J. SAFRA SARASIN
SUSTAINABLE ASSET MANAGEMENT

CIO Update

Investment Committee Bank J. Safra Sarasin
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Peak growth

Global economic growth peaked in the second quarter. It is probably a good idea to take profits on equities, but still stay invested.

Macro outlook – As good as it gets?
It is true that maintaining the positive momentum of the recent economic recovery is almost impossible. The US economy grew by 6.4% p.a. in the first quarter of this year, following annualized growth rates of 33.4% and 4.3%, respectively, in the previous two quarters. In addition, strong leading indicators are pointing to an optimistic outlook. The purchasing managers' index for the US printed 63.5 points in April, the highest level on record. A similar picture is emerging in other regions of the world. This is not surprising, as consumers have built up considerable financial resources due to a (forced) high savings rate, which should maintain this positive momentum in the second half of the year. Added to this are long-term spending programs in the US amounting to around USD 4 trillion, which have been set in motion. Whether and in what final form these ambitious plans will be passed is likely to become clear in the coming months.

So while the US economy appears to have emerged from the COVID 19 recession, Europe is rather sluggish. Economic output has declined again in the first quarter of this year, while Europe's regions are patiently awaiting the fiscal stimulus of the "Next Generation EU Fund", the first tranches of which are expected to be disbursed in the summer. The good news is that Europe is expected to have overcome its W-shaped double-dip recession in the course of the second quarter. An economic recovery path is therefore emerging which, although far from synchronous, is heading in the same direction.

Purchasing managers' indices at their peak?

Source: Refinitiv, Bank J. Safra Sarasin, monthly data, Jan 1998 to April 2021

Editorial
Dear readers

With the imminent transition from the economic acceleration phase to a moderation phase, the outlook for the financial markets remains fundamentally positive.
Nevertheless, it makes sense to rethink portfolio risk and take initial profits at the time when growth is peaking. There are a number of reasons why the short-term outlook for equity markets is less positive. Not least, history shows that returns usually are below average during the summer months. This year, however, one should add "...but don't go away" to the "Sell in May" adage. As the medium-term outlook remains positive, one should stay invested in equities, but at the same time prepare the portfolio carefully for the next phase.

Philipp E. Bärtschi, CFA, Chief Investment Officer

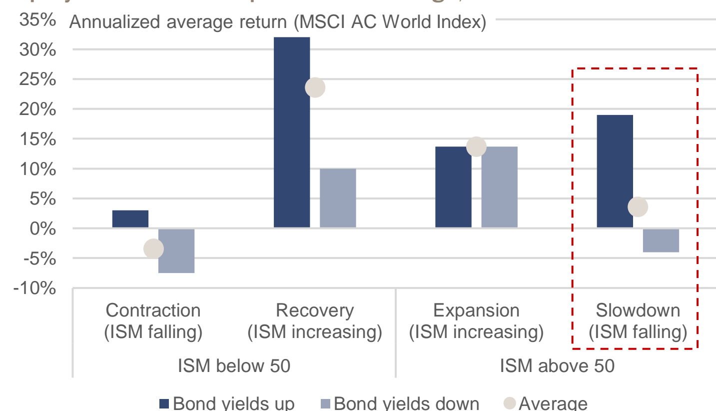
Bonds – Rising yields ahead?

The economic recovery of recent months, accompanied by extensive monetary and fiscal policy measures, and the prospect of its continuation in the coming quarters have caused inflation expectations priced on the bond market to rise significantly. Both short- and long-term inflation expectations are at their highest level in around ten years. Price pressure is not only evident in the commodity markets. Supply bottlenecks and business surveys increasingly point to rising inflation rates. However, neither the US Federal Reserve nor US Treasury Secretary Janet Yellen expect a sustained rise in inflation. Nevertheless, against the backdrop of the strong economic recovery and extensive fiscal policy measures in the US, she had raised the prospect of the need for rising interest rates. "It may be that interest rates will have to rise somewhat to make sure that our economy doesn't overheat," Ms. Yellen said. The bond market takes a similar view. Reactions were correspondingly muted.

Equities – Transition phase

Not so equities markets, which immediately reacted with significant price declines. The strong negative reaction showed how fragile and uncertain the markets are at current valuation levels. We are currently in a transitional process between the dynamic recovery in the aftermath of the recession and an expansionary phase in which the economy is still expanding, but at a slower pace. In this phase, developments on the equity markets are more heterogeneous and differentiated, and increasingly dependent on the interplay between growth and interest rate developments. A consolidation phase after the strong rally is therefore very likely.

Equity market returns positive on average, but more differentiated



Source: Refinitiv, Bank J. Safra Sarasin, monthly data, Jan 1988 to April 2021

However, strong growth, solid corporate earnings and fiscal and monetary policy support remain positive for equities in the medium term. Against the backdrop of slightly rising interest rates, cyclical value stocks in particular are likely to benefit.

Asset Allocation – Realize profits, but stay invested

Global equities have risen by around 80% since March last year. Following the strong rally, market participants are increasingly talking about "peak growth momentum" or "peak PMIs" - the expectation that rates of change in macroeconomic data have peaked and that their positive momentum will decline in the coming months. Against this backdrop, the strong performance of cyclical assets has taken a pause.

Although the cyclical trends themselves are likely to continue in the medium term, we are adopting a more neutral positioning within our equity allocation in the short term and are realizing initial gains. Volatility in the stock markets has risen again recently and is likely to remain with us in the coming months. Uncertainty is high with regard to future economic developments, the inflation path, higher interest rates, current valuation levels and tax plans in the context of fiscal policy measures in the US. There are therefore a number of potential catalysts that could lead to a correction and thus to better opportunities. We continue to favour equity markets outside the U.S., where economic activity levels still have significant catch-up potential and the economic setup is more cyclical. In addition, there is a lower probability of adverse developments in monetary, fiscal and regulatory matters.

We expect the positive economic development to continue in the coming quarters and that, in combination with rising inflation rates, this will lead to slightly higher yields. We therefore maintain our underweight in government bonds. We prefer high-yield bonds to investment-grade bonds. The quality of the segment has improved due to rating downgrades of investment grade bonds and default rates are likely to be below the long-term average this year. In addition, high-yield bonds are benefiting from the improved economic environment and are more resilient to rising nominal yields due to lower duration compared to investment grade.

The current peak in the economic recovery offers a good opportunity for a pause to catch one's breath and enjoy the view. It is probably worthwhile to reduce portfolio risk slightly, but still remain invested. Because even if the upside potential is low in the short term, the medium-term outlook for a multi-asset portfolio remains positive.

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Attractiveness of individual investments

Asset class	Weighting	Relative attractiveness within the categories			
Equities	=	Developed markets =	Emerging markets =	Large caps =	Small caps =
Bonds	–	Government bonds – –	Corporate bonds – –	High-yield bonds +	Emerging markets +
Alternative assets	+	Money market +	Convertible bonds =	Other alternatives +	Real Estate =

Source: Refinitiv, J. Safra Sarasin

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