

Global Investment Strategy

Third Quarter 2021

Overview

World economy

- Europe and the US: In the midst of a strong consumer-led recovery.
- Economic forecasts: Continued global upward revisions.

Special topic: Inflation

- Temporary price pressures, almost exclusively in the US.
- Inflation forecasts far less accurate than forecasts of the real economy. Low inflation the most likely scenario in the medium term.

Capital markets

- The economy and corporate earnings point to positive underlying equity market trends.
- A forthcoming loss of growth momentum and US inflation possible stumbling blocks in the summer months.

Agenda

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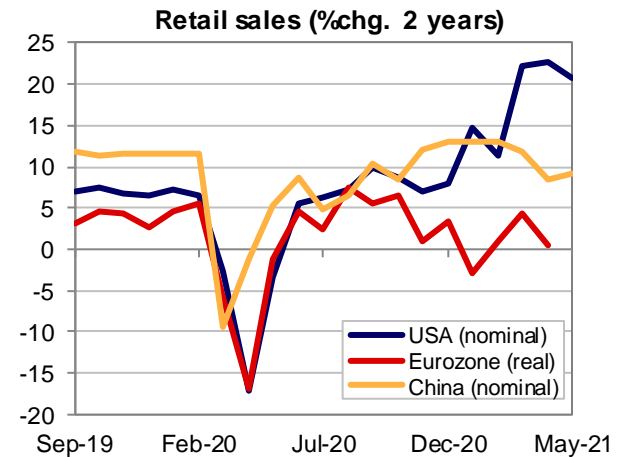
Chapter 2: World economy – Consumer-led recovery

The normalisation of economic activity follows the script laid out last November, when high vaccine efficacy profiles made herd immunity in the leading economies and a concomitant normalisation of economic activity the far most likely scenario this year.

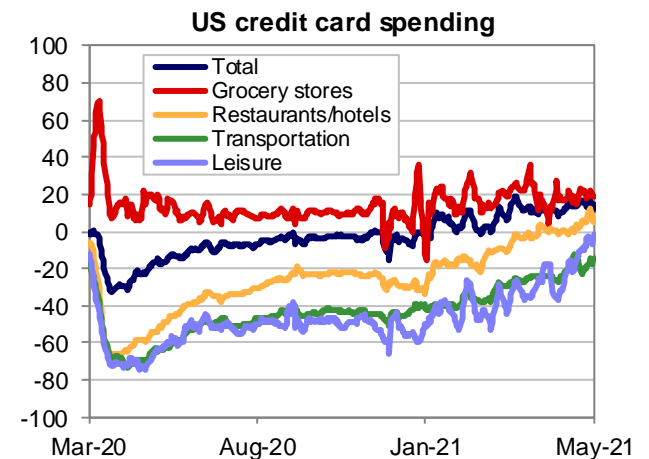
Consumers are the key driver of the economic recovery in Europe and the US. Purchasing power is high, driven by savings accumulated during the lockdowns. In the US, government support programmes (most notably, the stimulus checks handed out to households in January and March) have boosted retail sales to an unprecedented degree. Credit card data show that the segments hit hard by the pandemic (restaurants/hotels, transport and leisure) have been recovering in recent weeks.

The US's huge stimulus programmes are likely to have exacerbated bottlenecks in commodities, global supply chains and some goods categories. Supply bottlenecks weigh on the recovery in some parts of the economy but do not jeopardise a return to normal activity levels at large.

Inflation is currently rising in the US due to temporary capacity constraints, while in the euro area, somewhat surprisingly, no price pressures are discernible in the monthly consumer price data in total. We continue to expect price pressures in the US to ease towards the end of the year. In the medium term, we see inflation within the ranges prevailing in recent years.



Source: National statistics



Source: Opportunity Insights, Affinity Solutions

Overview and forecast

The table shows the consensus forecasts (the average of leading forecasters) and, if consensus figures are not available, IMF estimates. Growth forecasts for 2021 depend heavily on distancing measures, which have been eased much earlier in the US than in Europe. Inflation forecasts point to diminishing price pressure in 2022.

Overview world economy: Consensus forecast

	GDP growth			World share*			Inflation			Current acc.*	Unempl.rate		Governm.budget*			Gov. debt		Pop. (mil.)
	2020	2021	2022	Popul.	GDP	Growth	2020	2021	2022		2020	2021	2020	2021	2022	2020	2021	
Eurozone	-6.8	4.3	3.8	5.6	16.2	15.4	0.3	1.8	1.2	2.8	8.0	8.3	-7.6	-6.7	-3.3	97	98	342
Germany	-5.3	3.4	3.4	1.1	4.7	4.0	0.4	2.5	1.1	7.6	6.0	5.9	-4.2	-5.5	-0.4	69	70	80
France	-8.3	5.7	4.2	0.9	3.3	3.5	0.5	1.5	1.2	-2.1	8.2	8.4	-9.9	-7.2	-4.4	113	115	68
Italy	-8.9	4.6	3.6	0.8	2.4	2.2	-0.1	1.3	0.9	3.5	9.4	10.2	-9.5	-8.8	-5.5	156	157	62
Spain	-11.4	5.9	4.7	0.7	1.7	2.0	-0.3	1.6	1.3	1.0	16.0	16.0	-11.5	-9.0	-5.8	117	118	50
U.K.	-10.1	6.4	5.1	0.9	3.4	4.3	0.9	1.6	1.9	-3.9	4.6	5.2	-13.4	-11.8	-6.2	104	107	66
Switzerland	-3.3	3.4	2.8	0.1	0.9	0.6	-0.7	0.3	0.3	6.7	3.2	3.3	-2.6	-3.4	-0.7	43	45	8
Emerging Europe	-2.7	3.9	3.9	6.3	6.3	6.1	5.4	7.2	5.4	0.6	7.4	7.0	-	-	-	38	37	474
Russia	-3.5	3.3	3.8	1.9	2.0	1.9	3.4	5.3	3.4	3.9	5.9	5.2	-4.1	-0.8	-0.3	19	18	142
USA	-3.5	6.6	3.5	4.4	26.0	22.8	1.3	3.5	2.4	-3.9	8.1	5.5	-15.8	-15.0	-6.1	127	133	335
Latin America	-6.9	5.0	3.1	8.5	6.3	4.9	6.4	7.2	6.6	0.0	10.8	10.5	-8.7	-5.7	-4.5	77	75	647
Brazil	-4.5	4.0	2.6	2.8	2.3	1.5	3.2	5.5	4.0	-0.6	13.4	14.1	-13.4	-8.3	-7.2	99	98	212
Japan	-5.1	2.6	2.5	1.7	6.2	3.9	0.0	0.1	0.7	3.6	2.8	2.9	-12.6	-9.4	-3.8	256	256	126
Asia (excl. Japan)	1.4	5.4	5.0	52.4	28.8	36.0	2.3	2.2	2.2	2.0	-	-	-	-	-	-	-	3975
China	2.3	8.5	5.6	18.4	17.4	24.2	2.5	1.5	1.9	1.6	3.8	3.8	-11.4	-9.6	-8.7	67	70	1394
India	4.2	-7.5	6.9	17.5	3.5	6.0	4.8	6.2	4.1	-1.2	-	-	-12.3	-10.0	-9.1	90	87	1326
Africa/Middle East	-3.7	3.0	4.0	20.2	5.9	5.9	9.7	8.8	7.3	-3.2	-	-	-8.9	-6.6	-5.1	56	56	1535
World	-3.1	5.1	4.0	100	100	100	2.4	3.3	2.7	-	-	-	-	-	-	-	-	7585

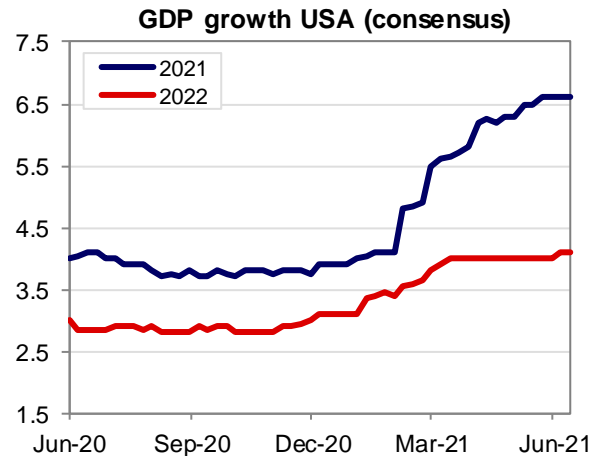
Note: *in % of GDP (2022, unless noted otherwise). Source: National statistics, forecasts Bloomberg-consensus/IMF, own calculations

Global economy: Consensus estimates

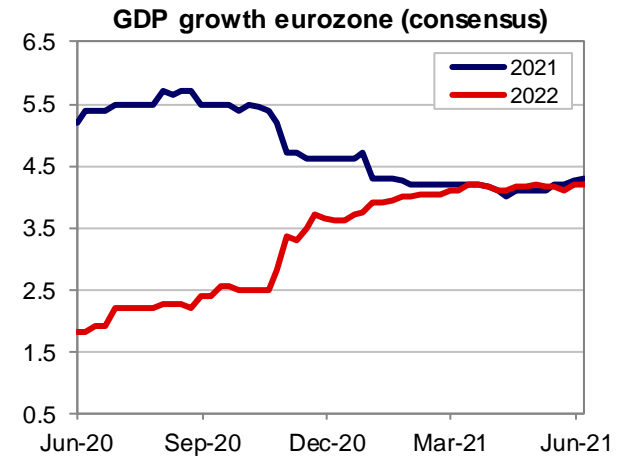
In the US – the key economy for capital markets – the prospects of a rapid, strong economic recovery have continued to improve in recent months following the announcement of significant stimulus packages and progress in vaccine distribution.

In the euro area, distancing measures, which have lasted longer than expected at the beginning of the year, have weighed on the economy in the first half of the year. We see potential for positive surprises in the second half of the year as economies reopen.

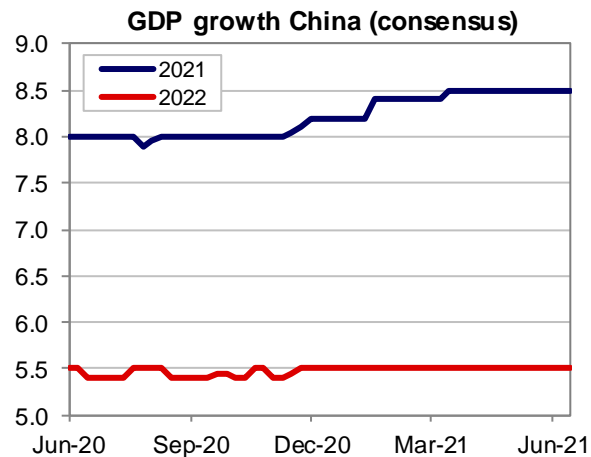
Next year's consensus growth forecast for China points to slowing growth in the medium term.



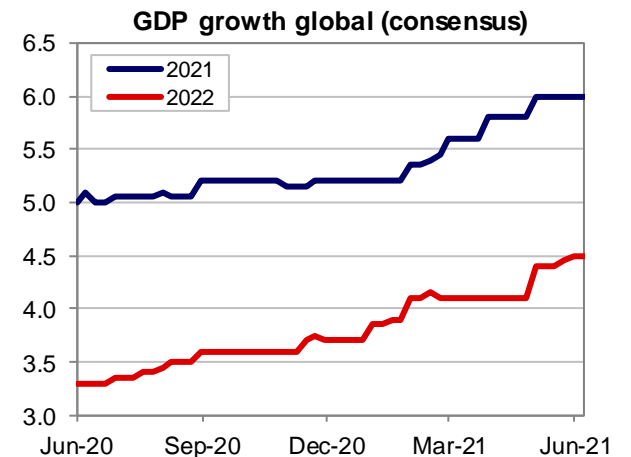
Source: Bloomberg indices



Source: Bloomberg indices



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Source: Bloomberg indices

Chapter 5: World currencies – Mixed dollar trend

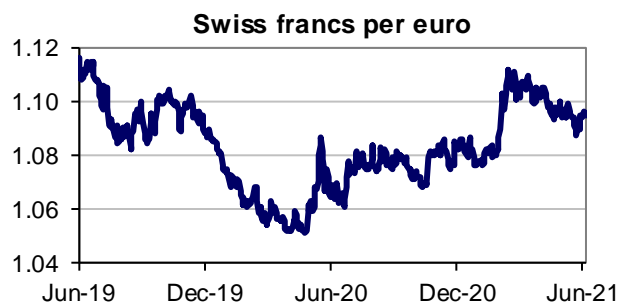
Progress towards economic normalisation should give European currencies upward potential in the remainder of the year, even though a foreseeable end to the US zero-rates policy will mitigate any dollar weakness.

Despite some weakening in recent months, the low inflation rates in Switzerland and an only modest yield discount vs. German government bonds argue for a strong Swiss franc. In addition, upcoming elections – in September in Germany and in spring 2022 in France – suggest some uncertainties ahead, which may benefit safe haven currencies.

An end of the pandemic and a normalising world economy argue in favour of emerging market currencies.



Source: Bloomberg BGN



Source: Bloomberg BGN



Source: Bloomberg BGN

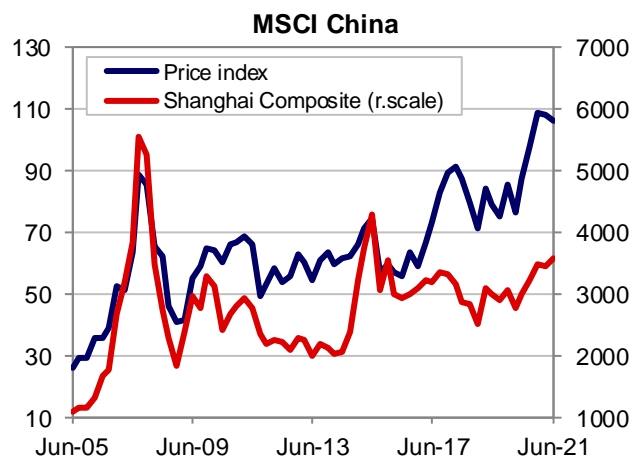
Currencies

	Perform. in euro		C.acc. (%GDP)
	2Q21*	2021*	
Switzerland	1.1%	-1.3%	6.7
Great Britain	-0.8%	4.1%	-3.1
Sweden	1.0%	-0.9%	5.1
Norway	-1.1%	3.3%	2.5
Czech Rep.	2.5%	2.9%	-0.3
Poland	2.7%	1.1%	0.5
Hungary	2.9%	3.1%	-0.2
Russia	3.0%	5.0%	3.8
Turkey	-7.3%	-13.0%	0.9
USA	-1.6%	2.5%	-2.2
Canada	0.4%	6.0%	-2.1
Brazil	12.3%	7.8%	-2.7
Australia	-1.7%	1.1%	0.7
Japan	-1.5%	-4.3%	3.7
China	-0.2%	3.5%	1.0
South Korea	-1.8%	-1.3%	3.6
India	-3.0%	0.8%	-0.9
Indonesia	-1.0%	-1.6%	-2.7

*Data as per 28-Jun-21. C.acc. = Current account balance. Source: National statistics, Bloomberg BGN

Equities China

The MSCI China is dominated by cyclical consumption (especially Alibaba, but also Meituan and JD.com) and communications (most importantly Tencent, the very broadly diversified and leading internet platform). Therefore, the index is geared towards growth. After a period of underperformance, the negative news on Alibaba should be priced in, improving the outlook for the index.



Source: National statistics, MSCI



Source: MSCI

MSCI China: Sector

	Index-Weight	Performance*	
		1 year	3 years
Consumer, cyclical	32.4%	19.4%	26.3%
Communications	19.6%	12.9%	56.0%
Financials	13.8%	7.0%	-10.1%
Healthcare	7.9%	47.1%	58.2%
Information technology	6.4%	39.9%	58.8%
Consumer, staples	5.0%	29.9%	50.4%
Industrials	5.0%	28.5%	9.0%
Real estate	4.2%	-7.7%	-15.4%
Materials	2.6%	47.9%	18.2%
Utilities	1.9%	24.8%	9.0%
Energy	1.3%	14.3%	-31.4%

*Data as per 23-Jun-21. Source: Index provider, own calculations

MSCI China: Top 10 companies

	Index-Weight	Performance*	
		1 year	3 years
Tencent	14.3%	17.1%	46.6%
Alibaba	13.5%	-7.6%	4.6%
Meituan Dianping	4.4%	74.2%	-
China Constr. Bank	2.5%	5.6%	-6.2%
Ping An Insurance	2.4%	-8.5%	7.8%
JD.com	2.4%	22.3%	79.6%
Pindoudou	2.2%	41.4%	-
Xiaomi	2.0%	115.8%	-
Baidu	2.0%	52.1%	-27.6%
Wuxi Biologics	1.9%	186.0%	364.6%
MSCI China	100.0%	18.7%	16.8%

*Data as per 23-Jun-21. Source: Index provider, own

Chapter 9: Investment strategy – Invested, despite stumbling blocks

In the US economy, which is central to the capital markets, normalisation is in full swing, and Europe's economies are now also clearly in solid recovery mode. Corporate profits are growing strongly and – as is typical in an upswing – have on average beaten analysts' forecasts. Fundamental trends and the monetary environment thus remain supportive of the capital markets. Possible stumbling blocks in the seasonally weaker summer months are the continuing price pressures in the USA and an inevitable loss of growth momentum, with purchasing managers indices likely dropping from their currently very high levels.

Against this backdrop, medium-term investors remain invested, even though we see some room for profit taking. In an environment of at least temporarily rising inflation (though the phenomenon is almost entirely confined to the US), commodities and inflation-linked bonds offer a possibility to hedge.

Our investment focus remains on equities. While both equities and corporate bonds are highly valued, equities offer better potential. High-yield bonds have an asymmetric return profile, given record low credit spreads and an expected rise in government bond yields.

In terms of regional equity allocation, the US market remains best positioned in the medium term due to its depth of innovative companies and comparatively stable earnings growth. This year, however, Europe's opportunities are better than usual. Emerging Asia (China accounts for about half of the MSCI Emerging Asia weighting) is home to a number of leading growth companies, and the region has catch-up potential after a period of underperformance.

Among the equity segments, we prefer "growth" in the medium term, but have no preference over "value" in the short term. Unlike in the beginning of the year, we have no clear preference for cyclical stocks and see defensives performing more in line with the overall market going forward. The segment of smaller and medium-sized companies remains strategically attractive, however.

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