Cross-Asset Weekly

11 June 2021

Emerging Markets equities look more attractive again

The macro outlook in Europe looks brighter than we had previously expected and we have revised up our GDP growth numbers for 2021 for the euro area, Switzerland and the UK. We also expect euro area GDP growth to be quite a bit stronger in 2022 (4.4% vs. 3.7% previously). We have made a big downward revision to our 2021 Japan GDP forecast (1.9% vs. 3.8% previously), largely on the back of a disappointing start of the year. Looking further ahead, large capacity constraints, strong expected demand, and loose policy should incentivise businesses to invest more during this business cycle than they did after the financial crisis. Still, recent surveys suggest that supply bottlenecks will probably ease more slowly than we had previously thought. Euro area inflation is likely to peak at 2.4% this summer, but move back to 1.2% early next year. In the US, the picture looks different, and we suspect that not all of the increase in inflation will prove to be transitory. We have revised up our US CPI forecasts to 3.4% for this year (2.6% previously) and to 2.5% for 2022 (2.2% previously). We see few indications that the ECB intends to alter its expansionary policy stance over the coming quarters even though it also revised up its macro forecasts at its meeting yesterday. The Fed, however, will probably gradually change its forward guidance, paving the way to a tapering of its asset purchase programme early next year.

We have left our rates and FX forecasts unchanged and reiterate our expectation of a moderate rise in yields in the latter part of the year. We expect higher inflation rates in the US to weigh further on the US dollar, while cyclical currencies should maintain a relative edge. In equity markets we add risk selectively. The most notable change to our preferences is the upgrade of emerging markets equities. After months of underperformance, we believe emerging markets equities should benefit from a bottoming of the credit cycle in China. As a result, we would prefer Asian markets over other EM regions, which may well see returns level off after the commodity-driven recovery in recent months. Our global sector preferences remain unchanged. We stick to our defensive tilt, as the US cycle is unlikely to re-accelerate over the coming months.

This week's highlights

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Global Macro: Forecast Update

'Harder, better, faster, stronger'

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We have made several changes to our forecasts this month. In Europe, the economic outlook looks stronger than we had previously anticipated, partly reflecting corporates' growing willingness to invest in this business cycle. We have revised up our inflation forecasts too, as supply bottlenecks will probably ease more slowly than we had previously thought. In the US, we see early evidence of downward price stickiness.

We have revised up our GDP growth forecasts for the euro area, Switzerland and the UK

We have revised up our GDP growth forecasts for the European economies this month. We expect the euro area to grow by 4.6% this year (4% previously) and by 4.4% next year (3.7% previously). In the case of Switzerland, we have pushed up our growth numbers by 0.3 and 0.1 ppt for 2021 and 2022 respectively. We also anticipate a much more robust expansion of the UK economy this year, with GDP growing by 6.7% (5.1% previously). The revisions to our 2021 numbers reflect, to a large extent, a smaller than previously expected contraction in output in the first quarter. In the case of the UK and Switzerland, a strong start of the second quarter also has contributed to these upward revisions. What's more, the pace of vaccination in the euro area and Switzerland have taken off, allowing governments to steadily remove restrictions to economic activity. This is boosting our confidence in the ability of these economies to grow above their trend rates over our forecast horizon.

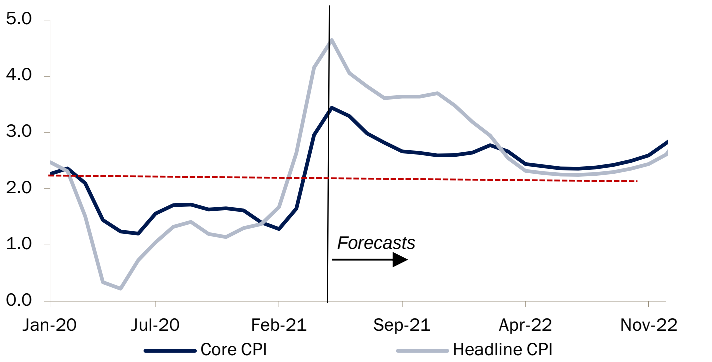
The medium-term outlook for the UK economy remains more uncertain. We have revised down our growth expectation for the Japanese economy

Strong demand, combined with severe capacity constraints, should incentivise corporates to expand capex at a faster pace, as a growing number of surveys have started to indicate. But despite the expected cyclical upswing, we think that the after-effects of Brexit will continue to weigh on the UK economy's medium-term outlook. Finally, we have revised down substantially our 2021 Japan GDP growth forecast (1.9% vs. 3.8% previously), reflecting a much weaker first half of the year than we had previously anticipated.

Inflation across most economies is likely to come higher than previously projected

We have made upward revisions to our inflation forecasts for Europe and the US. These reflect higher oil and food prices, as well as tighter supply bottlenecks than we had previously foreseen. In the case of the US, the last two CPI reports also suggest that higher inflation rates are likely to be stickier than we had forecast (Exhibit 1). We continue to expect no major changes to the ECB's policy stance. The Fed, however, will have to change its forward guidance over the coming months, in our view. We expect QE tapering to start early next year and the lift-off to take place in early 2023.

Exhibit 1: US inflation – probably not all transitory



Source: Macrobond, Bank J. Safra Sarasin, 09.06.2021

Exhibit 2: Macro forecasts in yoy%

		2020	2021	2022
US	GDP	-3.5	6.9	3.7
	CPI	1.3	3.4	2.5
Euro area	GDP	-6.6	4.6	4.4
	CPI	0.3	1.8	1.2
Switzerland	GDP	-2.6	3.3	3.0
	CPI	-0.7	0.5	0.9
UK	GDP	-9.8	6.7	4.5
	CPI	0.9	1.7	1.8
Japan	GDP	-4.7	1.9	1.5
	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, 09.06.2021

Fixed Income & FX: Forecast Update

Along with inflation, cyclical momentum to remain key

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We have left our rates and FX forecasts unchanged and reiterate our expectation of a moderate rise in yields in the latter part of the year. We expect the persistence of higher inflation in the US to catalyse further USD weakening, while the euro should maintain a relative edge given stronger expected macro momentum.

Surprisingly high CPI prints have brought inflation back in focus

With the April and May US CPIs having risen to historical highs, inflation remains in focus. Along with the steep surge in commodity prices, the unexpectedly high inflation prints have also led the market to reprice their future inflation expectations, which resulted in another substantial increase in break-even inflation throughout May, while some retracement has been visible as of late (Exhibit 3). We have repeatedly noted that for US 10-year break-even rates, the 2.6% area has proved to be a region difficult to surpass over the past 20 years. Hence we expect only little upside going forward, given that US long-term inflation expectations have already moved substantially beyond the Fed's average target of 2%. A further meaningful increase would signal a de-anchoring of expectations on the upside, which would most likely trigger a more forceful reaction from the Fed. Still, the future path of inflation will remain a key driver in our FX and rate projections.

We expect bond yields to increase modestly until year end and in 2022

We have not changed our rate forecasts (Exhibits 1 and 2). Though the upside for US Treasury yields looks limited (given that forward yields are already pricing 5- and 10-year yield levels close to or above the Fed's terminal rate), we should see a moderate rise in yields once the Fed becomes more specific about QE tapering, which may occur around the Jackson Hole meeting in late August 2021. In euro area bond markets, we expect some further rise in market-based inflation expectations, alongside some curve steepening. Any steepening of the curve is likely to be moderate as we expect the ECB to continue purchasing a substantial amount of bonds via its different programmes.

Exhibit 1: Our policy rate forecasts

	09-Jun-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: Refinitiv, Bank J. Safra Sarasin, 10.06.2021

Exhibit 2: Our 10y bond yield forecasts

	09-Jun-21	Sep-21	Dec-21	Jun-22	Dec-22
USA	1.49	1.80	1.90	2.10	2.20
Germany	-0.20	-0.20	-0.10	0.00	0.10
Switzerland	-0.13	-0.20	-0.10	-0.10	0.00
UK	0.80	1.00	1.00	1.05	1.20
Japan	0.06	0.10	0.10	0.15	0.15

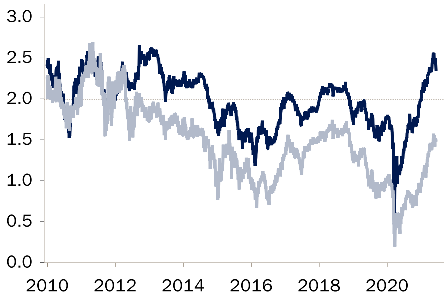
Source: Refinitiv, Bank J. Safra Sarasin, 10.06.2021

We reconfirm our FX year-end targets and continue to expect further USD weakening

Moreover, we reconfirm our FX year-end targets (Exhibit 7). We expect the dollar weakening trend to carry on for the next 12 to 18 months. In light of the strong wage pressures that employers are facing across the Atlantic, we think that the increase in US inflation is likely to be more persistent than elsewhere (Exhibit 4), which should weigh on the US dollar well into next year (see «Higher US inflation likely to keep the dollar weak», FX Atlas 2021/06/08). What's more, the narrowing gap between the US shadow policy rate – which aims to reflect the 'effective' policy rate by taking into account other measures such as QE and forward guidance – and the ones of the euro area and the UK has weighed on the dollar (Exhibit 5). A very dovish Fed in the near term could narrow that gap further.

Exhibit 3: US break-evens retreated in June

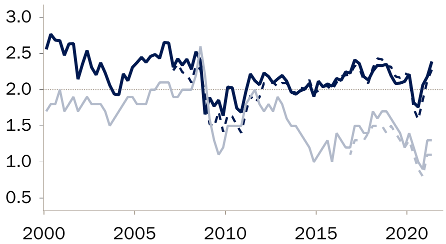
Market implied 10y breakeven inflation rates



Source: Macrobond, Bank J. Safra Sarasin, 10.06.2021

Exhibit 4: US inflation expected to be higher

Survey of Professional Forecasters
2022 inflation expectations, mean point estimate



Source: Macrobond, Bank J. Safra Sarasin, 10.06.2021

Exhibit 5: Shadow rates suggest weaker USD

*based on USD vs EUR / GBP, applying DXY TWs

Source: Macrobond, Bank J. Safra Sarasin, 10.06.2021

The euro should grind higher, while we should see the pound inching lower versus the European common currency

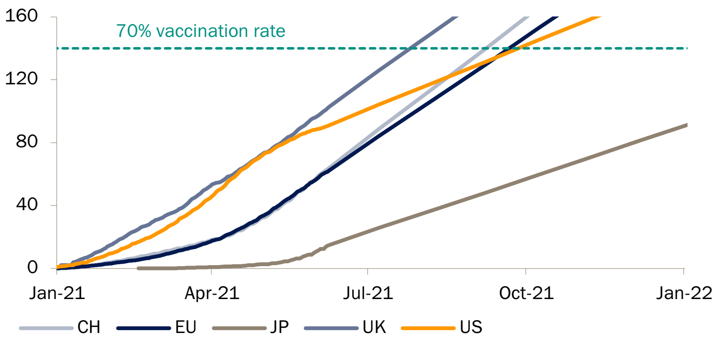
The outlook for the euro looks positive. The euro area economy is at an earlier cyclical stage than the US economy is. Given that most euro area economies have started to ease their lockdowns only recently, we continue to expect a more dynamic rebound potential for the euro area – a development, which should be additionally fuelled by the strong pick up in the pace of vaccinations (Exhibit 6). To the contrary, the pound has likely priced much of the vaccination-related tailwinds and the concomitant acceleration of economic activity. As a result, the GBP upside towards year end should be rather limited. In addition, the flare-up of tensions on the enforcement of Northern Irish customs borders in the aftermath of Brexit once again underscores that some more «post-Brexit struggles» may be still ahead, which should materialise in some pound retracement versus the euro.

The PBoC's higher reserve ratio requirement for foreign currency deposits is unlikely to derail the renminbi appreciation trend

The Chinese renminbi should grind higher versus the US dollar on the back of structural drivers and as China has allowed its currency to float more freely over the past 2-3 years. Yet the growing upward momentum has prompted the People's Bank of China (PBoC) to increase its reserve ratio requirement on foreign currency deposits in an effort to counter excessive currency appreciation. While the move may slow the pace of CNY appreciation, the decision should not unwind the overall appreciation trend. Despite a slowing Chinese cycle, we also expect the Japanese yen to push higher. Along with strong global growth, the yen should benefit from a slowing upside momentum in global equities, which in the past usually yielded support to the currency.

Exhibit 6: EU's vaccination pace finally exceeds US

Vaccine doses per capita, % (FC is based on latest mom growth)



Source: Macrobond, Bank J. Safra Sarasin, 10.06.2021

Exhibit 7: Our FX forecasts

	09-Jun-21	Sep-21	Dec-21	Jun-22	Dec-22
EUR-CHF	1.09	1.10	1.10	1.09	1.08
EUR-USD	1.22	1.25	1.28	1.30	1.32
EUR-GBP	0.86	0.87	0.88	0.89	0.90
GBP-USD	1.41	1.44	1.45	1.46	1.47
USD-JPY	110	106	105	103	100
USD-CHF	0.90	0.88	0.86	0.84	0.82
USD-CNY	6.39	6.35	6.30	6.25	6.20
Gold, USD/oz	1'890	1'820	1'770	1'800	1'830

Source: Refinitiv, Bank J. Safra Sarasin, 10.06.2021

Cross-Asset Weekly

11 June 2021

CARBON NEUTRAL 2035 CLIMATE PLEDGE

Global Equities: Forecast Update

Emerging markets looking more attractive

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We add equity market risk selectively. The most notable change to our preferences is the upgrade of emerging markets equities. After months of underperformance, we believe emerging markets equities should benefit from a bottoming of the credit cycle in China. As a result, we would prefer Asian markets over other EM regions, which may well see returns level off after the commodity-driven recovery in recent months. Our global sector preferences remain unchanged. We stick to our defensive tilt, as the US cycle is unlikely to re-accelerate over the coming months.

We remain cautious on global equities…

We reiterate the cautious view which has guided our positioning over recent months. The US macro cycle has moved beyond its acceleration phase and leaves markets in some sort of vacuum. Global equities (dominated by US equities) appear largely priced for a continuation of the strong run in earnings upgrades they have experienced over recent months. As such, they are exposed to the risk of a setback if that implied trajectory fails to materialise. We expect the market environment to remain difficult in the months to come, given that various tailwinds are set to fade or even turn into headwinds. This ranges from a Fed which is likely to start scaling back its support measures (unless the macro deteriorates) to a fiscal impulse, which has likely peaked in the US and will almost certainly turn negative in 2022. As a result, we keep our end-year target for the S&P 500 unchanged at 4300 and continue to have a slight preference for defensive sectors, with global sector preferences mostly reflecting the view on the US market.

…but add risks selectively. We raise our preference for emerging markets equities

Despite this cautious outlook for global equities, the outlook for emerging markets equities is starting to improve, in our view. Most importantly, the Chinese credit cycle appears closer to a trough after deteriorating since the beginning of the year. An improvement in Chinese equity performance should translate into EM equity outperformance, given the weight and significance of the Chinese equity market for EM in general and EM Asia in particular. As a result, we would expect EM Asia to lead other EM regions in the near term.

We keep our preference for Europe but the region's outperformance is well progressed

Lastly, we retain our preference for European equities but believe that the region's outperformance is well progressed as valuation gaps have started to close and the cycle in Europe is becoming more mature. Switzerland stands out, given that it benefits from stable or lower rates, remains attractively valued and is resilient against downside risks.

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	↓
↑ indicates most preferred		Real Estate	→
→ indicates neutral		Utilities	↑
↓ indicates least preferred		Consumer Staples	↑
		Health Care	↑

Source: Macrobond, Bank J. Safra Sarasin, 10.06.2021

Exhibit 2: End-2021 targets

	09.06.	P/E ratio	Dec-21
S&P 500	4'220	25.6	4'300
Nasdaq 100	13'815	31.4	14'100
FTSE 100	7'081	16.1	7'400
DJ Euro Stoxx 50	4'097	20.5	4'250
SMI	11'788	19.6	11'900
MSCI Japan	1'196	18.6	1'230
MSCI EM	1'373	13.6	1'460
MSCI China	107	14.7	117

Source: Macrobond, Bank J. Safra Sarasin, 10.06.2021

Economic Calendar

Week of 14/06 – 18/06/2021

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 14.06.2021						
EU	11:00	Industrial Production SA MoM	Apr	mom	0.40%	0.10%
	11:00	Industrial Production SA YoY	Apr	yoy	37.40%	10.90%
Tuesday, 15.06.2021						
GE	08:00	CPI EU Harmonised MoM	May F	mom	0.30%	0.30%
	08:00	CPI EU Harmonised YoY	May F	yoy	2.40%	2.40%
US	14:30	Retail Sales Control Group	May	mom	0.60%	-1.50%
US	14:30	PPI Ex Food and Energy MoM	May	mom	0.50%	0.70%
	14:30	PPI Ex Food and Energy YoY	May	yoy	4.80%	4.10%
	15:15	Capacity Utilisation	May	%	75.10%	74.90%
	16:00	NAHB Housing Market	Jun	Index	83.00	83.00
Wednesday, 16.06.2021						
JN	01:50	Core Machinery Orders MoM	Apr	mom	2.50%	3.70%
	01:50	Core Machinery Orders YoY	Apr	yoy	8.00%	-2.00%
UK	08:00	CPI MoM	May	mom	--	0.60%
	08:00	CPI YoY	May	yoy	--	1.50%
US	13:00	MBA Mortgage Applications	Jun11	mom	--	-3.10%
	14:30	Housing Starts	May	1'000	1650k	1569k
	14:30	Building Permits	May	1'000	1738k	1760k
	20:00	FOMC Rate Decision (Upper B)	Jun14	%	0.25%	0.25%
Thursday, 17.06.2021						
EU	11:00	CPI MoM	May F	mom	0.30%	0.30%
	11:00	CPI YoY	May F	yoy	2.00%	1.60%
US	14:30	Philadelphia Business Outlook	Jun	Index	31.50	31.50
	14:30	Initial Jobless Claims	June12	1'000	--	376k
	16:00	Leading Index	May	mom	1.10%	1.60%
Friday, 18.06.2021						
JN		BOJ Policy Balance Rate	Jun18	%	--	-0.10%
		BOJ 10-yr Yield Target	Jun18	%	--	0.00%
UK	08:00	Retail Sales Ex Auto Fuel MoM	May	mom	--	9.00%
	08:00	Retail Sales Ex Auto Fuel YoY	May	yoy	--	37.70%

Source: Bloomberg, J. Safra Sarasin as of 10.06.2021

Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W	Δ YTD	TR YTD in %
Swiss Eidgenosse 10 year (%)	-0.19	-5	36	-2.1
German Bund 10 year (%)	-0.26	-4	31	-2.1
UK Gilt 10 year (%)	0.75	-4	53	-4.0
US Treasury 10 year (%)	1.44	-11	52	-3.3
French OAT - Bund, spread (bp)	37	0	14	
Italian BTP - Bund, spread (bp)	105	-3	-6	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	11'811	19.2	2.6	13.4
DAX - Germany	15'571	15.6	-0.4	13.5
MSCI Italy	817	14.3	0.6	14.4
IBEX - Spain	9'134	19.1	-0.1	14.1
DJ Euro Stoxx 50 - Eurozone	4'096	18.7	0.4	17.4
MSCI UK	1'990	13.9	0.3	12.0
S&P 500 - USA	4'239	22.5	1.1	13.6
Nasdaq 100 - USA	13'960	28.4	3.2	8.7
MSCI Emerging Markets	1'379	14.7	-0.3	7.5

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.89	5.7	-0.6	1.4
EUR-CHF	1.09	3.8	-0.4	0.5
GBP-CHF	1.27	6.0	-0.5	5.5
EUR-USD	1.22	5.2	0.2	-0.9
GBP-USD	1.42	6.2	0.1	4.0
USD-JPY	109.4	5.3	-0.1	6.0
EUR-GBP	0.86	5.0	0.1	-4.7
EUR-SEK	10.04	4.9	-0.2	-0.4
EUR-NOK	10.07	7.9	-0.4	-4.2

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	95	14.7	1.0	22.9
Brent crude oil - USD / barrel	72	24.6	1.4	41.2
Gold bullion - USD / Troy ounce	1'900	11.6	1.6	0.3

Source: J. Safra Sarasin, Bloomberg as of 10.06.2021

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