INDOSUEZ
WEALTH MANAGEMENT

MONTHLY HOUSE VIEW

Marketing Material - September 2021

Focus
Pro-cyclical inflation

Architects of Wealth

• Table of contents

01 • Editorial

COMMON PROSPERITY: CONVERGENCE OR DIVERGENCE BETWEEN THE EAST AND THE WEST?

VINCENT MANUEL

Chief Investment Officer, Indosuez Wealth Management

Dear Reader,

This decade is decidedly unlike any in the past. In just a year, Western countries have gone from a triple consensus of liberalism/globalisation/ budgetary discipline to a more controlled view of capitalism and greater protection of their borders, while launching fiscal stimulus programmes unprecedented in size. This recalls the welfare state of the Roosevelt years or post-war years in Europe, when the role of the State increased substantially, and the economic goal of governments was not limited to growth rates but was to increase the well-being of the population. The question that arises now for companies is whether tax hikes and the acceptability of a higher dose of wage inflation will not end up impacting the record margins recorded in Q2, which have driven stock markets to new highs.

On the other side of the world, change of scene in China as well. After close to three decades of somewhat unbridled development of capitalism initiated by the first reforms of Deng Xiaoping and continued by Jiang Zemin and then Hu Jintao, the China of Xi Jinping appears to be implementing a different calibration between the State and the market. The regulatory tightening seen this summer in a growing list of sectors is in line with the search for “common prosperity”, a concept advocated on many occasions by Xi Jinping’s predecessors, and recently reiterated at the party’s 100th anniversary.

This is not just a slogan: the idea this time is to recreate the conditions for greater sharing and participation of the population in growth - following a sharp rise in inequalities - and to favour the demographics of an already ageing country, where the costs involved in having children (housing, education) have become exorbitant.

What resembles economic dirigisme, with spectacular decisions that have virtually reduced the market value of entire market sectors to nothing, such as education, is not a step backwards. This is not the end of Chinese capitalism, but a new phase marked by a stronger State presence and the search for a balance between the market and society, a condition for the social stability of the country, and vital to the party. Furthermore, it involves limiting the power of the large technology groups and their use of data. Three lessons can be learned: firstly, in China announcements are followed by actions, and more rapidly than anticipated; second, policymakers appear immune to the lobbying of the sectors concerned; third, the list of the sectors concerned could become longer.

After 18 months during which investors focused on the pandemic and then the monetary and fiscal recovery plans, it might be time to shift attention to the question of the political framework and changes underway, which could see three versions of capitalism and policy-mix emerge: a neo-Rooseveltian model in Washington (the State as reformer and builder), a neo-Beveridgian model in Europe (the State as insurer and redistributor) and State-directed prosperity in China. This becomes all the more necessary as the geopolitical events of the summer have accelerated the already well-anchored trends: the fallback of the US, the impossible interventionism of Europe, the ramp-up of China’s regions.

PRO-CYCLICAL INFLATION

In recent months, rising prices in the US have been a hot topic in the markets with inflation reaching record levels. The Fed's view on transitory inflation – explained by base effects and supply bottlenecks due to reopening economies implying a strong recovery – has been endorsed by the markets and reflected by stabilising inflation expectation while inflation numbers seem to have peaked in recent publications. Nevertheless, we can wonder if in the medium term, possible rising expectations and faster wage growth could trigger sustained inflation.

Workers real income decreased

1.7%

on a YoY basis

In June, leisure and hospitality business added a seasonally-adjusted 394'000 jobs, but many of these companies, which rely mainly on low-paid workers, struggled to hire new workers and meet the increasing demand implied by the strong recovery of the US economy. In response to this, companies such as Chipotle or McDonald's decided to increase wages in order to attract new workers. For Chipotle, this decision has paid off as hiring accelerated, but the company also decided to pass on higher labour costs on prices with a 3.5% to 4% increase on the menu. While some may consider current inflation as transitory, wage inflation is anything but transitory, as companies do not cut wages as they could cut prices: wages are stickier.

WAGE INFLATION: A 2022 STORY?

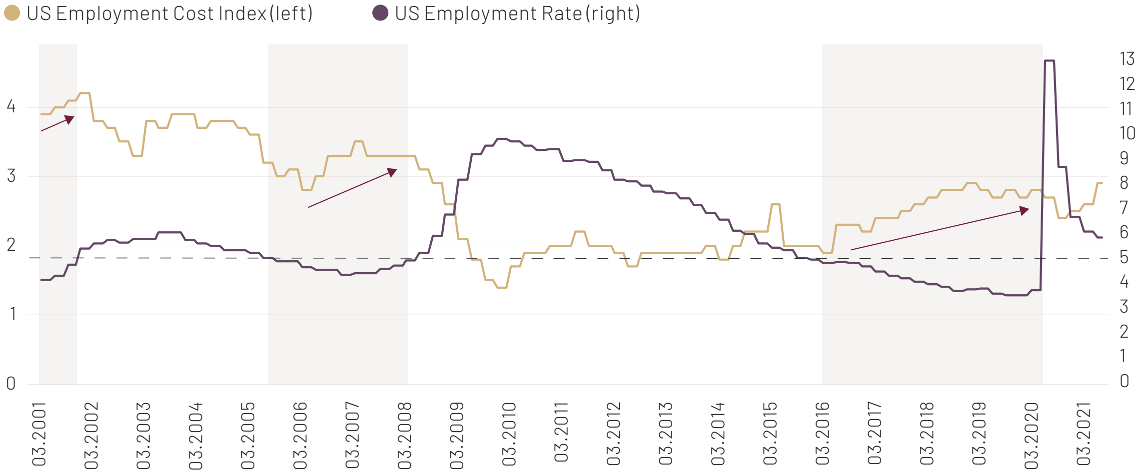
Wage growth is a critical point when it comes to the emergence of an inflation cycle where prices increase, followed by a rise in price expectations among workers who then ask for higher wages. To deal with higher labour costs (and thus lower margins) companies have two options: hike prices to absorb the costs or increase productivity.

Consequently, productivity plays a role in how firms are able to increase labour unit costs without raising prices and then leading to more inflation. In addition, when a company undertakes to increase salaries, it may force competing companies to do the same in order to remain attractive to job seekers.

While inflation significantly exceeded the Fed's target since April, the unemployment rate (5.4% in July) still has room to go before reaching the pre-pandemic level of 3.5%. Coming months should build the path for a strong labour market with high participation and low unemployment as the Fed forecasts the unemployment rate to be 3.8% in December 2022 and 3.5% in December 2023. During the 20th century, the US Congressional Budget Office estimated the non-accelerating rate of unemployment between 4% and 5%. As shown in Chart 1, in recent cycles, phases of wage increases occurred when the unemployment rate was under 5%.

Therefore, assuming that it might fall under 5% in 2022, a tighter labour market would imply more upward pressure on wages in the medium term, but this is probably not yet the case in 2021.

CHART 1: PERIODS OF WAGE INFLATION USUALLY OCCUR WHEN THE UNEMPLOYMENT RATE FALLS UNDER 5%



Source: Bloomberg, Indosuez Wealth Management.

Low-paid workers reservation wage is now

26%

higher than before the pandemic

In addition, average hourly earnings grew 3.6% Year-on-Year but adjusting by inflation leads to a 1.7% loss in purchasing power for US consumers over the past year. At the same time, while workers real income plummeted, US companies registered strong profits buoyed by solid economic growth. In a report published in August, TS Lombard explains that we could expect a strong wage demand in 2022 to reclaim lost real income and benefit from the profits made by their employers, as they estimate wages usually follow companies' earnings, with a year-long lag. In a context of stronger labour market in the year to come meaning more bargaining power for workers, the probability to see part of these wage demands being met would increase, which could give the way to an inflation process depending on companies' ability to raise productivity.

THE ROLE OF INFLATION EXPECTATIONS

Another key point when talking about an inflationary process is consumer inflation expectations. If inflation is expected in the future, one must borrow against future income to purchase today what will be more expensive tomorrow. This implies confidence in future increase in wages. Thus, we can observe that consumers' wages expectations recently started to rebound - even if they remain under pre-pandemic levels – as the inflation expectations published by the University of Michigan remained at high levels, pointing to 4.2% in June. When it comes to market inflation expectations incorporated in fixed income markets, inflation breakevens (5-year) have stabilised since March at around 2,5%.

Post-vaccination economics should provide a more normal environment and release some of the pressure on wages, giving more time to the Fed.

Goldman Sachs estimated that, the national expiration of federal unemployment insurance benefits would substantially increase the labour supply and reduce low-paid workers bargaining power.

Additionally, the return to full employment should imply wage growth to gradually reaccele-rating to 3.5-4%, a rate which would still be consistent with the Fed's inflation target of 2% based on average productivity gains between 1.5% and 2%. This forecast goes against the idea that a wage/price spiral would be already in place and coming to force in 2022.

PROFIT MARGINS AT RISK

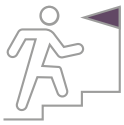
Across the Atlantic, companies' profit margins were at a record level of 11.1% in Q2, and the unprecedented corporate earnings growth sent the S&P 500 to record highs during 2021. Nevertheless, Bank of America declares that discussion of inflation in Q2 earnings calls hits record levels with inflation and labour inflation mentions rising to respectively 900% and 117% on a Year-on-Year basis. This reflects potentially increasing wage pressure coming ahead, especially with in consumer discretionary and industrial sectors, two of the most labour-intensive sectors in the index.

From an investor point of view, should the inflation be more persistent than currently priced by the markets, an inflation driven by wages would mean higher spending which usually corresponds to contexts of strong economic growth. Assuming that the price-wage feedback loop remains in control, avoiding a situation of unwanted high inflation implying any intervention of the central banks, this scenario could be a test for highly valued equity markets while being negative for nominal assets. Increasing wages would create margin pressures on companies, pushing investors to favour stocks from companies benefiting from a high pricing power allowing to pass on higher labour costs on wages. In any case, the upcoming labour market and inflation numbers will be worth watching to determine if wage push inflation will be a 2022 story.

03 • Macro economics

HAS MACRO MOMENTUM ALREADY STARTED TO FADE?

While most of the base effects are expected to be less beneficial as the time goes, macroeconomic momentum weakened in the US although the positive dynamic of the labour market raises questions about the timing of tapering. Steering East, the latest macro data in China disappointed market expectations and investors are now waiting for a move from the central bank, while in Europe, activity still remain at high level this month though decelerating as well.



The US economy added

943'000

jobs in July

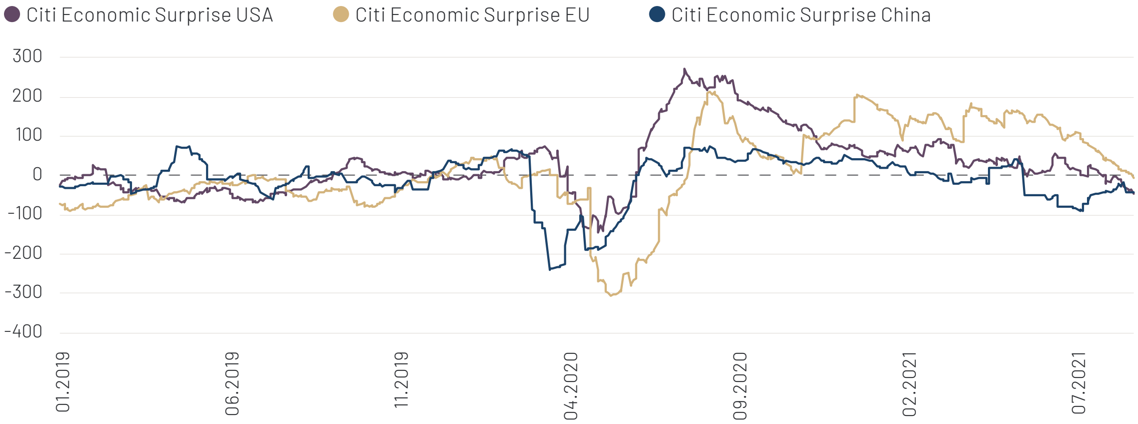
UNITED STATES: PEAK OF ACCELERATION SEEMS NOW BEHIND US

Over the summer and in a context of COVID-19 resurgence, macroeconomic publications in the US have globally disappointed as observed in the Citi Economic Surprise Index - it entered a negative territory in recent weeks after a continuous decline (Chart 2). Especially, the miss in last retail sales data (-1.1% on a monthly basis versus -0.3% expected), the slump in Michigan Consumer Sentiment (from 81.2 to 70.2 in August) as well as transportation challenges and bottlenecks lead some analysts to revise down their GDP growth forecasts for the US economy. However, since part of this weakness is related to the delta variant, we could anticipate that consumer spending could continue to ascend, helped by the recovery of the job market, while the US fiscal policy should support growth. These items will be closely looked in the coming months.

Over the summer, the US labour market showed stronger signs of recovery: the US economy added 943'000 jobs in July, the largest increase in seven months, while May and June's numbers were also revised upward, resulting in a decline of the unemployment rate from 5.9% to 5.4% (although still two points higher than pre-pandemic level). Thus, if the inflation held steady in July at 5.4% and markets appear to have bought into the transitory inflation story described by the Fed, the better dynamic from the labour markets has fuelled the debate over the tapering process. The latter is expected to take place by the end of the year and has helped to strengthen the dollar recently.

Late August, The House successfully passed the USD 3.5 trillion budget (including measures on education, healthcare, and climate change) that the Senate voted in early August. What remains to be defined is the financing of the plan which is supposed to be funded notably by higher corporate and income taxes, a topic that could divide Democrats and raise opposition from Republicans.

CHART 2: MACROECONOMIC MOMENTUM RECENTLY WEAKENED



Source: Bloomberg, Indosuez Wealth Management.

Besides, the Senate also successfully passed the USD 1 trillion infrastructure bill, including USD 550 billion in new spending on the nation's physical infrastructure, passing the baton to the House of Representatives for approval, which is supposed to examine the bill before the end of September.

CHINA: REGULATORS TIGHTEN THE SCREW

Against the backdrop of the 100th anniversary of the Chinese Communist Party, Chinese authorities continue to issue a deluge of new regulations on several sectors ranging from domestic private education sector to gaming. Beijing also issued new regulations for big tech companies citing their concerns over data privacy and national security while more recently, President Xi Jinping called for "common prosperity". This is a way to emphasise how the country will focus on reducing excessive inequality and inadequate allocation of resources to give back more to society, notably with an effort to support the middle class standard of living and fertility rate, as demography is a key concern for the government. Lately, the authorities tightened the limitations on online gaming for minors to three hours per week.

Chinese authorities continue to issue
A DELUGE OF NEW REGULATIONS

If this news brought volatility to the markets, investors were also concerned by the weakening macro momentum; though a bottom might have been found in late July as seen in the China Citi Economic Surprise Index above. In addition to bad weather conditions, the restrictions taken to contain a new wave of COVID-19 reinforced bottlenecks in some industries that did not need it.

As such, retail sales as well as industrial production have largely disappointed in July, and August non-manufacturing PMI fell sharply to 47.5. In this context, investors are now expecting a further cut in the reserve requirement rate to support specifically the SMEs that have been hugely affected over the previous months.

EUROPE: ECONOMIC ACTIVITY STABILISING AT HIGH LEVELS

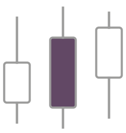
In Europe, while the PMIs edged down (Euro Area Composite at 59.5 in August vs. 60.2), they remain at very high levels; but here also last macro-economic figures no longer positively surprise the expectations from the markets. We could finally note the deceleration of the manufacturing PMI in Germany, notably linked to the sanitary situation, floods, and its greater exposure to China; this was also reflected in the ZEW Indicator of Economic Sentiment, which fell 23 points in August, its lowest level since November 2020.

Among the other macroeconomic news, the European Union (EU) made the first pay-outs to member states Tuesday from its 750-billion-euro post-Coronavirus recovery plan with the main beneficiaries, namely Italy and Spain, receiving respectively EUR 25 billion and EUR 9 billion.

In short, the global macro-economic context remains supportive, but reflects decoupling between mature and emerging economies with weakening momentum over the summer.

TAPPER NO TANTRUM

The year-end will once again prove interesting as the Central Banks monetary policies will try to trim their monetary impulse at a moment when economies probably passed their acceleration in the recovery path.



Lower long term yields driven by SOFTER MACRO-ECONOMIC DATA & STABILISING INFLATION

CENTRAL BANKS

The yield curves in developed markets once again fooled most of the investors as yields in the US 10 years traded as low as 1.16% during the summer. Many market participants had the opposite view, expecting turbulences ahead of the Jackson Hole Symposium held by the US Federal Reserve in late August. Indeed, economic publications travelled on the downside both in US and in Europe, while consumer data disappointed in China.

Long-term rates integrated the information, and dismissed at the same time the high prints in inflation: the "temporary" rhetoric holds the pattern, and the inflation swap curves stick to a short duration phenomena, as well, with a sharp drop in inflation forecast within the next 18 months or so. We consider the outperformance of the inflation linkers behind us in the short term, and thus reduce the house's conviction on this asset class. In China, the People's Bank of China (PBoC) eased its monetary conditions in July, which helped drive long-term yields lower.

M. Powell pre-announced its will to lower the pace of asset purchases as we go into year-end, which was widely anticipated by markets, but without providing a calendar. To avoid any 2013-like markets turbulences, this announcement is accompanied with dovish communication, while reasserting the temporary nature of inflation. Looking at flows in 2022, the lower fiscal deficit leads to lower financing needs, hence lower issuances by the Treasury in markets. All in all, the expected bond purchase reduction program should not affect market balances significantly.

The commodity-related economies sent interesting signals to broad markets: Canada, Brazil, and Mexico increased their key interest rates on inflation considerations, while the awaited 25 bps hike by the Bank of New Zealand was delayed as the country entered into lock-down by the end of August. The Central Bank Governor stated this hike is still live for the October meeting.

QUIET CREDIT MARKETS
during summer

CREDIT

The credit markets were very quiet during summer on both sides of the Atlantic, in the investment grade and high yield area. Companies published good results during summer, with top revenues ahead of forecasts, strong EBITDAs and decreasing leverage across the board. All these indicators strengthen the balance sheets and drive bond spreads to tighten. The banking industry published lower provisions for non-performing loans, which comforts us with our investments in this area.

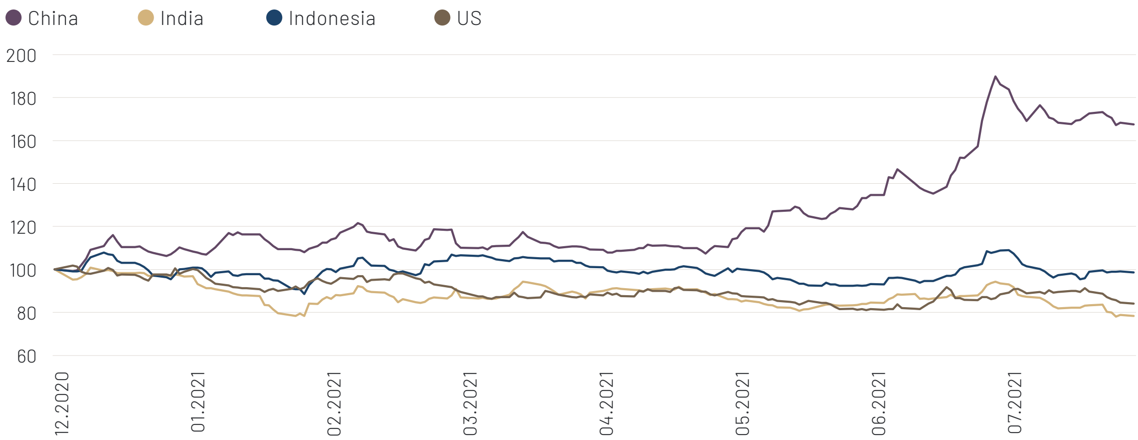
Looking forward to September, we do not expect an increase in volatility to derail the good performances year-to-date on developed markets. The carry still rewards investors with a good Sharpe ratio in developed markets fixed income.

The volatility on the credit area came out from China (Chart 3), with increased difficulties in the Chinese property market. The Evergrande stressed cash position weighted on the US-denominated bonds prices.

Nevertheless, the repricing in this area since late May makes valuation more attractive, and opportunities arise for selective investors.

While we take into consideration the increase in fundamentals in all credit segments but China, the management team downgrades its short term investment view on credit markets as primary markets are expected to be very active in September. We hold a constructive view for the medium to long term.

CHART 3: SELL-OFF PREDOMINANTLY IN CHINA



Source: BofA Global Research, BofA ICE Index, Indosuez Wealth Management.

05 • Equities

STRONG EARNINGS VS TAPERING

Q2 Earnings season has been strongly delivering, much better than most expected. We still consider earning growth and revisions as the core pillar of our bullish scenario.

We keep a constructive view on equity markets in developed markets but see two main risks to monitor in the short term, one of them is the evolution of the pandemic. Investors are now more likely to a risk-on mode despite the COVID-19 presence as long as vaccinations are helping to hold down death rates and governments are mostly determined to pursue strategies to limit lockdowns.

The second risk is on tapering. The previous tapering we experienced in 2009 and 2013 did not have a direct negative impact on markets, which have continued their uptrend nevertheless, it remains a first step towards a less accommodating monetary policy.

Linking these risks together, a more gradual transition from the pandemic also means a much more gradual shift in policy. The pandemic's resurgence may actually favour a slower end to stimulus.

In the medium run, earnings growth remains the key driver of equity performance, and the future path of markets will depend on the profit cycle's shape: will companies continue to post record earnings growth and margins, or should the percentage of positive surprises and profit revisions normalise at some point.

RECORD EARNINGS GROWTH IN Q2

driving positive revision of FY 2021 earnings expectations

UNITED STATES

In the United States, investors have been seduced by the earnings season for the second quarter. 87% of the companies in the S&P 500 reported actual revenues above the mean revenue estimate. In fact, the second quarter will mark the highest percentage of S&P 500 companies reporting revenues above estimates for a quarter since 2008. At the sector level, Healthcare, Communication Services, and Information Technology sectors have been the best performers with more than 95% of companies reporting revenue above estimates.

The other source of satisfaction came from the margin. The blended net profit margin for the S&P 500 for Q2 2021 is 13.0% , the highest net profit margin reported by the index since 2008 and far above the 5-year average of 10.6%.

The rise in profits and the absence of pressure on long rates make the valuation more attractive. The US remains the best place to play the technology theme and offers a good alternative to the Chinese BAT (Baidu, Alibaba, Tencent), and many global investors have probably switched their positions this summer. Fiscal stimulus and successful vaccine roll-out should continue to boost economic and EPS performance. 2022 is expected to be a more normal year of earnings growth (8% EPS growth expected in the US at this stage).

EUROPE

European EPS Growth expectations for 2021 have been systematically revised on the upside since the beginning of 2021 going from 31% at the end of 2020 to 51% now (MSCI Europe). This strong upward revision in earnings has been one of the main supports for the European equity market.

Cyclicals including banks, autos, and energy have driven most of these positive earnings revisions despite the spread of the Delta Variant and globally companies were positive on demand, margins and pricing.

The main challenge is to maintain profit margins at these high levels, and so far, there are encouraging trends on that front. Some companies are using price increases and productivity gains particularly in the reduction of office space and in IT (especially in software and the cloud) to offset rising material costs.

The MSCI Europe operating margin has rebounded from pandemic lows to over 11% on a quarterly basis (Chart 4), the highest since 2011. Many unknowns from COVID-19 and inflation remain, but profit fundamentals remain supportive.

These very supportive earnings revisions allowed some P/E multiple contractions even if stocks recorded a very strong rally.

EMERGING MARKETS

The recent wave of regulatory pressure by authorities on some Chinese sectors added more fuel to the fire and made for a volatile equity market environment in Asia which was already impacted by the worrying trends in COVID-19 infection cases in Asia (mainly Southeast Asia, India and now parts of China as well) and stop-and-go jitters on rising US interest rates and inflation.

Also, some kind of lingering trade war between the US and China is still at play (more Chinese companies added to the US sanction entity list lately) at this time, weighing on overall sentiment toward Chinese equities.

Within Asia equities, we are currently overweight South Korea and Singapore, neutral Taiwan, Indonesia and the Philippines and underweight India, Malaysia, and Thailand.

We believe that the market has not really priced in the severity of the ongoing COVID-19 wave in Southeast Asia and India yet. This could mean headwinds to these stock markets down the line, some of which appear already richly valued such as India for instance.

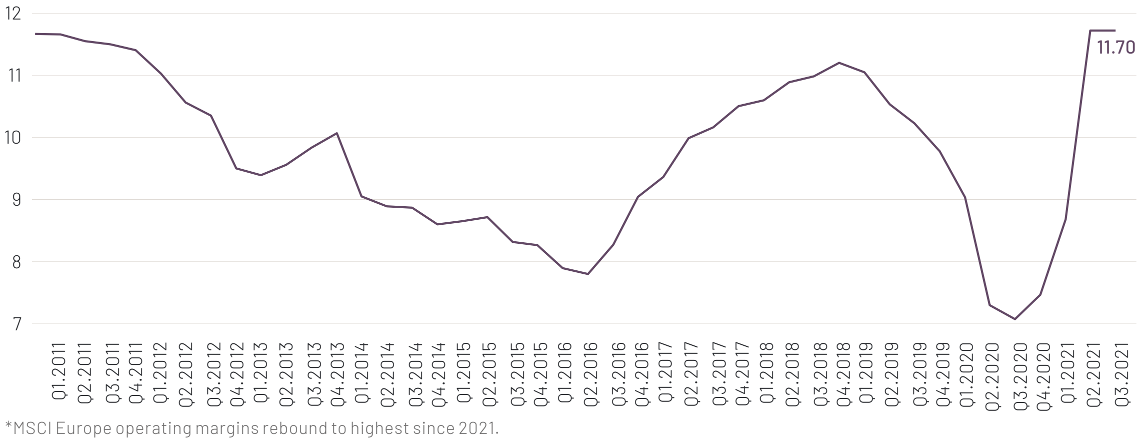
The summer was also negative on equities in Brazil, with a c. 10% correction since early June's peak. We remain cautious on the region's equity markets notably for international investors who are also affected by FX risk.

SENTIMENT

The S&P 500 achieves all-time highs in August. Usually when equity markets hit all-time highs, sentiment indicators are in euphoria. We are currently witnessing a paradoxical situation in which the markets are making new highs with low realized volatility while the VIX, the Put Call and the Bull Bear remain in neutral zone.

This situation is favourable to the continuation of the uptrend because it implies that a good number of investors have missed the bull market.

CHART 4: PROFITABILITY RECORD*

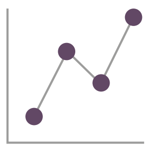


*MSCI Europe operating margins rebound to highest since 2021.
Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

06 • Forex

QUIET SUMMER WITH ILLIQUID MOVES

August has been characterised by a lot of talk but little news, most of the action in Forex & Precious Metals markets has arisen out of illiquid stop-loss driven trading most evident in Gold, whilst the main macro narratives remain unchanged since July – Delta Variant affecting macro momentum, inflation stabilisation, ECB providing forward guidance while Jerome Powell is buying some time before confirming a tapering calendar. Meanwhile, the GBP is emerging as a resilient recovery play, whilst CNY has managed to maintain a stable position against the USD despite domestic challenges.



Range-trading

&

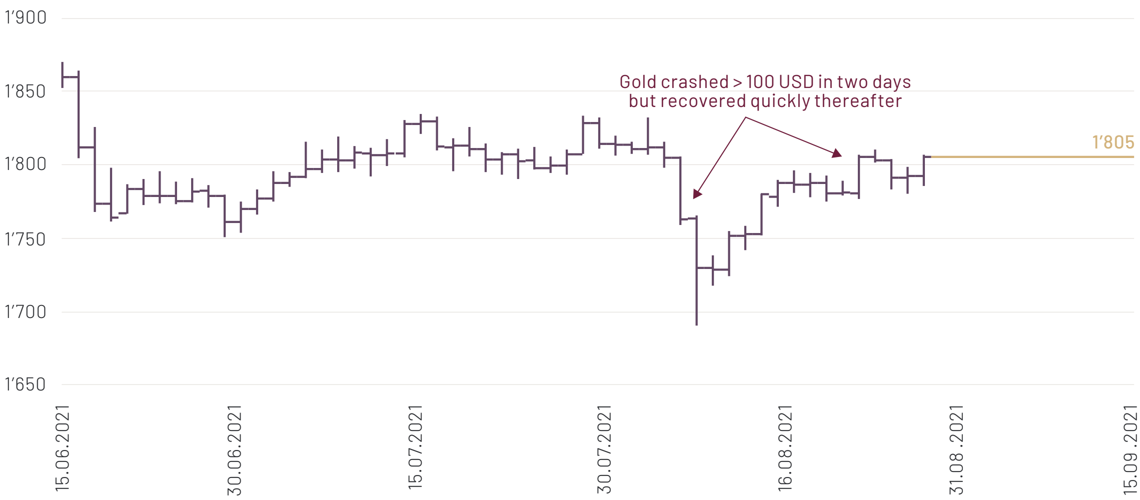
flash crashes

GOLD – SUMMER FLASH CRASHING

Early August saw an over USD 100/oz two-day crash in Gold (Chart 5), however this was merely driven by some stronger-USD and stop-loss executions in very thin out-of-hours trading, the relatively fast recovery back to USD 1'800 tells us interest remains strong. The episode however does pro-vide a useful reminder that Gold is not as liquid as currencies and can suffer large stop-loss driven swings such as this one.

It is therefore always better to invest in Gold on a very long-term horizon. In the current inflationary environment with debt monetisation rampant and zero interest rates, we think the case for holding Gold as a hedge remains compelling, especially when the price is still nearly 15% away from the all-time high set last year, and these flash crashes merely represent opportunities for alert investors.

CHART 5: GOLD PRICE IN AUGUST, USD/OZ



Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

GBP – RESILIENCE AMIDST COVID-19 CHAOS

GBP has emerged as one of the most resilient G10 currencies since the start of the USD rally at the beginning of August, and thanks to the gradual lifting of COVID-19 restrictions since Q1, the UK economy is recovering even if we also register a significant weakening of economic surprises since May (from +157 to -54 points).

Core inflation lowered to 1.8% in July vs. 2.2% in June, in line with the Bank of England's view of inflation as transitory, even if unemployment rate is now just 1 point above pre-COVID-19 levels and with many employers in the UK reporting difficulty in hiring labour. Even if the Bank of England (BoE) intends to maintain its current accommodative policy in place at least into year end, it could potentially start reducing asset purchases or hiking rates next year. Q4 will be important to watch as some pandemic support programs roll off, especially the furlough support which has prevented some labour market mobility, but otherwise USD investors looking for a recovery story in a liquid currency could find the GBP an interesting source of diversification.

EUR – FINDING SUPPORT AT LAST?

We began 2021 with very bullish predictions for EUR climbing up to 1.25, as the USD twin-deficits would weigh the greenback down whilst strategists were starting to gauge the timing of normalisation on both sides of the Atlantic. In reality the gap in vaccination policy was widening the gap of macro momentum in favour of the US, evidenced by US rate curve steepening, and this helped the USD outperforming in Q1.

USD - BID UP IN ANTICIPATION FOR TAPER TURN

While the acceleration of vaccinations in Europe helped the EUR in Q2, USD has regained its strength this summer and broke an important support around 1.17 against the Euro, in the expectation of a clarification on the Fed's tapering calendar while the ECB has communicated a revised symmetric inflation target, postponing normalisation of rates beyond the foreseeable future.

While strategists were left wondering whether the USD was on its way to breaking new highs, Jackson Hole soft stance on tapering and dovish view on inflation have reverted USD strengthening. Much ado about nothing in the end... Jerome Powell is de facto giving an appointment at the next FOMC meeting to investors wishing to revise their EUR/USD positioning.

However, the consensual view of a tapering starting at year end remains unchanged, justified by improving employment data as well as a plateau of above-target inflation, and this anticipation could give birth to a last wave of USD strengthening against Euro before investors sell the news.

We think EUR/USD may be able to stay range-bound, making 2021 one of the years with the narrowest ever ranges.

We do not forecast a significant nor sustainable dollar recovery beyond year-end, given persistent negative real rates, limited gap in short term rates with the EUR, progressive normalisation of GDP growth in 2022, and ongoing twin deficit concerns.

CNY - INEVITABLE SLOWDOWN MET BY LOOSER POLICY ADDRESS

Following their COVID-19-peak growth spurt, China's economic data has slowed of late, exacerbated by severe flooding in many regions in addition to activity restrictions driven by the Zero-COVID-19 policy. As such, the People's Bank of China (PBoC) also keen to address and cap rising property prices may now need to counteract falling credit demand by considering a cut in their required reserve ratio yet again this year. This further maintains the attraction of their 10-year Government bonds offering relatively high real rates versus peers. Thus, on dips, the renminbi still appears an attractive alternative source of portfolio diversification and yield enhancement for foreign investors, as the Chinese currency is among the few currencies offering both positive real yields and moderate volatility.

07 • Asset Allocation

INVESTMENT SCENARIO AND ALLOCATION

Weakening
ECONOMIC SURPRISES
in most regions

INVESTMENT SCENARIO

MACRO TRENDS

Weakening economic surprises in most regions over the summer (US, China, Europe) but activity indicators stabilising at elevated levels in developed markets. This still contrasts with disappointing retail sales and weakening non-manufacturing PMI below 50 in August. China. Northern Asia expected to benefit from acceleration of vaccination campaigns in Q4.

INFLATION

Stabilising at elevated levels in the US, validating the idea of a plateau, with transitory inflation lasting more than Fed's expectations, but affected by post-pandemic bottlenecks and no wage/price spiral witnessed at this stage.

CENTRAL BANKS

Supportive monetary policy in most regions, with different directions ahead, between the Fed expected to reduce asset purchases by year end and the Chinese central bank expected to provide more support in the coming months. Revised inflation targeting and forward guidance of the ECB as well as moderate inflation in the Euro Area (except Germany) should provide significant visibility and anchoring of expectations in Europe.

FISCAL POLICY

Largely supportive, with an USD 3.5 trillion spending budget validated in the US, and rising fiscal deficits in most countries this year, without spill over of the funding pressure on government bonds due to very supportive policies.

PROFIT CYCLE AND CORPORATE FUNDAMENTALS

Record earnings growth and level of positive surprises in the Q2 earnings season in the US and Europe are the most supportive factors explaining the positive direction of equity markets this summer. Lower defaults in developed markets supporting tighter corporate spreads, while regulatory pressure, a softer macro and specific risks on the Chinese real estate market led to spread widening.

RISK ENVIRONMENT

Volatility remains limited but political uncertainty is on the rise with regulatory crackdown in China and uncertainties around the upcoming German elections.

GLOBAL

Overall, the environment remains favourable for investors, but with less support coming from the macro sphere and a question mark on the sustainability of recent profit growth, notably in light of potential pressure on margins in the future. Some vulnerability due to rising policy and regulatory uncertainties to monitor.

ALLOCATION CONVICTIONS

EQUITIES

NEUTRAL
in the short term on China due to regulatory crackdown

Neutral view overall with a positive view on developed, backed by strong fundamentals and supportive policy-mix but with more limited potential in the short term after a strong performance year-to-date.

Neutral view on China in the short term due to regulatory crackdown and softer macro, which starts to offer attractive valuations, but with lack of earnings momentum and short-term catalysts to anticipate the return of risk appetite. Constructive long-term view maintained.

Japan raised to neutral as the significant performance gap with western equities this year could offer relative value opportunities as well as diversification benefits in particular from a currency standpoint.

FIXED INCOME

Underweight maintained on government bonds with some moderate steepening expected on US long term yields. Euro bond yields expected to remain in negative territory, held in portfolios purely for hedging purposes. Stabilisation of inflation expectations providing a less supportive call for inflation linked bonds.

Constructive view maintained on credit in mature markets and notably financial debt and corporate high yield; no further tightening expected but carry is positive. Neutral view on emerging debt. Within Asian HY universe, while we acknowledge that lower valuations after the summer widening on Chinese property could offer entry points into the sector, we consider that it may be too early to increase our overall positioning on the asset class as ongoing regulatory issues and defaults' news effect reduce the visibility on the short term.

CURRENCIES

US dollar should remain supported by tapering expectations in Q4 but limited potential, and any renewed strengthening could be used to diversify to other currencies. In the medium term, we maintain a 1.15-1.20 trading range against EUR.

Within emerging currencies, we remain constructive in the longer run on the renminbi, and any further weakening related to the macro or policy environment could be used to rebuild positions.

KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
Core EUR 10Y (Bund)	=	=
EUR Periphery	=	=/-
USD 10Y	=/-	=
CREDITS		
Investment grade EUR	=	=/+
High yield EUR/BB- and >	=/-	=/+
High yield EUR/B+ and <	=/-	=
Financials Bonds EUR	=/-	=/+
Investment grade USD	=	=/+
High yield USD/BB- and >	=/-	=/+
High yield USD/B+ and <	=/-	=
EMERGING DEBT		
Sovereign Debt Hard Currency	=	=/+
Sovereign Debt Local Currency	=	=
Latam Credit USD	=/-	=/-
Asia Credit USD	=	=/+
Chinese Bonds CNY	=/+	+
EQUITIES		
GEOGRAPHIES		
Europe	+	=
United States	=/+	=/+
Japan	=	-/=
Global EM	-/=	=/+
Latin America	-/=	=
Asia ex-Japan	-/=	=
China	=	+
STYLES		
Growth	+	+
Value	+	=
Quality	-/=	=
Cyclical	=	=
Defensive	-/=	-/=
FOREX		
United States (USD)	=	=/-
Euro Area (EUR)	=/+	+
United Kingdom (GBP)	=/+	=/+
Switzerland (CHF)	=/-	=
Japan (JPY)	=/+	=
Brazil (BRL)	=/-	=
China (CNY)	=	+
Gold (XAU)	=/-	=/+

Source: Indosuez Wealth Management.

OVERVIEW OF SELECTED MARKETS

DATA AS OF 31 AUGUST 2021

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10Y	1.31%	13.66	39.56
France 10Y	-0.03%	10.30	31.10
Germany 10Y	-0.39%	9.80	18.70
Spain 10Y	0.34%	10.60	29.40
Switzerland 10Y	-0.32%	8.40	23.10
Japan 10Y	0.02%	1.40	0.30

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Governments Bonds Emerging Markets	43.68	0.34%	-3.47%
Euro Governments Bonds	221.06	-0.44%	-0.50%
Corporate EUR high yield	214.11	0.26%	3.41%
Corporate USD high yield	330.55	0.76%	3.89%
US Government Bonds	324.12	-0.35%	-0.54%
Corporate Emerging Markets	52.6	0.46%	-0.94%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	1.08	0.76%	-0.04%
GBP/USD	1.38	-1.16%	0.62%
USD/CHF	0.92	1.26%	3.38%
EUR/USD	1.18	-0.46%	-3.33%
USD/JPY	110.02	0.90%	6.56%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	16.48	-1.56	-6.27

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	4'522.68	2.25%	20.41%
FTSE 100 (United Kingdom)	7'119.70	0.20%	10.20%
Stoxx Europe 600	470.88	1.18%	18.01%
Topix	1'960.70	1.53%	8.65%
MSCI World	3'141.35	1.58%	16.78%
Shanghai SE Composite	4'805.61	-2.61%	-7.78%
MSCI Emerging Markets	1'308.67	1.12%	1.35%
MSCI Latam (Latin America)	2'514.72	0.31%	2.57%
MSCI EMEA (Europe, Middle East, Africa)	283.03	2.14%	17.31%
MSCI Asia Ex Japan	837.64	0.72%	-0.63%
CAC 40 (France)	6'680.18	-0.65%	20.33%
DAX (Germany)	15'835.09	1.80%	15.43%
MIB (Italy)	26'009.29	2.58%	16.99%
IBEX (Spain)	8'846.60	0.84%	9.57%
SMI (Switzerland)	12'411.11	2.04%	15.95%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	5'233.00	-2.93%	24.00%
Gold (USD/Oz)	1'813.62	0.18%	-4.46%
Crude Oil WTI (USD/Bbl)	68.50	-2.92%	41.18%
Silver (USD/Oz)	23.96	-6.34%	-9.28%
Copper (USD/Tonne)	9'520.00	-0.23%	22.59%
Natural Gas (USD/MMBtu)	4.38	8.69%	72.39%

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

MONTHLY INVESTMENT RETURNS, PRICE INDEX

FTSE 100 · Topix · MSCI World · MSCI EMEA · MSCI Emerging Markets
Stoxx Europe 600 · S&P 500 · Shanghai SE Composite · MSCI Latam · MSCI Asia Ex Japan

BEST PERFORMING

MAY 2021	JUNE 2021	JULY 2021	4 WEEKS CHANGE	YTD (31.08.2021)
7.75%	2.37%	2.27%	2.25%	20.41%
5.29%	2.22%	1.97%	2.14%	18.01%
4.06%	1.40%	1.72%	1.58%	17.31%
2.14%	1.36%	-0.07%	1.53%	16.78%
2.12%	1.07%	-0.49%	1.18%	10.20%
1.30%	0.21%	-2.19%	1.12%	8.65%
1.26%	-0.11%	-4.24%	0.72%	2.57%
1.01%	-0.41%	-7.04%	0.31%	1.35%
0.76%	-0.94%	-7.76%	0.20%	-0.63%
0.55%	-2.02%	-7.90%	-2.61%	-7.78%

WORST PERFORMING

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

Backwardation: Refers to a situation where a futures contract's price is below the spot price of the underlying. The opposite situation is referred to as Contango.

Barbell: An investment strategy that exploits two opposing ends of a spectrum, such as going long both the short- and long-end of a bond market.

Basis point (bps): 1 basis point = 0.01%.

Below par bond: A bond trading at a price inferior to the bond's face value, i.e. below 100.

Bottom-up: Analyses, or investment strategies, which focus on individual corporate accounts and specifics, as opposed to top-down analysis which focuses on macro-economic aggregates.

Brent: A type of sweet crude oil, often used as a benchmark for the price of crude oil in Europe.

Bund: German sovereign 10-year bond.

Call: Refers to a call option on a financial instrument, i.e. the right to buy at a given price.

CFTC (Commodity Futures Trading Commission): An independent US federal agency with regulatory oversight over the US commodity futures and options markets.

COMEX (Commodity Exchange): COMEX merged with NYMEX in the US in 1994 and became the division responsible for futures and options trading in metals.

Contango: Refers to a situation where the price of a futures contract is higher than the spot price of the underlying asset. The opposite situation is referred to as Backwardation.

CPI (Consumer Price Index): The CPI estimates the general price level faced by a typical household based on an average consumption basket of goods and services. The CPI tends to be the most commonly used measure of price inflation.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates, expressed in years. The longer the duration of a bond, the more its price is sensitive to any changes in interest rates.

EBIT (Earnings Before Interest and Taxes): Refers to earnings generated before any financial interest and taxes are taken into account. It takes earnings and subtracts operating expenses and thus also corresponds to "operating earnings".

EBITDA (Earnings Before Interests, Taxes, Depreciation and Amortisation): EBITDA takes net income and adds interest, taxes, depreciation and amortisation expenses back to it. It is used to measure a company's operating profitability before non-operating expenses and non-cash charges.

ECB: The European Central Bank, which governs the euro and euro-member countries' monetary policy.

Economic Surprises Index: Measures the degree of variation in macro-economic data published versus forecasters' expectations.

EPS: Earnings per Share.

ESG: Environmental, Social and Governance.

ESMA: European Securities and Markets Authority.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

Futures: Exchange-traded financial instruments allowing to trade the future price of an underlying asset.

G10 (Group of Ten): One of five groups, including also the Groups of 7, 8, 20 and 24, which seek to promote debate and cooperation among countries with similar (economic) interests. G10 members are: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the UK and the US with Switzerland being the 11th member.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

GHG: Greenhouse gases.

Gulf Cooperation Council (GCC): A grouping designed to favour regional cooperation between Oman, Saudi Arabia, Kuwait, Bahrain, United Arab Emirates and Qatar.

High yield: A category of bonds, also called "junk" which ratings are lower than "investment grade" rated bonds (hence all ratings below BBB- in Standard & Poor's parlance). The lower the rating, the higher the yield, normally, as repayment risk is higher.

Hybrid securities: Securities that combine both bond (payment of a coupon) and share (no or very long maturity date) characteristics. A coupon might not be paid, as with a dividend.

iBoxx investment grade/high yield indices: Benchmarks measuring the yield of investment grade/high yield corporate bonds, based on multi-source and real-time prices.

IMF: The International Monetary Fund.

Investment grade: A "high quality" bond category rated between AAA and BBB- according to rating agency Standard & Poor's.

LIBOR (London Interbank Offered Rate): The average interbank interest rate at which a selection of banks agree to lend on the London financial market. LIBOR will cease to exist in 2020.

LME (London Metal Exchange): The UK exchange for commodities such as copper, lead, and zinc.

Loonie: A popular name for the Canadian dollar which comes from the word "loon", the bird represented on the Canadian one dollar coin.

LVT: Loan-to-Value ratio; a ratio that expresses the size of a loan with respect to the asset purchased. This ratio is commonly used regarding mortgages, and financial regulators often cap this ratio in order to protect both lenders and borrowers against sudden and sharp drops in house prices.

Mark-to-market: Assessing assets at the prevailing market price.

OECD: Organisation for Economic Co-operation and Development.

OPEC: Organisation of Petroleum Exporting Countries; 14 members.

OPEC+: OPEC plus 10 additional countries, notably Russia, Mexico, and Kazakhstan.

Policy-mix: The economic strategy adopted by a state depending on the economic environment and its objectives, mainly consisting of a combination of monetary and fiscal policy.

PMI: Purchasing Managers' Index.

Put: An options contract that gives the owner the right, but not the obligation, to sell a certain amount of the underlying asset at a set price within a specific time period. The buyer of a put option believes that the underlying stock price will fall below the option price before expiration date. The value of a put option increases as that of the underlying asset falls, and vice versa.

Quantitative Easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

Renminbi: Translating literally from Chinese as "currency of the people", this is the official name of China's currency (except in Hong Kong and Macao). It is also frequently referred to as the yuan.

Russell 2000 Index: A benchmark measuring the performance of the US small cap segment. It includes the 2000 smallest companies in the Russell 3000 Index.

SEC (Securities and Exchange Commission): The SEC is an independent federal agency with responsibility for the orderly functioning of US securities markets.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

SRI: Sustainable and Responsible Investments.

Subordinated debt: Debt is said to be subordinated when its repayment is conditional upon unsubordinated debt being repaid first. In return for the additional risk accepted, subordinated debt tends to provide higher yields.

Swap: A swap is a financial instrument, often over the counter, that enables two financial flows to be exchanged. The main underlyings used to define swaps are interest rates, currencies, equities, credit risk and commodities. For example, it enables an amount depending on a variable rate to be exchanged against a fixed rate on a set date. Swaps may be used to take speculative positions or hedge against financial risks.

USMCA: The United States-Mexico-Canada Agreement, signed by the political leaders of the three countries on 30 September, 2018, replacing NAFTA (created in 1994).

VIX: The index of implied volatility in the S&P 500 Index. It measures market operators' expectations of 30-day volatility, based on index options.

Wedge: A wedge occurs in trading technical analysis when trend lines drawn above and below a price chart converge into a arrow shape.

WTI (West Texas Intermediate): Along with Brent crude, the WTI is a benchmark for crude oil prices. WTI crude is produced in America and is a blend of several sweet crude oils.

WTO: The World Trade Organisation.

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The banks of the Indosuez Wealth Management Group are preparing for the replacement or restructuring of interbank interest rates, such as the LIBOR, EURIBOR and EONIA, the fixing terms of which will be strengthened significantly, as decided by the financial market authorities and banking agents. At the European level, the European Central Bank began publishing the €STR (Euro Short Term Rate) in October 2019, which will sit alongside the EONIA until December 2021 and will replace it in January 2022. Concerning the EURIBOR, the European Money Markets Institute confirmed in November 2019 that the transition phase for the Hybrid EURIBOR has been completed, paving the way for full restructuring between now and December 2021. Each IBOR interest rate (e.g. the LIBOR US Dollar) will also be overhauled between now and the end of 2021. Accordingly, the Swiss National Bank announced in June 2019 the introduction of its own policy interest rate in Swiss francs, calculated based on the SARON (Swiss Average Rate Overnight) with the goal of creating forward rates that will also be calculated based on the SARON.
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