J. SAFRA SARASIN
SUSTAINABLE ASSET MANAGEMENT

Cross-Asset Weekly

14 May 2021

Consumer price inflation – asset price moderation

US consumers flocked back to stores in April and helped inflation data to come in well above consensus estimates. Inflation will likely move even higher in May, driven by base effects, before abating over the rest of the year. We reiterate our view that the price pressure in the US will be stickier than the Fed currently thinks. This contrasts with underlying inflation in the Euro area, which should remain more muted.

As a result, we expect moderately higher bond yields and steeper yield curves in 2021. While we continue to see upside for break-even rates across the developed markets' space, most of the move has likely already happened in the US. We expect US real rates to experience some upward pressure in H2 2021 as the Fed will likely become more specific about the timeline for tapering its asset purchases in 2022.

We are leaving our year-end FX targets unchanged. The acceleration of national vaccination programs in the EU has created strong tailwinds for the euro along with European yields, while the US dollar re-embarked on its longer-term downward trend. Going forward, we expect the euro to do well, given that relatively stronger macro momentum likely persists on the back of higher pent-up demand.

Lastly, we reiterate our cautious stance on global equities. The rolling over of US macro momentum removes a key support factor which has propelled equity markets higher over recent months. While we believe that market upside will be sustained until year-end, global equities remain vulnerable to set-backs in the short term and should see a moderation of returns in the second half of the year. We stick to our S&P500 end-year target of 4300, but caution against adding risk in the short term.

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Global Macro: Forecast Update

A rising gap between US and Europe inflation rates

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The US April CPI report shows that the first part of the inflation story – the reopening surge – is real. Inflation is likely to move higher in May before abating over the rest of the year. We reiterate our view that price pressures will probably be stickier than the Fed thinks. Euro area underlying inflation, however, should remain relatively muted.

Inflation is surging as economies are reopening. Still, we expect inflation rates to drop again later this year as the supply side of the economy adjusts to strong demand

We have broadly kept our forecasts unchanged, but we think it's important to reiterate our view on inflation. Over the next several months, base effects and imbalances between supply and demand will push inflation rates to elevated levels across advanced economies. With huge backlogs of orders, capacity constraints and very strong pent-up demand, corporates on both sides of the Atlantic are planning to pass on to their customers some of the increase in costs. And this is already evident in the hard data. US CPI inflation came in at 4.2% in April, much higher than we and the consensus had anticipated (3.6%). We are likely to see a further pick-up over the rest of the quarter. In the euro area, inflation should peak at 2.1% in Q3. But as strong base effects drop out from the annual price comparison calculations and imbalances between supply and demand shrink, inflation should edge lower over the rest of the year.

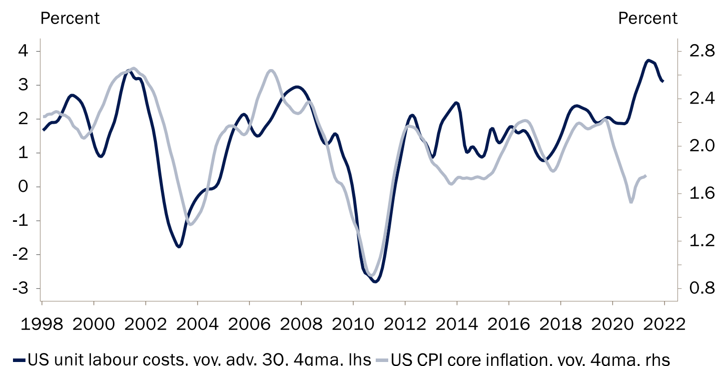
Higher inflation rates are likely to be far stickier in the US than in Europe

Looking further ahead, we anticipate price pressures to be stickier in the US than in the euro area. In Europe, inflation should drop to below 1% in 1Q22 and increase thereafter only very gradually to 1.3% by year end. In contrast, US CPI inflation will trough at about 2% by the beginning of 2022, before rising back to 2.4% by the end of the year, in our view. Different wage- and inflation-expectations dynamics explain these differences. These reflect the respective stages of the economic recoveries, the amount of policy support and the nature of the support provided to workers during the pandemic. In Europe, firms have largely held on to their staff, whose wages have been subsidised by governments. In the US, however, companies fired their employees, whose livelihoods have been protected through fiscal transfers. Many companies are now struggling to re-hire workers, which is leading to upward pressure on wages.

The risks to our US inflation forecasts are tilted to the upside

We see the risks to our US inflation forecasts tilted to the upside. The price of rents and medical care, which account for the bulk of the core CPI basket, could see some sharp upward moves over the coming months. In addition, the Biden administration is pushing for $4trn worth of investment in infrastructure and social programmes. Demand should remain well supported over the next few years, quickly absorbing any increase in labour supply.

Exhibit 1: US unit labour costs are pointing to higher core inflation



Source: Macrobond, Bank J. Safra Sarasin, 12.05.2021

Exhibit 2 : Our macro forecasts are broadly unchanged this month

		2020	2021	2022
US	GDP	-3.5	6.9	3.7
	CPI	1.3	2.6	2.2
Euro area	GDP	-6.6	4.0	3.7
	CPI	0.3	1.6	1.1
Switzerland	GDP	-2.8	3.0	2.9
	CPI	-0.7	0.3	0.7
UK	GDP	-9.9	5.1	4.7
	CPI	0.9	1.7	1.8
Japan	GDP	-4.9	3.8	1.4
	CPI	0.0	0.2	0.8
China	GDP	2.3	8.2	5.4
	CPI	2.5	2.1	2.5

Source: Macrobond, Bank J. Safra Sarasin, 12.05.2021

Global Fixed Income: Forecast Update

Inflation is all the rage

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We expect moderately higher bond yields and steeper yield curves for 2021. While we continue to see some upside for break-even rates across the developed markets' space, most of the move has likely already happened in the US. We expect US real rates to experience some upward pressure in H2 2021 as the Fed will likely become more specific about the timeline for tapering its asset purchases in 2022.

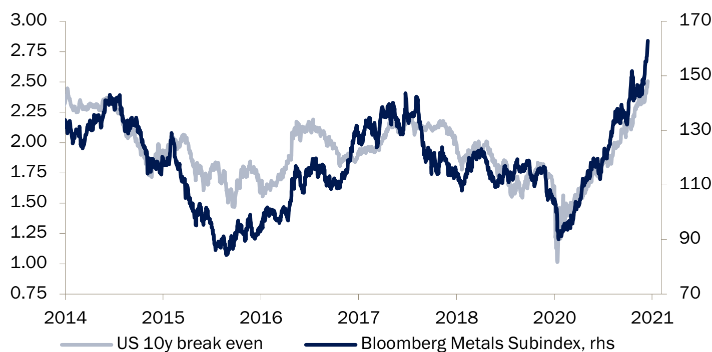
Inflation worries are mounting

Inflation is all the rage at the moment. A resurgence in demand for commodities after the COVID-related shutdowns, emerging supply bottlenecks as well as strong financial flows into the commodity space – as an inflation hedge – are currently driving commodity prices and marked-based inflation expectations (Exhibit 1). Moreover, price components in manufacturing and service PMIs have risen strongly after the pandemic (together with employment costs), stirring up fears about runaway inflation.

US break-evens are already pricing elevated long-term inflation expectations

We have had the long-held view that inflation expectations would rise significantly as the post-COVID recovery was taking hold. Also, we were of the opinion that the US inflation trajectory would more elevated than in the past (see our Cross Asset Weekly *"Higher inflation expectations likely to persist"*, 12th Feb 2021), leading to more persistent break-even rates at the upper end of the historic range. Indeed, 10-year break-even rates in the US have risen by 200bp to 2.5% over the past 12 months, while the rise has been more modest in the euro area. (Exhibit 2). At current levels, US long-term inflation expectations are already substantially above the Fed's average target of 2%. Given that the inflation narrative is in full swing now, there is probably a bit more upside to US break-evens in the short term, but we note that the 2.6% area of 10-year break-even rates is a region that has proved to be difficult to surpass persistently over the past 20 years (Exhibit 2). The reason is that a meaningful move above that level eventually poses the risk of un-anchoring consumers' long-term inflation expectations. The Fed will want to avoid that.

Exhibit 1: Commodity melt-up is driving inflation expectations



Source: Macrobond, Bank J. Safra Sarasin, 12.05.2021

Exhibit 2: US break evens are close to a long-term upper limit

Source: Bloomberg, Bank J. Safra Sarasin, 12.05.2021

Real rates, however, are extraordinarily low

On the other hand, real rates continue to be much lower than usual at this stage of the cycle. They are driven by the Fed's commitment to keep policy rates lower for longer as stipulated by its *Average Inflation Targeting* framework (AIT), but even by those standards they are probably too low now (Exhibit 3). We expect a moderate rise once we have more specific indications as to the time line of tapering, which will likely happen in H2 2021.

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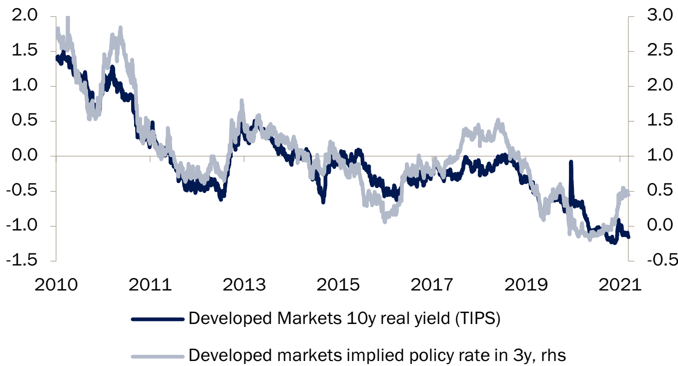
US yields with limited upside

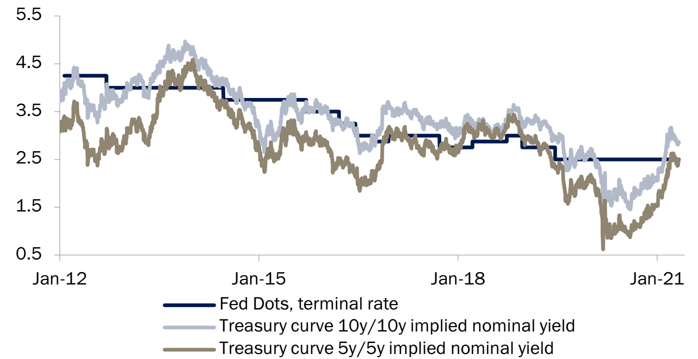
Despite the current low absolute yield levels, the yield curve has undergone a substantial repricing and steepening in the past months. Forward yields are already pricing 5-year and 10-year yield levels close to or above the Fed's terminal rate. We conclude that the upside for US Treasury yields is limited from here (Exhibit 4).

Exhibit 3: DM real yields probably have some upside in H2 2021



Source: Bloomberg , Bank J. Safra Sarasin, 12.05.2021

Exhibit 4: Overall, the upside for Treasury yields looks limited



Source: Bloomberg,, Bank J. Safra Sarasin, 12.05.2021

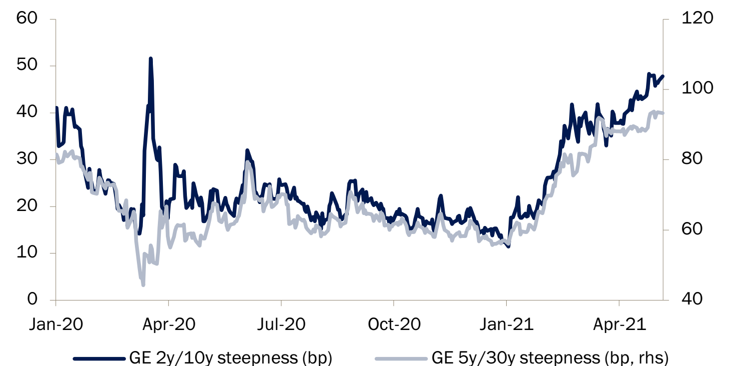
Expect steeper curves in Europe

Unlike in the US, 10-year break-evens in the euro area are still substantially below target (Exhibit 5). With an increase in the pace of vaccinations and a concomitant acceleration in economic growth, markets will likely demand some additional term premium for holding longer dated euro area bonds. The ECB will likely accept some more moderate curve steepening in euro area bond markets along with a further rise in market-based inflation expectations, as long as financing conditions in the euro area do not tighten meaningfully (Exhibit 6). The ongoing asset purchase programs will be an excellent tool for the ECB to engineer a smooth and moderate increase in bond yields led by the long end.

Exhibit 5: Euro area inflation expectations have probably further to go

Source: Bloomberg, Bank J. Safra Sarasin, 12.05.2021

Exhibit 6: Expect EA curves to steepen as the recovery gains traction



Source: Bloomberg, Bank J. Safra Sarasin, 12.05.2021

Forecast update: Policy rates

	13-May-21	Sep-21	Dec-21	Jun-22	Dec-22
US Fed Funds	0.25	0.25	0.25	0.25	0.25
EUR depo rate	-0.50	-0.50	-0.50	-0.50	-0.50
CHF Saron	-0.75	-0.75	-0.75	-0.75	-0.75
BoE base rate	0.10	0.10	0.10	0.10	0.10
JP O/N rate	-0.10	-0.10	-0.10	-0.10	-0.10

Source: Bloomberg, Bank, J. Safra Sarasin, 14.05.2021

Forecast update: 10y Bond yields

	13-May-21	Sep-21	Dec-21	Jun-22	Dec-22
USA	1.66	1.80	1.90	2.10	2.20
Germany	-0.33	-0.20	-0.10	0.00	0.10
Switzerland	-0.27	-0.20	-0.10	-0.10	0.00
UK	0.95	1.00	1.00	1.05	1.20
Japan	0.09	0.10	0.10	0.15	0.15

Source: Bloomberg, Bank J. Safra Sarasin, 14.5.2021

FX: Forecast Update

Cyclical momentum to remain the driving force

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We are leaving our year-end targets unchanged. The acceleration of national vaccination programs in the EU has created strong tailwinds for the euro along with European yields, while the US dollar re-embarked on its longer-term downward trend. Going forward, we expect the euro to do well, given that relatively stronger macro momentum likely persists on the back of higher pent-up demand. Moreover, we are noting some upside for safe havens, which should be limited to the short term.

US dollar real yield advantage has narrowed

The US dollar has declined ever since it reached its year-high on March 30, when the DXY index hit 93.3. With recent European data surprising more positively, government bond yields in several developed countries have risen more than in the US as Treasury yields have consolidated. In our view, the somewhat smaller dollar yield advantage (Exhibit 1) should set the stage for an environment in which cyclical forces should play out more decisively. Hence, we reiterate our view that the anticyclical dollar should weaken further.

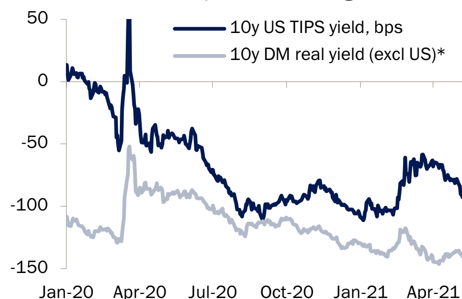
Expect the euro to benefit from more dynamic macro momentum, given that the European lockdowns have likely led to high pent-up demand

Conversely, the European common currency largely benefited from an acceleration of national vaccination campaigns within the EU, which appear to be on the verge of breaking the third wave of Covid-19 infections. We expect the euro to be well-supported by a more dynamic macro momentum, given that the European lockdowns have likely resulted in high pent-up demand. Also, the British pound should continue to benefit from cyclical momentum. Given that the UK's vaccination campaign has already reached an advanced stage, we would expect to see some pound retracement versus the euro throughout the second half of the year.

Increasing risk aversion creates near-term upside for safe havens

The Swiss currency has lately gained some upside momentum as risk sentiment has turned more cautious. Last week, the SNB's average sight deposits held at banks saw the highest weekly increase since last July, revealing that markets have retested the SNB's willingness to intervene in the FX market (Exhibit 2). Beyond the Swiss franc, we also note some near-term upside risk for the Japanese yen and gold (see «Short-term, gold may surprise to the upside», FX Atlas 2021/05/11). Both should benefit from a temporary rotation away from risk assets, while we expect real yields to eventually grind higher, which should act as a headwind for the precious metal towards the end of this year.

Exhibit 1: USD real yield advantage shrank



*calculated as a trade-weighted average of EUR / GBP / JPY 10y real yields

Source: Macrobond, Bank J. Safra Sarasin, 14.05.2021

Exhibit 2: SNB is back in action

Source: Macrobond, Bank J. Safra Sarasin, 14.05.2021

Exhibit 3: Our FX forecasts

	13-May-21	Sep-21	Dec-21
EUR-CHF	1.09	1.10	1.10
EUR-USD	1.21	1.25	1.28
EUR-GBP	0.86	0.87	0.88
GBP-USD	1.41	1.44	1.45
USD-JPY	109	106	105
USD-CHF	0.91	0.88	0.86
USD-CNY	6.45	6.45	6.40
Gold, USD/oz	1'822	1'770	1'770

Source: Refinitiv, Bank J. Safra Sarasin, 14.05.2021

Global Equities: Forecast Update

Moderation

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We reiterate our cautious stance on global equities. The rolling over of US macro momentum removes a key support factor which has propelled equity markets higher over recent months. While we believe that market upside will be sustained until year-end, global equities remain vulnerable to setbacks in the short-term and should see a moderation of returns in the second half of the year. We stick to our S&P500 end-year target of 4300, but caution against adding risk in the short term.

Equity returns are set to moderate as the macro rebound is set to slow from here

We have highlighted in the past few weeks that (a) the peak in US macro momentum tends to be met with a moderation of equity returns and (b) we believe that the second half of 2021 will see positive, yet more subdued equity returns than the first half of the year. Tactically, we believe the market will continue to display a fairly anaemic behaviour, lacking clear macro drivers and is vulnerable to setbacks. The slowdown in US macro momentum slightly dents the recovery narrative equities are priced for. Earnings revisions, which have seen one of the strongest first quarters on record, will likely soften in the weeks ahead and leave the market searching for adequate valuation levels.

Europe tends to lag the global cycle, which should be reflected in equity returns

We continue to see the most upside in European markets, which should benefit from (a) the fact that the European cycle has lagged the cycle in other parts of the world, (b) its selectively defensive exposure (CH & UK) and (c) attractive valuations, in particular compared to the US. We stick to our neutral position on emerging markets equities. Although they have been by far the weakest major market over the past three months, macro- and regulatory headwinds in China are only abating slowly. The deceleration of Chinese macro momentum also explains the sharp underperformance of Japanese equities over the past month. We stick to our cautious position on Japanese equities but acknowledge that there will be a moment in the coming months at which they provide a very attractive entry level.

At the sector level, tech appears the most vulnerable

At the sector level, highly-valued tech names are among the most exposed, in our view. They have been a key beneficiary of the combination of persistently low real rates and rising macro momentum. As the macro rebound is slowing, tech (and tech-heavy consumer discretionary and communication services) appear vulnerable to a setback. We prefer more defensive sectors, given the vulnerable macro environment, and hedge ourselves against rising inflation expectations with some financials exposure (insurers).

Exhibit 1: Region and sector preferences

Regional preferences		Sector preferences	
Emerging Markets	→	Information Technology	↓
China	→	Industrials	→
United Kingdom	↑	Energy	→
USA	→	Materials	↓
Japan	↓	Consumer Discretionary	↓
Eurozone	↑	Banks	→
Switzerland	↑	Insurance	↑
		Communication Services	↓
		Real Estate	→
		Utilities	↑
		Consumer Staples	↑
		Health Care	↑

↑ indicates most preferred
→ indicates neutral
↓ indicates least preferred

Source: Refinitiv, Bank J. Safra Sarasin, 14.05.2021

Exhibit 2: End-2021 targets

	13.05.2021	P/E ratio	Dec 21
S&P 500	4'113	24.9	4'300
Nasdaq 100	13'109	29.8	14'400
FTSE 100	6'963	15.8	7'200
DJ Euro Stoxx 50	3'952	19.8	4'150
DAX	15'200	17.3	15'700
SMI	11'034	18.3	11'700
SPI	14'142	20.2	14'200
SMIM (Mid-Caps)	3'038	24.0	3'250
MSCI Japan	1'128	17.5	1'250
MSCI EM	1'293	12.8	1'400
MSCI China	101	13.9	114

Source: Refinitiv, Bank J. Safra Sarasin, 14.05.2021

Cross-Asset Weekly

14 May 2021

Economic Calendar

Week of 17/05 – 21/05/2021

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 17.05.2021						
US	14:30	Empire Manufacturing Index	May	Index	24.00	26.30
	16:00	NAHB Housing Market Index	May	Index	83.00	83.00
Tuesday, 18.05.2021						
UK	08:00	ILO Unemployment Rate 3Mths	Mar	%	--	4.90%
EU	11:00	GDP SA QoQ	1Q P	qoq	--	-0.60%
	11:00	GDP SA YoY	1Q P	yoy	--	-1.60%
US	14:30	Building Permits	Apr	1'000	1770k	1766k
	14:30	Housing Starts	Apr	1'000	1710k	1730k
Wednesday, 19.05.2021						
UK	08:00	CPI MoM	Apr	mom	--	0.30%
	08:00	CPI YoY	Apr	yoy	--	0.70%
EU	11:00	EU CPI MoM	Apr F	mom	--	0.60%
	11:00	EU CPI YoY	Apr F	yoy	--	1.30%
US	13:00	MBA Mortgage Applications	May14	mom	--	2.10%
	20:00	FOMC Minutes	Apr28			
Thursday, 20.05.2021						
US	14:30	Philadelphia Fed Business Outl.	Apr	Index	42.20	50.20
	14:30	Initial Jobless Claims	Apr	1'000	--	--
	16:00	Conference Board Leading Index	Apr	mom	1.30%	1.30%
Friday, 21.05.2021						
FR	09:15	Markit France Manuf. PMI	May P	Index	--	58.90
	09:15	Markit France Services PMI	May P	Index	--	50.30
GE	09:30	Markit Germany Manuf. PMI	May P	Index	--	66.20
	09:30	Markit Germany Services PMI	May P	Index	--	49.90
EU	10:00	Markit Eurozone Manuf. PMI	May P	Index	--	62.90
	10:00	Markit Eurozone Services PMI	May P	Index	--	50.50
UK	10:30	Markit UK Manuf. PMI	May P	Index	--	60.90
	10:30	Markit/CIPS UK Services PMI	May P	Index	--	61.00
US	15:45	Markit US Manufacturing PMI	May P	Index	62.00	60.50
	15:45	Markit US Services PMI	May P	Index	65.00	64.70

Source: Bloomberg, J. Safra Sarasin as of 14.05.2021

Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W	Δ YTD	TR YTD in %
Swiss Eidgenosse 10 year (%)	-0.20	0	35	-2.0
German Bund 10 year (%)	-0.23	-2	34	-2.2
UK Gilt 10 year (%)	0.79	-5	58	-4.2
US Treasury 10 year (%)	1.57	-6	64	-4.3
French OAT - Bund, spread (bp)	37	1	14	
Italian BTP - Bund, spread (bp)	113	2	2	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	11'111	18.1	0.3	6.5
DAX - Germany	15'197	15.7	0.3	10.8
MSCI Italy	784	13.9	1.2	9.7
IBEX - Spain	8'982	18.9	1.8	11.8
DJ Euro Stoxx 50 - Eurozone	3'999	18.6	0.5	14.0
MSCI UK	1'986	14.2	1.9	11.3
S&P 500 - USA	4'202	22.9	-0.2	12.4
Nasdaq 100 - USA	13'614	28.3	-2.5	5.9
MSCI Emerging Markets	1'341	14.6	-1.7	4.3

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.91	6.4	-0.6	3.0
EUR-CHF	1.09	4.3	-0.3	1.0
GBP-CHF	1.26	7.3	0.1	5.1
EUR-USD	1.21	5.8	0.3	-2.0
GBP-USD	1.39	7.2	0.6	2.1
USD-JPY	109.2	6.0	-0.1	5.8
EUR-GBP	0.87	6.1	-0.4	-4.0
EUR-SEK	10.15	5.2	-0.2	0.7
EUR-NOK	10.01	8.1	0.1	-4.7

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	93	10.5	3.5	20.3
Brent crude oil - USD / barrel	68	27.4	0.7	34.5
Gold bullion - USD / Troy ounce	1'818	13.0	2.6	-4.0

Source: J. Safra Sarasin, Bloomberg as of 14.05.2021

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