J. SAFRA SARASIN
SUSTAINABLE ASSET MANAGEMENT

CIO Update

Investment Committee Bank J. Safra Sarasin
11 February 2021

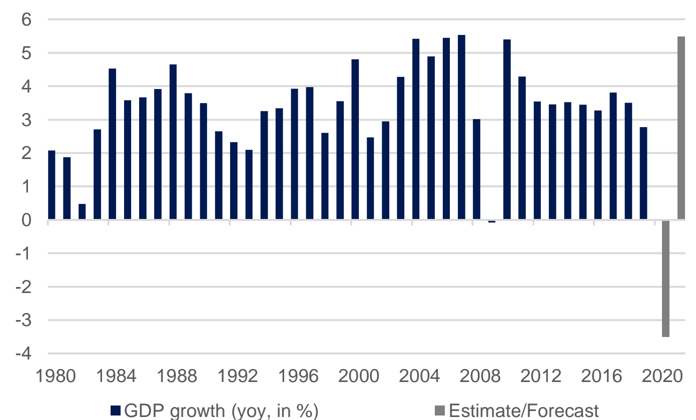
Onwards and upwards

Despite setbacks, vaccine distribution is moving forward and the equity markets upwards.

Macro outlook – China as growth engine
The 46th President of the United States, Joseph R. Biden, moved into the White House in January, and with him the hope for a more orderly and less erratic policy style. The focus on fighting the pandemic and the related fiscal policy measures should have a meaningfully positive impact on US economic growth this year. Not least because the Democrats now have a majority in both chambers of Congress and this majority should be enough to initiate fiscal policy measures. However, the narrow Senate majority will not be enough to push through controversial reforms, such as major tax changes. A welcome environment for financial markets. With regard to foreign policy, it has already become clear in the first days after President Biden's inauguration that the political direction vis-à-vis China will be maintained, although the style is likely to change significantly.

In economic terms, the Middle Kingdom came through the past year relatively unscathed. Thanks to the successful containment of the pandemic and also due to generous stimulus measures, China is the only one of the major economies to have achieved positive economic growth in 2020. In contrast, other countries are in the midst of fighting new waves of COVID-19 infections. Now, while several vaccines are already available, vaccine distribution is surprisingly slow. In addition, coronavirus mutations add to the uncertainty about achieving herd immunity soon. This is likely to weigh on sentiment indicators and macro data in the short term. Ultimately, however, we expect significant economic growth for the year as a whole due to a gradual improvement in the vaccination strategy and especially due to the extensive fiscal and monetary policy measures.

IMF expects strongest global economic growth since 2007



Source: Refinitiv, IMF, Bank J. Safra Sarasin, annual data, 1981 to 2021

Editorial

Dear Readers,

One of the most important skills for successful investors is to distinguish the essential market information from the rest, the so-called noise.

In this sense, the media story of retail investors banding together on social media to fight hedge funds falls into the noise category. After a few days of high volatility, the spectacle was over and markets refocused on the main issues. The economic recovery is on track despite vaccination mishaps, corporate profits will rise significantly in 2021 and nothing stands in the way of higher share prices. For this reason, we are also maintaining our clear overweight in risky assets.

Philipp E. Bärtschi, CFA, Chief Investment Officer

This has a direct impact on the inflation trend. Inflation expectations have recently risen noticeably in many regions. On the one hand, this is due to increased demand and low inventories in the months after the end of the first lockdown in March and April last year. On the other hand, due to a significant price increase of industrial metals.

Bonds – Rising long-term interest rates
The recent rise in inflation expectations has translated into rising yields and steeper yield curves in government bond markets. The environment for government bonds, but also investment grade bonds, will remain challenging due to already historically low yields and low credit spreads. After all, while the credit risk premiums on high-quality bonds offer a barely sufficient safety buffer, this is still a valid investment argument for high-yield and emerging market bonds. Especially since substantial fiscal policy measures are keeping default rates low and a weak dollar should support inflows into emerging market assets. Although the US dollar recovered slightly, especially against the euro, at the beginning of February, the medium-term trend is likely to remain downward, giving a boost to investments outside the US.

US Dollar in a downtrend

Source: Refinitiv, Bank J. Safra Sarasin, daily data, 31.1.2020 to 10.2.2021

Equities – Hardly any time to catch a breath
The strong performance of cyclical sectors and regions has recently lost momentum due to a vaccination start that did not go smoothly in many regions of the world. In Europe in particular, investors' doubts about the growth and profit potential of companies have weighed on prices. However, this does not mean that the general direction has changed. The recent price increases in some equity segments have been intense anyway and a certain fatigue after this sprint to be expected. Equities currently remain supported both technically and fundamentally.

On the one hand, inflows into the asset class have increased significantly since November last year. In particular, inflows into European equities and emerging market equities - both regions with a high share of cyclical sectors - have been exceptionally strong. This development can also be seen at the sector and style level. On the other hand, companies are delivering extremely robust earnings in the current reporting season. Especially in the US, where the majority of companies reported better-than-expected results for the fourth quarter of 2020. It is therefore not surprising that after a small setback at the end of January, new record highs were reached in the US equities market just a few days later. The trend for equities continues to point upwards.

Asset Allocation – Positive environment for risky assets
Economic uncertainty has increased noticeably recently. But we expect the first positive effects of the vaccine coverage to become apparent in the second quarter. This will not only reduce uncertainty about macroeconomic developments, but also increase the predictability of corporate earnings. We are still in an early phase of the economic cycle, whose increasing growth momentum is likely to be accompanied by rising interest rates and inflation rates. As long as interest rates rise only gradually, which we expect, this is a generally positive environment for equities and other risky assets. We hence remain overweight in cyclical sectors that benefit most from such an environment. Small companies in particular outperform at the beginning of an economic cycle. On a regional level, we are overweight in emerging market regions in particular.

We remain underweight in bonds, especially government bonds. Due to the more favourable risk-return profile, we prefer high-yield and emerging market bonds to investment-grade bonds. We plan to gradually increase our overweight in emerging markets bonds, as they offer a significantly higher credit risk premium and should benefit from additional capital flows. We have recently reduced credit and duration risks in the investment grade segment somewhat and slightly increased our cash position.

We remain slightly overweight in alternative investments that are as uncorrelated as possible in order to ensure an efficient diversification contribution at the portfolio level.

Contact
Philipp E. Bärtschi, CFA,
Chief Investment Officer
+41 58 317 3572 | philipp.baertschi@jsafrasarasin.com

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: J. Safra Sarasin, 11.2.2021

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Bank J. Safra Sarasin Ltd
Alfred-Escher-Strasse 50
P.O. Box
CH-8022 Zürich
T: +41 (0)58 317 33 33
F: +41 (0)58 317 33 00
www.jsafrasarasin.com