income segment. Interest rates are likely to move higher gradually and moderately with our 12-month forecast for ten-year US Treasuries standing at 2%. We remain neutral on government bonds and high yield issues, favoring emerging-market debt for its more attractive yield levels. This sub-segment should continue to outperform, we believe. Our strong underweight in investment-grade bonds (IG) remains in place. We consider the yield prospects of these long-duration securities unattractive.
3 Equities				→		Some investors have second thoughts about equities in light of recent gains. We acknowledge their concern, but reiterate our equity overweight and our views on all sub-segments. While many stocks are no longer cheap, they aren't pricier than developed-market government bonds or investment-grade corporate paper, for example. There is less room for a further rise in equity multiples – the price investors are willing to pay for future earnings. Likewise, the potential for unexpectedly strong corporate results seems limited. But this in no way implies that future returns will be negative. While the going will get tougher, we are confident that equities will be able to cope with risks from rising yields and inflation. We stay positive for Swiss, US, Japanese and emerging-market stocks. Our neutral view on Europe stems from a less attractive sector composition and our belief that much of the so-called reopening trade is now priced in.
4 Gold				→		We reiterate our slight overweight in gold. The precious metal has recently benefited from declining US real yields and a weaker US dollar. Our expectation of real yields remaining more or less stable in the months ahead warrants a favorable view as well. Apart from that, we continue to appreciate gold for its hedging properties – not only when it comes to unexpected risks, but also in the context of inflation.
5 Commodities				→		We maintain our overweight on commodities, which had a stellar run since our recommendation earlier this year, benefiting from the cyclical reopening of the economy. While some of these tailwinds have now started to wane – the Chinese credit impulse is fading, and short-term Covid-related supply issues are starting to abate – we think a positive view is still appropriate. The reasons are the prospects of continued economic growth as well as increased "decarbonization" efforts, which should translate into higher demand for metals. Investors worrying about rising yields and inflation may find commodities appealing as a natural hedge against such risks.
6 Alternative strategies			→			We reiterate our negative view on hedge funds and our neutral take on other types of alternative investments, such as insurance-linked securities. This leaves us with an overall neutral – and therefore unchanged – view on alternative investments.

Changes month-on-month: same → higher ↗ lower ↘

The global economy more or less as good as it gets

With the US economy hurtling down the highway at full speed, market participants seem almost oblivious of the pandemic. While economies still struggle with widespread containment measures to bring Covid-19 under control, sentiment indicators in developed markets have hit new highs as a further reopening of the economy seems close. However, this suggests that the global growth momentum is likely to top out in the coming months.

—
Reto Cueni, PhD
Chief Economist,
Vontobel

—
Michaela Huber
Economist,
Vontobel

—
Sandrine Perret
Senior Economist,
Fixed Income Strategist,
Vontobel

—
Sven Schubert, PhD
Head of Strategy Currencies,
Vontobel

Our economic momentum indicator points to strong economic activity with emerging markets peaking while developed markets look set to reach a top soon (see chart 1). With the US powering ahead and the euro zone trailing behind but keeping up, China is losing steam while remaining solid.

Upward pressure on prices will remain in place with demand possibly outpacing supply temporarily. This, alongside base effects[1], will see inflation in the US peaking in the second quarter and in the euro zone towards the end of the year, in our opinion, with readings in both regions significantly above the central banks' inflation targets. Given this temporary surge and the still high probability of more "normal" inflation levels in 2022 (see chart 2), central banks are likely to keep supporting the economy some more.

Old and new risks could, of course, derail our rather optimistic scenario. These include another Covid-19 wave or the emergence of new virus mutations, stronger-than-expected second-round effects such as corporate bankruptcies and significant layoffs, or an overheated economy with a surge in inflation that prompts central banks to quickly reduce monetary policy support.

Europe: consumers waiting to open their wallets

Sentiment indicators show that the services sector expects a strong rebound once the economy will be reopened further, and positive consumer confidence data indicates that consumption should recover swiftly. The slower relaxation of Covid-induced restrictions in Europe hasn't hurt the industrial sector, which is running quite hot and looks set to peak rather sooner than later. The latest developments around the European Union's recovery fund and other public spending suggest a stronger-than-expected fiscal impulse that is likely to exceed that of the US. After a contraction in the first quarter, the economy should rebound strongly in the second quarter with the growth rate reaching its top in the third quarter before "normalizing" again towards the end of the year.

We expect prices to trend higher and rise substantially above the European Central Bank's target of 2% before the year's end with the inflation rate subsequently falling back to a level within the ECB's comfort zone in early 2022 (see chart 2). Overall, we doubt that the central bank will withdraw its monetary stimulus anytime soon. Nor do we expect any ECB announcement regarding a return to the previous lower level of monthly bond

[1] This year, an important base effect stemmed from energy prices. They fell massively in March 2020 and stayed low throughout 2020, pushing inflation down. So this year in March, the year-on-year price comparison started from a very low base (from March 2020), which increases inflation mechanically throughout the current year 2021.

purchases at the central bank's meeting in June. However, there is still the risk that a quicker recovery and stronger inflation readings could trigger faster-than-expected ECB "taper action".

US: job market seen recovering further
Surveys of US manufacturing activity are beginning to suggest it is past its peak, while the sentiment in the services sector remains in a rising trend. This points at further gains in private consumption. The flash US services purchasing managers' index reached a new high of 70.1 points, confirming expectations that services can still replicate a previous rebound in manufacturing activity. Breaking down consumption data, we see that the intake of goods has spiked until March, while that of services remains well under pre-Covid levels and should accelerate in the next few months (see chart 3). We continue to expect the US economic growth rate to peak in the second quarter at 10% annualized, after which the gross domestic product will keep expanding but at a slower pace. Job creation was weaker than expected in April but a drop in jobless claims and reports of difficulties to find skilled workers suggest America is still hiring. We expect the labor market to continue recovering during the summer months.

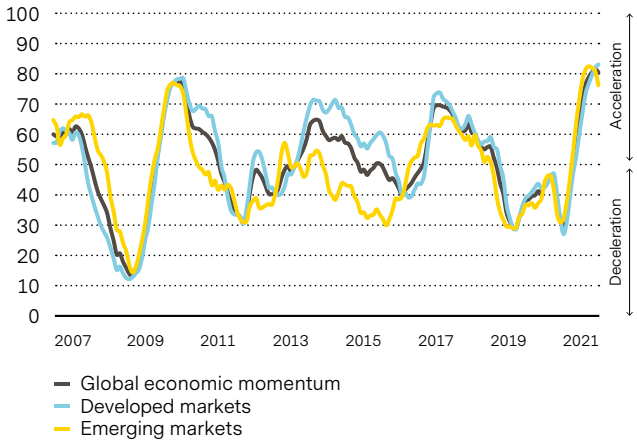
With inflation rising sharply above 4% in April, the US Federal Reserve will be keeping a close eye on prices. For now, the Fed is likely to help the job recovery rather than trying to wean the economy off support measures. Serious discussions about slowing bond purchases should only start in the second part of the summer.

Japan: pandemic pain
Extended emergency measures to control the pandemic and a sluggish vaccine roll-out have left their mark on both sentiment and consumption. The government hopes to speed up the vaccination campaign, which is also a deciding factor in any go-ahead for the Olympic Games in Tokyo.

Emerging markets: less economic support
Progress on the vaccination front and hopes for an improvement in the Indian pandemic situation have clearly improved emerging markets' prospects. At the same time, countries like China, Brazil, Russia, and Turkey have started cutting economic support, which is likely to translate into slowing growth rates later this year. Even so, real GDP growth will reach 6.7% this year, in our view, the highest rate in 11 years.

Policy normalization in emerging economies is welcome from a financial stability point of view. The episode of surging US yields earlier this year highlighted their vulnerabilities when asset prices plunged, particularly across Latin America. But the normalization process is likely to be gradual given the still moderate inflation pressure when adjusted for the Covid-19 base effect dating to early 2020. The central banks will be wary of sudden tightening steps, knowing this could undermine economic prospects.

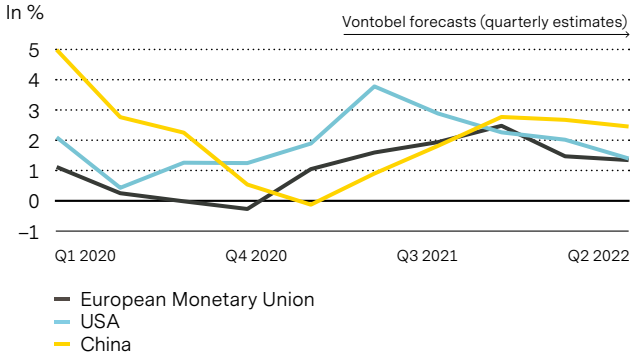
Chart 1: Vontobel's economic momentum indicator points to an upcoming peak in global growth
GDP-weighted indicator[1], three-month average, in %



[1] An index of more than 700 hard and soft indicators with readings above 50% pointing at an acceleration of economic growth, below 50% at a deceleration. The indicator tends to lead GDP growth by a few months.

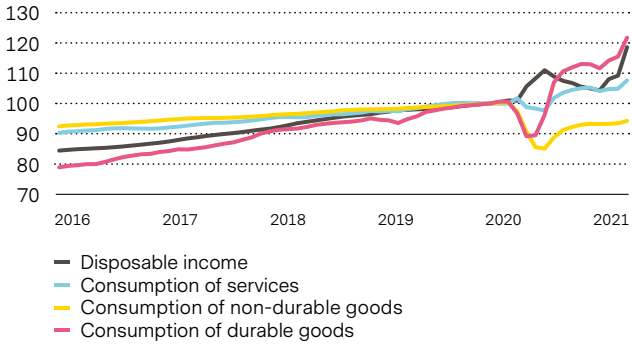
Source: Various economic data sources, Refinitiv Datastream, Vontobel

Chart 2: Inflation seen exceeding central banks' targets in 2021, but falling back again in 2022



Source: Refinitiv Datastream, Vontobel forecasts

Chart 3: Demand for goods has spiked amid rising US incomes, services have room to recover this summer
Index, quarterly moving average (December 2019=100)



Source: Refinitiv Datastream, Bureau of Economic Analysis (BEA), Vontobel

—
Pascal Dudle
Head of Listed Impact,
Portfolio Manager
Vontobel

—
Matthias Fawer
Senior ESG & Impact Analyst
Vontobel

—
Marco Lenfers
Client Portfolio Manager
Vontobel

To make your money matter, try impact investing

“I can’t get no impact action,” the Rolling Stones might have sung back in the days. Well, the world has changed. Today, there’s hardly any investor satisfaction without impact action.

In the Investors' Outlook from May, we have highlighted our "thematic and impact" campaign as part of our wider sustainable investing approach. Here, we want to concentrate on the impact part of it, summarizing our recent white paper "Make your money matter – creating impact through public equity."

There is rising demand for companies that contribute to a better environment and/or societal change. At the same time, investors want to see results, both in terms of performance as well of measurable outcomes. This is where impact investing, an approach we follow for our Clean Technology and Global Impact Equities products, comes in. It essentially means an actively managed portfolio of companies that can create a positive social or environmental effect.

To evaluate whether the companies' goods or services actually have the desired effect, impact-focused investment managers measure and report benefits – the impact – in a transparent manner. Impact investors typically use some of the United Nations' 17 Sustainable Development Goals (SDGs) and specific impact objectives as a base for targeting investments. The SDGs and their corresponding targets establish a clear and universal framework that aligns governments, public investors, private companies and other organizations across the globe.

Market opportunities – need for private-sector funding
Efforts to meet these global goals are going to be enormous, but should also increase market opportunities within sectors such agriculture, urbanization, energy or health, and create millions of jobs. This will require capital from both public and private actors, as governments aren't able to foot this bill alone. The United Nations Conference on Trade and Development (UNCTAD) estimates that funds dedicated to investment in sustainable development have reached 1.2 to 1.3 trillion US dollars. Over the next ten years, the "decade of delivery" for the SDGs, such sustainability-linked products are expected to grow significantly.

Impact investing can do the trick here, and listed companies that help to meet the goals will play a major role. The SDGs provide an ideal framework for impact investors to expand into the public equity space. This will allow money from large institutions – including corporations, mutual funds and pension funds – to flow into listed companies, enabling a much wider impact.

What's the mechanism behind impact investing?
Both the Global Impact Investing Network (GIIN) and the International Finance Corporation (IFC) – the World Bank's investment arm – have established principles for impact investing that overlap to a large degree. Both organizations aim to provide a straightforward framework for impact investing throughout the investment process to establish the foundation of a credible impact management system.

The principles the organizations created in co-operation with asset owners, asset managers, as well as multilateral development banks and development finance institutions have been designed to fit a wide range of institutions and funds. These principles can be summarized as follows:

1 – Intentionality of the impact investment
The investment process starts off by defining the impact objective(s) at the core of the intended positive social and environmental impacts aligned with the 17 UN SDGs or other widely accepted goals.

2 – Aims for financial returns
Apart from achieving the desired effect, impact investors aim for a financial return on capital that ranges from at least a market rate to a risk-adjusted market rate. This is to distinguish impact investment from philanthropy, which solely focuses on social or environmental change and not on financial returns.

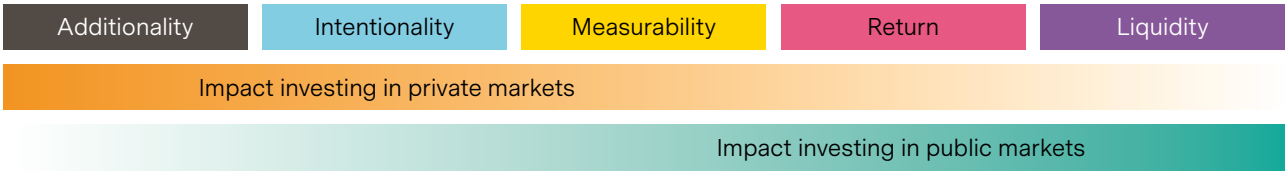
3 – Investments across asset classes
There are numerous opportunities across multiple types of asset classes, from private equity and private debt, to listed equities and "green bonds".

4 – Managing and measuring impact
Defining indicators according to the intentions, then measure each investment's achievement and report results.

Creating impact through listed equities
Listed equities play a growing and indispensable role. Traditionally, impact investing was confined to private debt, often in the form of microfinance, and to private equity. It focused on creating impact through small-scale social or environmental projects. When innovations or pilot projects prove promising, they need large investments to evolve and ultimately mature. This is where public equity can be an enabler and a natural complement to private investments, providing large-scale manufacturing and a global distribution network.

Over the past decade, impact investing via the stock markets has created the required critical mass, scalability and global reach. The global challenges are so huge that tackling them entails a targeted yet broad approach across all asset classes while considering their specific characteristics.

The key principles of impact investing and where they are applicable



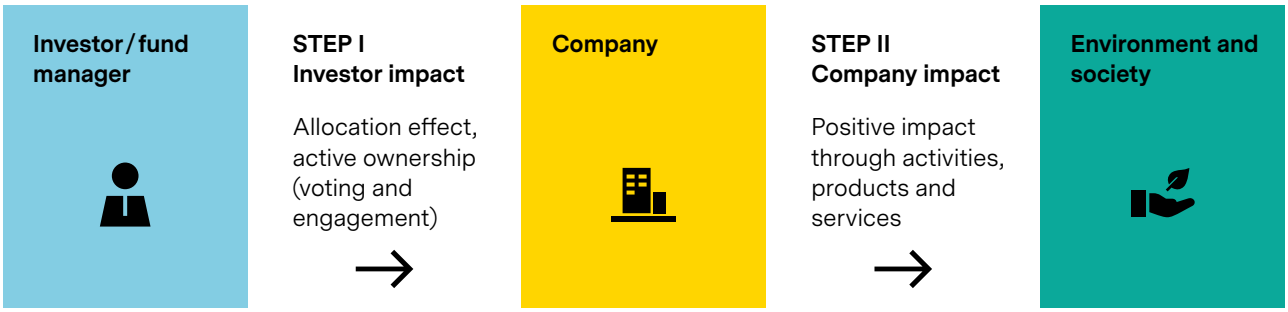
Additionality	Intentionality	Measurability	Return	Liquidity
Impact wouldn't occur without this investment	Impact investments are made with the intention of generating positive impact	Measuring and reporting on environmental and social impact performance to ensure accountability	Impact investors expect to generate financial returns in line or above market rate	Extends to securities that can be traded on public markets

Source: Vontobel

Two-step approach focuses on impact at both investor and company level

Investing in publicly traded stocks with the ultimate goal of bringing about environmental and/or social change is an indirect approach. It lacks the immediate effect, or "additionality", that investments in projects or microfinance offer. In a first step, an impact investor influences a listed company through engagement and the allocation of capital. This should result in lower financing costs for these companies. In a second step, companies can grow the businesses with superior impact credentials faster, scaling up the beneficial effects on environment and society.

Two steps between impact investors' capital allocation to beneficial effect



Source: Vontobel; University of Zurich, Dep. of Banking and Finance, Center for Sustainable Finance and Private Wealth (CSP), "Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact," July 2019

Our approach: driving change through impact investment

There is no such thing as a neutral investment. Every transaction has an impact, be it positive or negative. This awareness has become an important driver. In our view, every investment must start with the following question: "What is the potential impact on the environment and the society?" The core of our philosophy is the intention to drive positive change via our investments. We believe that the investment industry needs a paradigm shift away from short-term financial gains to long-term investment benefits that ultimately contribute to a better quality of life. Impact investing plays an important part in this.

What do we want to achieve?

For us as managers of a broad impact portfolio with an environmental and social focus, eight challenges are particularly relevant: resource scarcity, rising pollution, climate change, global water problems, aging population, health problems, food distribution issues, and growing inequality. Each of these areas offers considerable and varied investment opportunities. Using the theory of change[1] as a guideline, we aim to invest in companies whose goods and services generate profitable growth as well as positive impact.

[1] A method going back to the Austrian management consultant Peter Drucker. It is based on the assumption that planners need to trace back their steps from a long-term goal via an intermediate stage to the beginning of the process.

Our key objectives
Based on the global challenges mentioned in the previous paragraph, we defined key goals – be it for environmental and / or social focused investment strategies – and identified eight impact pillars. All pillars support some of the much broader United Nations' Sustainable Development Goals (see figure below). Our portfolios only contain companies offering products and services that align with one of our eight impact pillars described below and contribute to at least one of the SDGs.

Our impact objectives and their link to the United Nations' SDGs

Source: Vontobel

How to monitor key performance indicators
A precondition of a credible impact offering is an asset managers' ability to regularly measure key performance indicators (KPIs). The latter should be coherent with global criteria as defined by IRIS+, a globally recognized system with standardized impact indicators. IRIS+ is the generally accepted impact accounting system of GIIN that leading impact investors use to measure and manage their impact. The IRIS+ framework ensures a reasonable level of consistency in impact claims and reporting.

Key performance indicators

Sustainably produced food / distribution of it	Access to healthcare provided	Education provided	Drinking water provided	Renewable power generated	Waste management	Access to financial services provided	Cargo / passengers transported	Circular economy	Potentially avoided CO_2 emissions
Preserved biodiversity			Water recycled / treated / saved	Renewable energy devices shipped		Minority involvement			Carbon footprint

Source: Vontobel

Real yields have room to move higher again

—
Sandrine Perret
Senior Economist,
Fixed Income Strategist,
Vontobel

Real yields have dropped after a tentative climb in the first quarter. But we see them going up again in the second half amid peaking inflation expectations – following second-quarter inflation readings that spiked due to base effects and a reopening of economies. That said, any rise in real yields will probably be gradual, mirroring a guarded rhetoric from the US Federal Reserve. Jerome Powell will be as cautious as possible when signaling plans to take his foot off the liquidity pedal. Any such communication around late summer will come in a form palatable to financial markets.

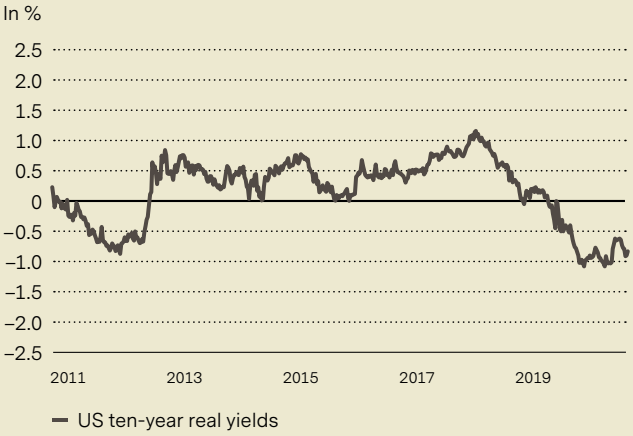
Real returns and real yields play an important part in fixed income investors' asset allocation considerations. Real yields – nominal yields minus the expected inflation rate – are currently at low levels and mostly in negative territory. Taking one closely watched market indicator, ten-year US yields based on Treasury Inflation-Protected Securities (TIPS), real yields are currently hovering around –0.8 %, after recovering somewhat in the first quarter. While above the –1.1 % level in the aftermath of the pandemic last summer, US real yields remain extremely low in historical terms, and even more so when compared to their most recent high of +1.2 % at the end of 2018 (see chart 1).

Real yields started falling when central banks and governments began to support the pandemic-hit economy with unprecedented amounts of liquidity. Expectations regarding breakeven inflation – the gap between nominal yields and inflation-linked debt issues, or the future inflation rate expected by markets – have recently hit levels not seen in many years. The surge reflects a view that prices would temporarily rise above the high-water marks tolerated by central banks, driven upwards by a global economy still recovering from the pandemic.

The Fed is wary of a sudden rise in real yields

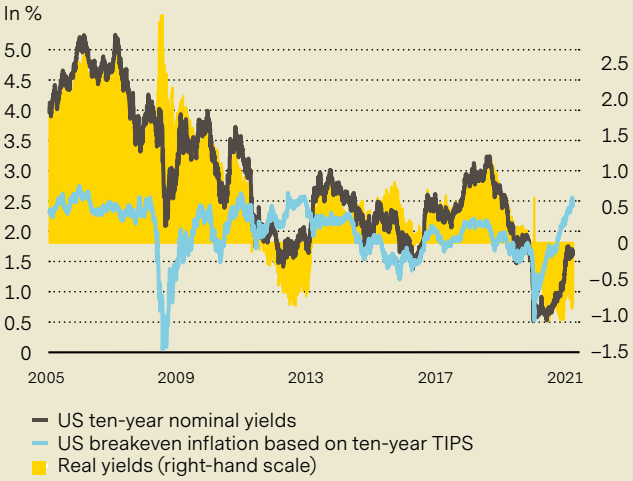
Nominal yields paused after a strong increase in the first quarter but are set to rise again in the second half (see chart 2). The key factor to watch will be signals of a gradual withdrawal of monetary policy support from the US Federal Reserve. Jerome Powell and his colleagues, who we expect in late summer to start discussing the possibility of reducing the amount of the Fed's monthly asset purchases, will proceed with utmost caution. This also holds true for the way such a step will be communicated. Memories of 2013 are still fresh, when the Fed surprised markets with plans to scale back its support measures known as quantitative easing. The sudden spike in real yields that followed (see chart 1) led to market turmoil. Central banks learned their lesson in communication management during that time.

Chart 1: The low level of US ten-year real yields suggests upside



Source: Refinitiv Datastream, Vontobel

Chart 2: Breakeven inflation could peak as real yields normalize



Source: Refinitiv Datastream, Vontobel

"Peak growth" doesn't mean "peak stock prices"

—
Stefan Eppenberger
Equity & Commodity Strategist,
Vontobel

Our closing in on peak economic growth hasn't hurt equity investors so far. With no recession around the corner, negative equity returns currently seem to be a distant possibility. While we cannot rule out a market downturn, we would probably be among the buyers in such a case.

Since the end of the first lockdown, we have been in an economic upswing with global purchasing managers' indices (PMIs) rising from rock bottom to the very top. They cannot continue to rise much further in the short term, nor can global growth accelerate much more. We are at peak growth.

What are the consequences for the equity markets? Chart 1 shows the development of global equity indices since the launch of the global PMI. In times of rising PMIs, equity markets not only perform better, but also display lower volatility, confirming the conventional wisdom that improved economic conditions should translate into higher expectations for corporate earnings.

But what happens to equities when PMIs start falling? Such a situation doesn't generally mean equity returns turn negative – but clearly, stocks tend to take a hit at such times (–6.5% average performance versus +30.4% in times or rising PMIs). However, the drop typically occurs in periods that end in recessions, which is an unlikely scenario at present.

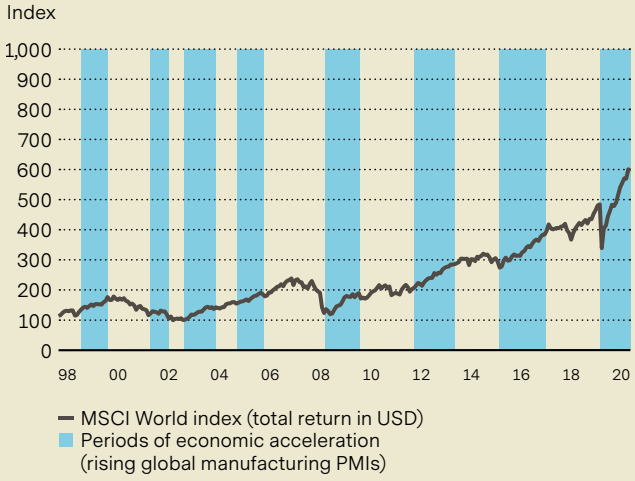
Similarities to the period after the financial crisis

Moreover, our research shows that the first 12 months after a peak in the global PMI are still positive for equities on average (+3.3%), especially in recession-free times. The financial crisis and its aftermath could provide a clue where we may go next (see chart 2). This was a period marked by the end of fiscal and monetary stimulus, low inventories, inflation concerns, and strong equity markets. At that time, shares corrected by more than 20% after a peak in the PMI, but later recovered strongly. In light of the exceedingly bullish sentiment in some quarters, we cannot rule out such a scenario this year. Given our analysis, we would probably tend to buy the dips.

Eyes on defensives such as healthcare stocks

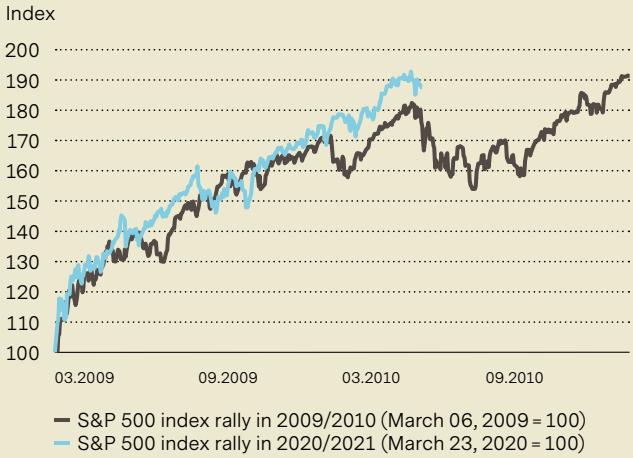
We have also tried to establish which sectors could benefit the most in peak growth times. Defensive stocks such as those of healthcare companies should regain their attractiveness, according to our research. The single most important factor, however, is the US Federal Reserve's policy. If the central bank remains on the cautious side – continuing to provide ample liquidity to the economy and the markets – demand for technology stocks could rise (again). If, on the other hand, there are signs of a rapid end to bond purchases, financial stocks will be more likely to perform better.

Chart 1: Equities gain in times of rising PMIs, keep losses in check when PMIs fall



Source: Refinitiv Datastream, Vontobel

Chart 2: Short-term pain, mid-term gain? A possible lesson from the financial recovery rally 2010



Source: Refinitiv Datastream, Vontobel

Copper: China is still the elephant in the room

—
Stefan Eppenberger
Equity & Commodity Strategist,
Vontobel

Copper has recently staged an impressive rally. Many think this will continue thanks to strong demand from renewable energies and electric vehicles. A more important driver is the Chinese economy. Its growth rate will slow, which will limit the upside potential for metals.

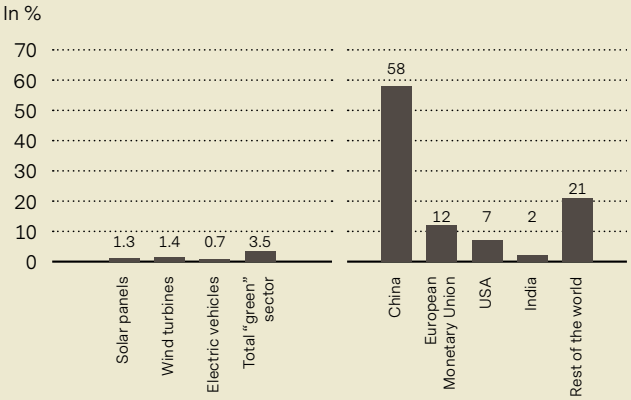
At the beginning of May, copper broke through the mark of 10,000 US dollars per ton for the first time since 2011, reaching our price target earlier than expected. The price more than doubled within a year from a level below USD 5,000 at the height of the corona crisis during the first lockdown. And the red metal continued to climb, hitting new all-time highs.

"Green" demand alone cannot move the price
Some observers attributed this to the rise of renewable energies and the popularity of electric cars. The ongoing decarbonization trend, in which copper will play an important part, is certainly an important aspect to consider. But a hard look at the available data shows that demand from the renewable energy side alone cannot explain the surge in copper prices. The "green" sector only accounts for 3.5% of global copper consumption, although its share is rising fast (see chart 1).

There are other reasons for the spike in copper prices, such as pandemic-induced disruptions in some South American copper mines, and the demand generated by a global growth engine that's running hot. But most of all, the red metal depends on the Chinese economy, which takes in over half of global shipments. The country imported a record amount of copper in the past 12 months. Demand is so strong due to the China's efforts to crank up its economy that domestic inventories have declined. However, the economic momentum is now starting to turn. The so-called Chinese credit impulse, a measure of China's stimulus measures, is collapsing (see chart 2). This can only mean headwinds for metal prices, although booming demand elsewhere will support them to a degree.

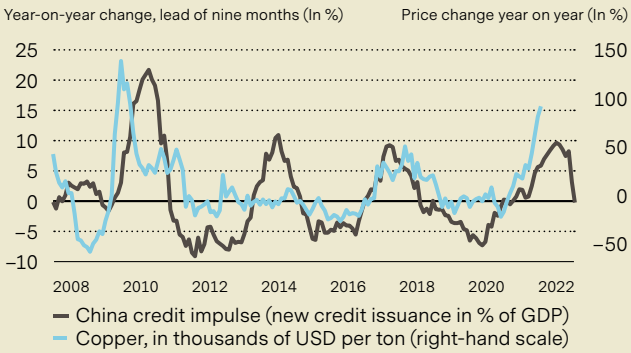
Take profits or ride out a slow-growth period?
One negative for copper is the prospect of ramped-up South American production thanks to the advancing vaccination campaigns, with rising supply potentially weighing on prices. At the same time, the supply situation looks bleak in the long term. In recent years, too few projects for new mines were lined up because the copper price was considered too low. This may lead to a supply gap from 2024 onwards, at the latest. Leaving aside the possibility of a metal (or more broadly, commodity) bull market on the back of "green" demand, investors will have to weigh whether to take profits or ride out the expected economic slowdown in China.

Chart 1: China as the world's biggest copper consumer can move the market



Source: ICA, IRENA, IEA, Goldman Sachs, WBMS, BCA, Vontobel

Chart 2: Weakening Chinese "credit impulse" indicates that the impressive copper rally may soon be over



Source: Bloomberg, Vontobel

Recovery supports the euro, but the dollar is waiting in the wings

—
Sven Schubert, PhD
Head of Strategy Currencies,
Vontobel

The cyclical currencies of Europe, Australia, New Zealand and emerging markets are currently enjoying a place in the sun thanks to the global economic recovery. However, the US dollar is getting ready to step out of the shadow later this year once the US Federal Reserve starts preparing markets for policy normalization.

In line with our expectations, the euro has climbed back to the upper end of the EUR/USD 1.16–1.25 trading range. Its recovery from lows of 1.17 in late March seems to contradict the weaker economic prospects in Europe relative to the US. Yet it doesn't come as a surprise because the US dollar seldom benefits when global growth picks up, even if the US economy outperforms.

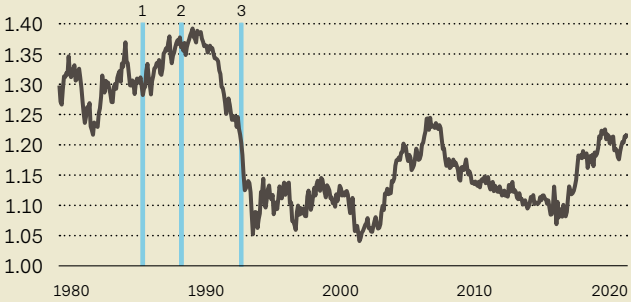
Dollar bulls shouldn't get too excited
While the euro will probably remain strong in the near term, the US dollar looks set to turn the tables in a few months' time. Sometime this summer, the US Fed is likely to flag a reduction of its bond-purchasing program in early 2022. But if history is any guide, dollar bulls shouldn't get overly excited. When the US central bank started cutting back its liquidity supply in January 2014, the USD lost 4% within six months. Only when the Fed began to prepare the market for policy tightening did the USD rally from 1.40 versus the euro to below 1.10 by early 2015 (see chart 1). With no policy tightening in sight before late 2023, any rebound in the dollar will probably be rather moderate in late 2021.

One might think that the euro's sturdiness versus the US dollar should result in gains against the Swiss franc as well. But things are more complicated. The Swiss currency typically shrugs off most of the euro's gains against the greenback (see chart 2), and for good reason. For instance, Switzerland's lower inflation compared to that of the European Monetary Union supports the franc due to the relative increase in purchasing power. Therefore, any move higher of the EUR/CHF cross to levels around 1.12–1.14 presents an opportunity to sell euros and buy Swiss francs. As far as the franc-dollar exchange rate is concerned, our EUR/CHF forecast translates into very moderate CHF recovery potential over the next few months. As for the EUR/USD cross, we see slight upside for the dollar vs. the Swiss franc in the second half of 2021.

Emerging-market currencies still supported
Given tentative signs that the second Covid wave in India may have peaked, and in light of some vaccination progress in emerging markets, many currencies have recouped previous losses. While this trend should continue in the near term, the risk of a setback rises the closer we get to US policy normalization. Fortunately, emerging-market fundamentals look much better than in 2014 when a tighter monetary policy in the US proved to be a real burden for emerging economies.

Chart 1: US monetary policy tightening, not "tapering", is likely to drive the dollar higher

Dollar-euro exchange rate



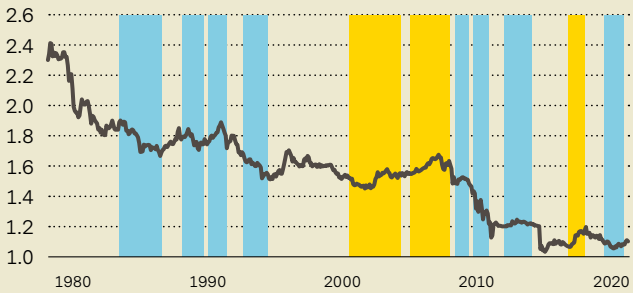
— EUR/USD

1 "Taper tantrum" shock after Fed announcement
2 The Fed actually starts tapering, i.e. reduces bond purchases
3 The Fed starts cycle of monetary policy tightening

Source: Refinitiv Datastream, Vontobel

Chart 2: The Swiss franc tends to disregard most of the euro's gains against the US dollar

Euro-Swiss franc exchange rate



— EUR/CHF
Periods of euro strength versus the US dollar but weakness against the Swiss franc
Periods of euro strength versus the US dollar as well as the Swiss franc

Source: Refinitiv Datastream, Vontobel

Economy and financial markets 2019 – 2022

The following list shows the actual values, exchange rates and prices from 2019 to 2020 and our forecasts for 2021 and 2022 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates and commodities.

GDP (IN %)	2019	2020	CURRENT	FORECAST 2021	FORECAST 2022
Euro zone	1.3	–6.7	-1.8	4.4	4.0
US	2.2	–3.5	0.4	6.3	4.2
Japan	0.3	–4.9	-1.8	2.6	1.9
United Kingdom	1.4	–9.9	-6.1	5.4	4.9
Switzerland	1.1	–3.0	-1.7	3.5	2.8
China	5.8	2.3	18.3	9.0	6.1
INFLATION (IN %)					
Euro zone	1.2	0.3	1.6	1.8	1.4
US	1.8	1.2	4.2	2.8	2.2
Japan	0.5	0.0	-0.2	0.1	0.3
United Kingdom	1.8	0.9	0.7	1.8	1.7
Switzerland	0.4	–0.7	0.3	0.5	0.8
China	2.9	2.5	0.9	1.7	2.3

KEY INTEREST RATES (IN %)	2019	2020	CURRENT	FORECAST 3 MONTHS	FORECAST 12 MONTHS
EUR	–0.50	–0.50	-0.50	-0.50	-0.50
USD	1.75	0.25	0.25	0.25	0.25
JPY	–0.10	–0.10	-0.10	-0.10	-0.10
GBP	0.75	0.10	0.10	0.10	0.10
CHF	–0.69	–0.76	-0.75	-0.75	-0.75
CNY	4.35	4.35	4.35	4.35	4.35
10-YEAR GOVERNMENT-BOND YIELD (IN %)					
EUR (Germany)	–0.2	–0.6	-0.1	-0.2	0.0
USD	1.9	0.9	1.6	1.7	2.0
JPY	0.0	0.0	0.1	0.1	0.2
GBP	0.8	0.2	0.9	0.9	1.1
CHF	–0.5	–0.5	-0.1	-0.2	0.0
EXCHANGE RATES					
CHF per EUR	1.09	1.08	1.09	1.10	1.10
CHF per USD	0.97	0.88	0.90	0.88	0.90
CHF per 100 JPY	0.89	0.86	0.83	0.83	0.88
CHF per GBP	1.28	1.21	1.27	1.31	1.28
CHF per AUD	0.68	0.68	0.70	0.70	0.66
USD per EUR	1.12	1.22	1.21	1.25	1.22
JPY per USD	109	103	109	106	103
USD per AUD	0.70	0.77	0.78	0.80	0.77
CNY per USD	6.95	6.51	6.86	6.35	6.40
COMMODITIES					
Crude oil (Brent, USD/barrel)	66	52	69	70	70
Gold (USD/troy ounce)	1521	1898	1863	1900	1900
Copper (USD/metric ton)	6149	7749	10345	10000	10000

Source: Thomson Reuters Datastream, Vontobel; closing prices for all data: 17.05.2021, forecasts as of 20.05.2021

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Bank Vontobel AG
Gotthardstrasse 43
8022 Zurich
Switzerland

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