INDOSUEZ
WEALTH MANAGEMENT

MONTHLY HOUSE VIEW

Marketing Material - November 2021

Focus
Should we be worried about wage inflation in the US?

Architects of Wealth

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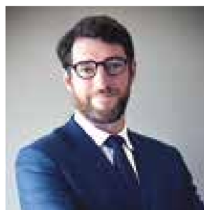
REBOOTING THE SYSTEM



VINCENT MANUEL

Chief Investment Officer, Indosuez Wealth Management

Dear Reader,

Let's see if you can spot the mistake: investors are seeing growth wane in China and expect the Chinese central bank to cut its rates. The US Fed has been extremely cautious and is holding off on tapering its asset purchases since we are not yet back at full employment. In Europe, they're still talking about negative rates until the end of time.

Could the mounting risk of stagflation[1] have led to a misdiagnosis?

Recent economic history shows that it is only natural to want to prescribe the same treatments to heal the wounds of the current crisis as the last one. The various French governments of the 1990s became obsessed with the failure of the 1981 stimulus and were driven by the single currency goal to support competitiveness and a strong franc policy. The result was real interest rates of 6% and mass industrial unemployment. This same story played out in 2011, when southern Europe underwent shock therapy and experienced its recessionary effects. In some Member States, industry is still not back on its feet.

Due to the failed recovery in the Euro Area over the last decade, a neo-Keynesian consensus has been reached since COVID-19 on a massive increase in fiscal spending and public investment. This trend also reverberated in the United States, where a series of different administrations implemented numerous fiscal stimulus plans to support the economy, like the plans signed by the Biden administration at the height of the pandemic. The central banks' chronic difficulty in anchoring inflation expectations in recent years led them (perhaps belatedly) to change their inflation targeting.

This consensus raises some questions given the actual explanations for the current difficulties facing the global economy, as reflected in the current energy crisis.

And what if we have once again missed the diagnosis and the cure? What if we are just trading in a demand deficit for a supply shortage that is exacerbated by just-in-time management, global interconnectedness and underinvestment?

In 2020, evidence of a self-inflicted recession provided good reason to give aid to both households and businesses in order to exit the recession as quickly as possible and prevent mass failures. But, in 2021, mounting evidence of an overriding supply issue (expected to last beyond 2021) has not been enough to change our approach. Fiscal stimulus is useless in a supply crisis and creates the risk of overheating (a risk that Larry Summers clearly identified at the beginning of the year), while keeping rates negative encourages over indebtedness and triggers a higher risk for the real estate markets.

The burning questions now are how long it will take to fix supply chains and correct the underinvestment in energy and infrastructure. This requires a fairly careful calibration of the policy mix, which could entail facilitating business investment while cooling down the real estate market. The idea here is that central banks may have to shift from quantitative easing to macroprudential oversight.

Lastly, the market's read on US employment shows that the skilled labour shortage is one of the explanations put forward for disappointing job creation, and if that's the case then zero interest rates won't help very much: it makes more sense to encourage people to get training and get back into the job market, and to stay in the workforce longer. This basically means investment and reforms rather than fiscal stimulus and asset purchases.

There is no question that investments need to be made in renewable energies and digital, but they must also be accompanied by investments in automation to shorten the supply chains and improve production flexibility. Investment also likely needs to be boosted in nuclear power, the primary non-intermittent source of low-carbon energy. This will be a key issue for the German coalition and in the French presidential elections.

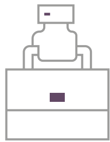
1 - An economic situation where slowing growth, and sometimes recession, is accompanied by rising prices and wages.

SHOULD WE BE WORRIED ABOUT WAGE INFLATION IN THE US?

The US Bureau of Labor Statistics has published its latest figures for September. Although job gains disappointed, the unemployment rate came in well below expectations. With the Fed still defending the idea that the rise in inflation is only transitory, the latest US employment numbers raise questions about whether higher inflation is here to stay, supported by wage growth.

EMPLOYMENT FIGURES MAY NOT BE AS DISAPPOINTING AS AT FIRST GLANCE

The US economy added 194'000 jobs in September, while the consensus had expected an increase of 500'000. Employment growth was notably curbed by the 123'000 jobs lost in the public sector, notably in education (with the vaccine mandates a major hindrance to hiring in the education and health sectors). The private sector recorded 317'000 job gains. While these disappointing new job numbers also come in the wake of a poor August report, the revisions for the months of July and August nevertheless added 169'000 new jobs.



The unemployment rate fell from 5,2 % TO 4,8 % in September

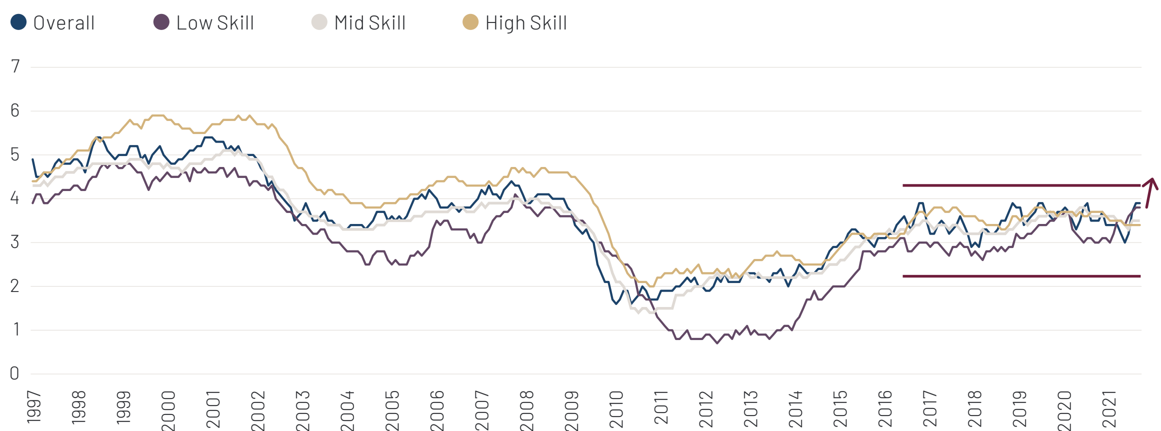
Meanwhile, the unemployment rate fell from 5.2% to 4.8% in September, vs. 5.1% expected, which Joe Biden took credit for. This surprise drop despite the poor job figures is partly due to the decrease in the participation rate to 61.6% (the labour force shrunk by 183'000), and especially to an important difference in methodology, which means that the household survey data produced a drop in the number of unemployed persons of 710'000 over the month, which is difficult to reconcile with the above job growth data (from the establishment survey data section of the monthly employment report). At the same time, the average hourly wage increased by 0.6% over the month (vs. 0.4% over the quarter), and 4.6% year on year, with a +10.8% year increase for the leisure and hospitality sector, indicating that this growth is primarily driven by the lower wage brackets (Chart 1).

The Atlanta Fed's Wage Growth Tracker somewhat mitigates the past months' figures, which were impacted by the recovery and several sector biases, but this indicator was also above 4% in September, a level not seen since 2007.

IMBALANCES DUE TO THE HEALTH SITUATION

The wage increases coming out of the recent economic reports are a result of the reopening of economies increasing demand for workers, combined with supply constraints due to the health situation and high unemployment benefits.

CHART 1: ACCELERATION IN WAGE GROWTH IN THE LOWEST WAGE SEGMENT, %



Source: Bloomberg, Indosuez Wealth Management.

1,4
TIMES
MORE
job openings than the number of job seekers

This situation has created a supply/demand imbalance, reflected in a number of job openings that is 1.4 times higher than the number of jobseekers, the highest multiple in 20 years.

However, the macroeconomic publications for Q4 are likely to reflect the effects of the reopening of schools and day-cares, as well as the end of unemployment measures. In addition, with the ongoing vaccine roll-out and overall improvement in the health situation in the US, a rebound in the participation rate is expected in the coming months, which should reduce the labour market imbalances and lead to more moderate wage growth, notably in the low-wage sectors such as leisure and hospitality.

Furthermore, the projections of the Conference Board regarding pay raises decreased over the summer, with 17.3% of US households now expecting their incomes to increase in the next six months, vs. 20% at end-June, while 11.5% of households now expect their incomes will decrease compared to 8.4% at the start of the summer.

A NEW PRICE-WAGE SPIRAL?

Therefore, while the rebound in labour supply is likely to curb wage growth momentum in the lower-wage segment, some inflationary pressure could continue to be exerted on the high-skill segment, where there appears to be a more lasting shortage of workers. Wage inflation is likely to continue to be a major issue for companies in the medium term, while the policy mix in the US tends to favour a tightening of the job market, with the underlying objective of higher wages. This end goal has been explicitly endorsed by President Biden and recently adopted by several large groups, which could affect company margins.

Against this backdrop, the quarterly results publications have already shown that companies are particularly concerned about the downside risk of wage inflation for their earnings.

In the second quarter, 43% of the companies in the Russell 3000 index mentioned the words "wage" and "labour", the highest level in over a decade. For example, Bank of America recently announced that it was raising its minimum hourly salary to 21 dollars, while companies such as Walmart, Amazon and Starbucks have already made or planned to make increases. The latest survey of the NFIB (National Federation of Independent Businesses) indicates that a record level of 30% of small businesses are also planning to raise salaries.

However, companies' productivity has increased at a faster pace than wages since the start of the year, with unit labour costs down by 1.5% in the first half of the year. If productivity growth continues to offset wage growth, company margins would not necessarily be compressed. Furthermore, wages only represent 13% of the revenues of the SP 500, and an increase in this metric would not necessarily trigger a widespread price-wage spiral like the one that occurred in the 1970s. Given the strong economic and earnings growth for the year, these wage increases could easily be absorbed and would thus have a moderate impact on margins. Nevertheless, we can expect that the impact of the combined pressure of wages and commodities prices would start to be felt more on margins, or alternatively would be passed through to prices as of this quarter, in a context of targeted shortages favouring manufacturers.

CONCLUSION

With the September employment report being the last publication before the FOMC meeting on 3 November, these disappointing new jobs figures are unlikely to throw off the Fed's timetable, with the tapering expected to begin in November 2021, notably given the level of wage growth observed, which reflects the tensions on the labour market.

Investors will have to keep an eye on the impact of wage growth on company margins in 2022, in a context of lower earnings growth.

SHOULD WE FEAR A STAGFLATION SCENARIO?

We were highlighting last month that supply shortages and bottlenecks should imply a slowdown in the pace of global growth in the short term. With inflation stabilising at high levels in the United States and energy prices soaring, some analysts are now evaluating the risk of a stagflation scenario by 2022. In our view, this should not be considered a base case yet.

Smooth normalisation of economic GROWTH EXPECTED IN THE US

US: ECONOMIC ACTIVITY ABOVE POTENTIAL GROWTH DESPITE SHORT-TERM HEADWINDS

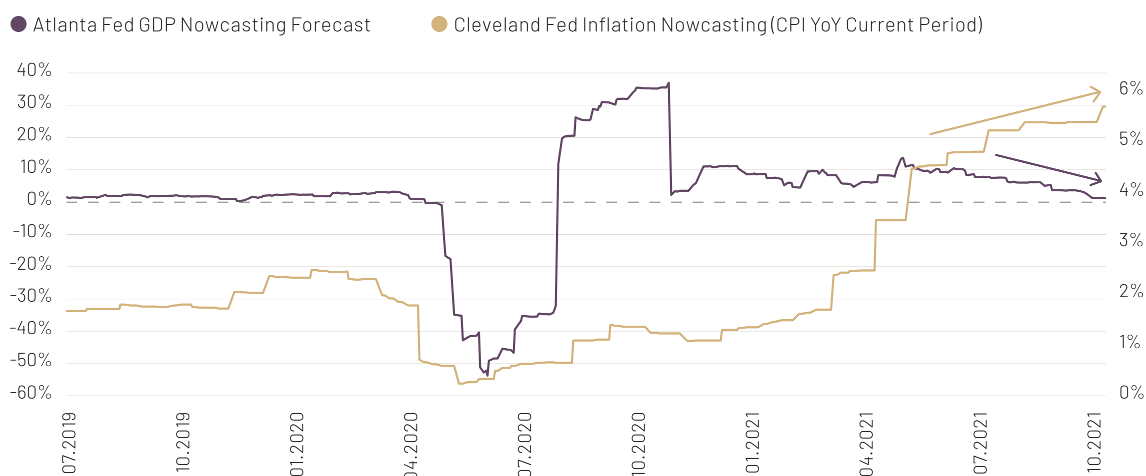
Within a one-month timeframe, the Atlanta Fed's estimate of the US growth domestic product continues to point to a deceleration in economic activity: the live estimate has thus fallen from around 4.5% in September to 1.2% at the time of writing (Chart 2). The International Monetary Fund's (IMF) latest projections also predict a slowdown for Uncle Sam, with growth now expected to reach 6% for 2021 compared to 7% previously, reflecting both supply chain tensions, labour shortages, and less support than expected from fiscal policy in the coming quarters.

However, the US' economic growth should remain relatively strong and above the long-term average trend in 2021 and 2022. Latest macroeconomic indicators also argue for a very smooth normalisation of the economic activity: retail sales have surprised to the upside for the second consecutive month (+0.7% vs. -0.2% expected), the ISM Manufacturing increased to 61.1 beating estimates, while the Citi Economic Surprise shows that a floor may have been found in early September.

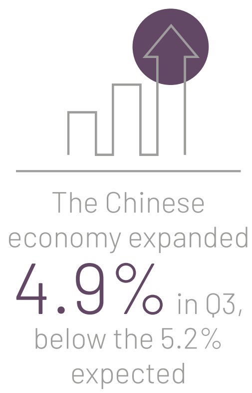
Going into 2022, the replenishment of inventories should also contribute positively to economic growth in the US.

Regarding inflation, prices edged up to 5.4% on a yearly basis and 4% excluding food and energy components, which supports our view that inflation should stabilise at high levels in the second half of 2021. If the monthly progression (+0.4%) is driven by increases in food and shelter, we also expect several components such as transports to accelerate as last month's lower figures do not reflect current tensions on energy prices. But if inflation is persisting longer than expected, it does not reflect a structural drift in inflation expectations and it is not fuelling a price-wage loops yet, although this should be closely monitored.

CHART 2: SLOWING ECONOMIC ACTIVITY AND HIGH LEVELS OF INFLATION IN THE US, %



Source: Atlanta Fed, Cleveland Fed, Bloomberg, Indosuez Wealth Management.



The Chinese economy expanded **4.9%** in Q3, below the 5.2% expected

CHINA: A COMBINATION OF FACTORS AFFECTED THE ECONOMIC ACTIVITY IN Q3

The Chinese economy expanded 4.9% Year-on-Year in Q3 2021 (vs. 5.2% expected), easing sharply from a 7.9% growth in the Q2. This can be explained by four factors: the slowdown of the property markets; the supply chain bottlenecks; the power shortage – which has affected about 50% of the Chinese provinces representing 65% of the GDP –, and the zero-COVID-19 policy restrictions. This is well reflected by disappointing industrial production figures in September (3.1% versus 5.3% previously) and lower manufacturing PMI. On the positive side, both the balance of trade as well as the retail sales surprised on the upside in September, while GDP now casting figures started to slowly rebound in October.

Finally, monetary and fiscal measures will play a role in the effort to counteract the economic slowdown. In this context, the next People's Bank of China (PBoC) meeting will be closely monitored, as several analysts expect the bank to cut the reserve requirement ratio by 50 bps in coming months, while local authorities already asked some major banks to accelerate approval of mortgages for Q4 2021.

EUROPE: ENTERING A MORE DIFFICULT PHASE OF ITS RECOVERY?

In Europe, if vaccination progress allowed the economy to strongly rebound, downside risks to the outlook intensified with supply shocks affecting the industrial sector. Higher energy prices should weigh both on the manufacturing activity and on consumption, especially as we approach the Christmas shopping season.

In this context, economic sentiment decreased, especially in Germany, where the automobile sector is mainly impacted by supply shortage, particularly semiconductors.

Despite these short-term difficulties, the overall picture is anything but gloomy: leading economic indicators still point to high levels in September, albeit slightly lower than expected. In addition, the Next Generation plan funds have started to flow, and are likely to significantly benefit the economy, especially in peripheral countries. Finally, the monetary policy should remain very accommodative despite some minor adjustments on the pace of asset purchases.

In conclusion, while debates around a stagflation scenario are raging, perhaps it is not yet appropriate to discuss such a scenario. On the one hand, while inflation is likely to remain high in the United States and accelerate in Europe, at least until spring 2022, in particular due to higher energy prices and supply chain disruptions, it should progressively return to more normal levels later next year as these shocks lose ground. On the other hand, economic activity should continue to normalise but should remain above the long-term average on the short term (5.2% expected next year in the United States and 4.3% in the Euro Area according to the IMF). It is over a longer time horizon that questions will have to be asked surrounding the level of potential growth, as under-investment over the last few decades has raised uncertainties about the growth path.

US HIGH YIELD CREDIT SPREADS COULD REMAIN EXPENSIVE FOR AN EXTENDED PERIOD

US High Yield spreads resisted quite well recently, absorbing a sharp increase in treasury yields. So far, the worsening property sector debt crisis in China has had very little impact on the US high yield (HY) asset class. Current valuations are reflecting the current economic momentum as illustrated by distressed indicators close to zero and the extremely low default rates.

CENTRAL BANKS

While many central banks are starting to withdraw emergency stimulus, divergence is increasing between central banks' guidance. Indeed, The European Central Bank (ECB) and the Bank of Japan are intending to keep stimulating their economies aggressively. The Fed is likely to remain patient with a progressive tapering expected to take in place in November this year (with monthly asset purchases expected to be reduced by USD 15 billion) and a first rate hike by end of 2022. The Bank of England (BoE) surprised markets by suggesting that it will raise its key rate before the end of its quantitative easing in order to curb inflationary forces. Money markets are pricing in 40 basis points of tightening for the BoE's December 2021 meeting. On the more hawkish side, Norway, Brazil, Mexico, South Korea, and New Zealand have already raised their key rates to fight against inflation pressures.

Money markets are pricing in
40 BPS
of tightening for the BoE's by the end of the year

Concerns about the evolution of energy prices and the impact of supply bottlenecks on inflation triggered a repricing of bond yields globally. The strong sell off over the last month was fuelled by the hawkish stance from the Bank of England and, more generally, the reassessment of the reaction function of central banks.

GOVERNMENT BONDS

Global rates, in particular the US yield curve, have experienced a strong bear-steepening movement. More recently, the US yield curve bear flattened, signalling that the street is betting on "more tightening sooner means less tightening altogether". On the short term, a combination of quantitative easing (QE) tapering announcements, the continuation of the economic recovery, President Biden's infrastructure spending, and rising inflation pressures are contributing to push nominal yields higher. On the medium term, restoring forces could, at some point, cap the magnitude of the rate increase, namely the expensiveness of the cost of carry for duration shorts, the overfunding of US treasuries in the years ahead, and the cheapness of Forex hedge costs.

BREAKEVENS

Regarding inflation, the breakevens have continued to strongly perform. In the Euro Area, the inflation curve is increasingly inverted on the front end, signalling a peak in published data to come by year-end. In the US, a slightly faster September CPI reading halted the downward trajectory since July. However, we continue to expect significant slowing in the year ahead, but we acknowledge that inflation has lingered longer than most predicted. Given current market valuations, we do see more value in short term breakevens.

Asian HY credit spread increasing from 1'133 BPS to 1'474 BPS since October

CREDIT MARKETS

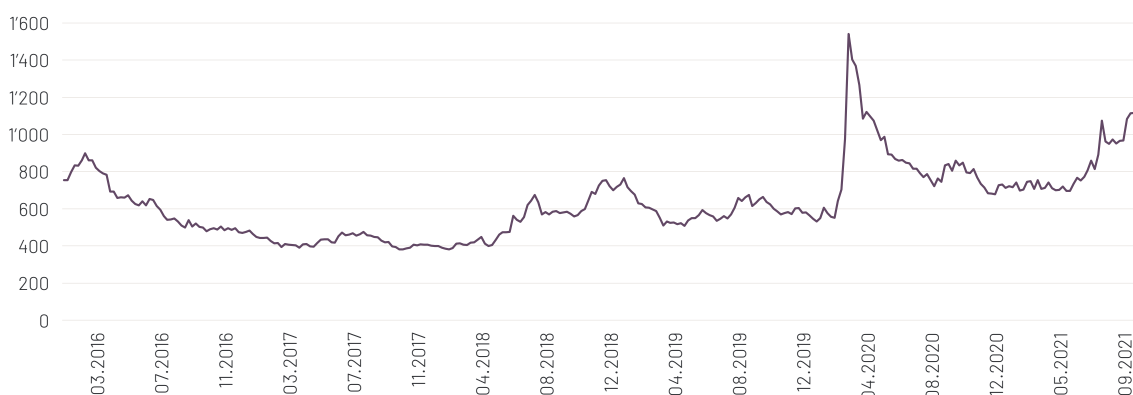
For developed markets, Investment Grade credit spreads remained stable and healthy. On their side, high yield spreads resisted quite well, absorbing a sharp increase in treasury yields. So far, the worsening property sector debt crisis in China has had very little impact on the high yield asset class. Indeed, for the euro and US HY, valuations are reflecting the current economic momentum as illustrated by distressed indicators close to zero and the extremely low default rates (below 2% for US HY and below 1.5% for euro HY). Nevertheless, little capital upside is anticipated at current levels.

Regarding sub financials and corporate hybrids, we have had some correction on high beta AT1 because of low reset and long call dates. On a valuation basis, spreads are at lows and offered no cushion to prevent the rise in rates. On corporate hybrids, the segment has showed signs of weakness, but should look attractive again when rates will stabilise.

ASIAN CREDIT

The emerging credit asset class strongly underperformed developed markets credit, with Asian credit suffering the most. Dragged down by the Chinese real estate woes, the Asian HY segment is clearly showing signs of capitulation, with credit spread to worst increasing from 1'133 bps to 1'474 bps since the beginning of October (as of 15 October) (Chart 3). Regarding Asian HY and specifically the Chinese property sector, with fundamentals and technicals deteriorating from a weak level, a prudent approach is favoured until we have more clarity on Evergrande's potential debt restructuring. Indeed, we remain comfortable with investment grade companies and strong BBs from the Chinese Property sector. Issuer picking will be key as more defaults are expected within the sector.

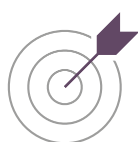
CHART 3: EVOLUTION OF ASIA USD HY CREDIT SPREADS, OAS SPREAD IN BPS



Source: Bloomberg Asia USD High Yield Bond Index, Indosuez Wealth Management.
Past performance does not guarantee future performance.

BEHIND THE WALL OF WORRIES

The wall of worries, built on concerns driven by energy shortages, supply chain disruptions, high inflation, tapering and China uncertainty, have effectively driven volatility back on the equity market. So far, the myriad of worries have finally materialised in a correction of at least 5%. Now the main driver of equity market performance will be determined by the upcoming earnings season.



EPS expectations for 2022:

+8%

EARNINGS

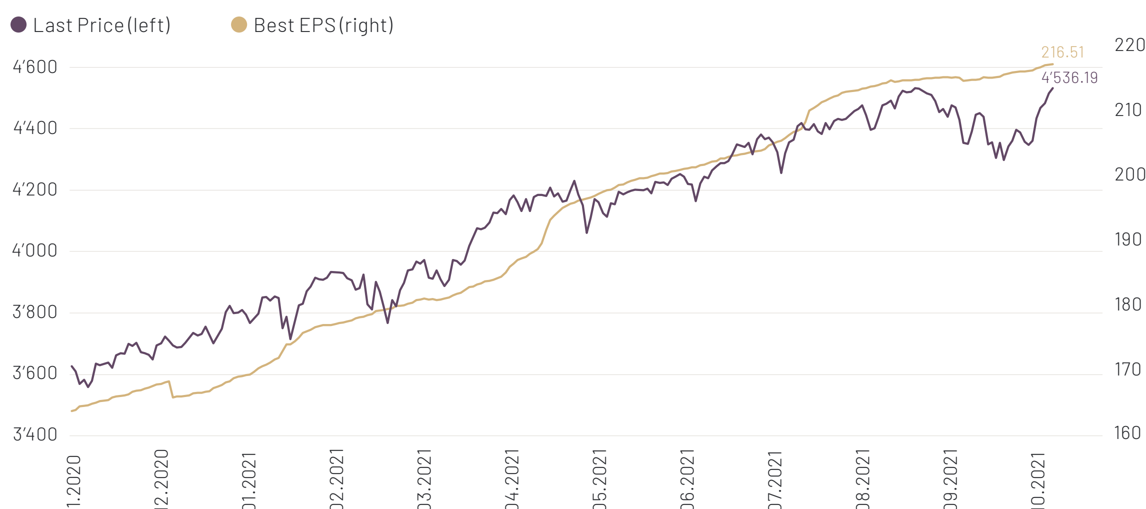
Investors are expecting some challenging Q3 publications affected by headwinds such as supply chain disruptions, strong energy and raw material costs, or a negative COVID-19 impact. If some specific sectors are going to be negatively impacted, the global earnings season could finally be more positive than anticipated. Although few companies have published their results so far, the first earnings releases in the United States seem relatively favourable with a high rate of positive surprises in the most cyclical sectors, even though Year-on-Year growth is now trending at a lower pace, in line with the sequential deceleration in activity momentum. As regards to next year, EPS expectations for 2022 remained quite reasonable at +8%.

UNITED STATES

Barely a month ago, investors were showing a particularly high level of pessimism, as illustrated by the VIX, at its highest level in four months. Recently, some of these concerns appear to have abated: the debt ceiling issue has been resolved and the first earnings releases are reassuring. Only concerns about inflation continue to make headlines in the press.

Nonetheless, companies do not seem to be worried about their earnings announcements. Analysts continue to revise upward earnings forecasts for all sectors (Chart 4.). Moreover, several of the US companies listed on the stock exchange appear to be unconcerned with inflation issues in their businesses, either because they have a small number of employees, they are in non-commodity related businesses, they have adopted a subscription model, or they have pricing power.

CHART 4: S&P 500 VERSUS 12M FORWARD EARNINGS



Note: After the recent stabilisation, the EPS trend is back on the upside.
Source: Bloomberg Finance LP, Indosuez Wealth Management.
Past performance does not guarantee future performance.

PRICING POWER
will likely stay a key investment theme

EUROPE

We continue to favour the European equity market as it combines attractive valuation, good EPS growth and a resilient EPS revisions trend, for 2021 and 2022. In addition, this market is more tilted towards value sector than the rest of World and this part of the market is particularly cheap when compared to the market average. The ongoing Q3 earnings season will be an opportunity to get a better insight into the impact of rising input costs and supply chain disruptions on corporate profits. Pricing power will likely stay a key investment theme for the months to come.

JAPAN

We have increased our view on the Japanese market. The vaccination rate in Japan is currently higher than in the United States and is close to European levels. At the same time, contamination cases are at the lowest levels and Japan has started its gradual reopening since the beginning of October. The reopening of the economy combined with a potential stimulus package should be positive for domestic consumption. In addition, Lower House elections will be held on 31 October and should improve political visibility.

EMERGING MARKETS

Lingering concerns and jitters surrounding a combination of increased regulation of some Chinese sectors, high tensions on the Chinese property sector (Evergrande issue) and China's current "zero-tolerance" COVID-19 policy all make for a volatile equity market environment in Asia at this time.

However, COVID-19 vaccination is progressing all over Asia (80% of Chinese people are fully vaccinated), which should help domestic consumption to recover. We believe domestic consumption (including sustainable development) will lie at the core of China's long-term growth strategy.

Global investors should start to look back at fundamentals and actual growth perspectives beyond pure negative regulatory news flow, as a large part is already reflected in current valuations.

Finally, Chinese authorities may announce targeted easing measures (e.g. property sector) by the end of the year that could somewhat ease some investor concerns and improve sentiment towards Chinese equities.

STYLES

After several disappointing months, the rotation into Value has benefited from renewed positive factors. Rising bond yields, significant soaring power prices, gas, coal, and oil have reminded investors that Value is a good hedge versus inflation.

We confirm our positive view on the Growth side as the market is going to focus more on pricing power and operational leverage rather than on valuation impact. Profitable technology leaders remain the best place to be in that area, at the expense of defensive growth (particularly consumer staples).

TAPERING TRENDS IN FOREX

Stronger USD trend still supported but decreasingly so as strong resistances appear across most USD pairs and conflicting macro impulses. Gold looks stuck and increasingly capped as it fails to break a narrowing downtrend, whilst the yen seems to be suffering from its low carry rate.

USD - HELD BACK BY DEBT CEILING FEARS DESPITE LESS NEGATIVE REAL YIELDS

USD
is relatively well insulated

The greenback is experiencing contrasting trend paths. On the one hand appreciating handsomely versus the interest rate sensitive Japanese yen whilst languishing at best versus the resilient CNY, CHF, EUR and commodity exporting pairs. This divergence largely incorporates the energy import sensitivity of countries exposed to rapidly rising input prices. The US dollar is relatively well insulated from a spike in USD denominated crude prices and should weather the storm better than peers. However, the merely delayed again fiscal cliff concerns in partisan Washington should cap any further strength into the fresh year-end deadline.

Nevertheless, in the short term as less transitory inflation woes assist US yields higher, we would not be surprised if the dollar crept up higher conditional to a new debt ceiling cap being secured come December. Importantly, the relative resilience and outperformance of US equities versus peers provides a solid backdrop (for now).

GOLD – TOPSIDE CAPPED AS NEGATIVE REAL YIELDS BOTTOM OUT

The yellow metal is dwindling aimlessly whilst virtually all industrial commodities rip higher given supply chain disruptions, environmental goals. Lacklustre gold is lagging as the FOMC's upcoming tapering phase inevitably approaches. As perceptions grow that ever accommodative central banks remain behind the inflation curve – negative real yields are gradually grinding back up and interest rate increase cycles are brought forward. This backdrop in the absence of geopolitical tensions should weigh on gold's strong upper resistance near USD 1'910 just as the underlying COVID-19 and worsening global debt concerns support on dips near USD 1'675 per ounce. We remain opportunistically bullish on bouts of weakness within this static range as the "buy and hold" mantra towards gold is challenged further.

CNY – HEADWINDS ARE BUILDING

Over the past few months, several factors have allowed the CNY to post a strong performance. First, the relative carry of inflation helped the Chinese currency, as we expected, while fears about the property market did not act as a counterforce. In addition, the attitude of the PBOC - which decided to keep its rates unchanged - has allowed the CNY to fill the gap of mid-June against the greenback and the dollar-yuan parity is now trading below 6.40. However, going forward, macro weakening as well as macro-prudential easing required by the real estate sector could weigh a bit on the CNY, which offers less potential in the short term. On the longer term, we maintain our constructive view due to net carry, portfolio diversification purposes and internalisation of the currency.

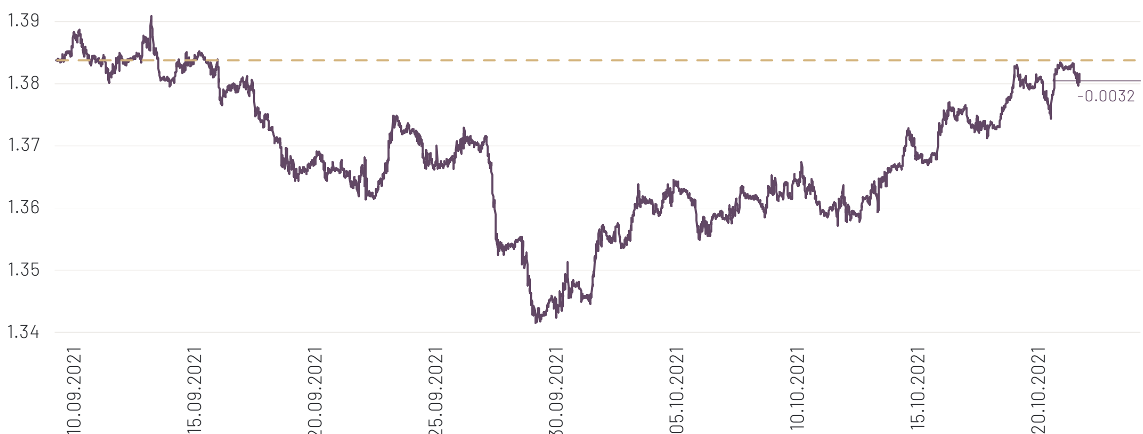
YEN – HURT BY CARRY TRADE STRATEGIES

As for the Japanese currency, the relative macroeconomic momentum and the dynamics of central bank policies should act as countervailing forces for the yen. However, the yen has already retreated in recent weeks from a three-year low of 109 against the dollar to 114. Finally, the yen remains a good diversification factor and a good hedge against volatility shocks.

GBP – UP & DOWN

The pound started October in a really bad way, with GBP/USD having fallen from 1.38 to 1.34 (Chart 5) as the market became gripped with fears that inflation might force the Bank of England (BoE) to hike rates into an already slowing economy – a pure stagflation situation (which indeed would be awful for GBP). However continued strong data prints and a slight but growing yield advantage versus USD have given it some support, and the tide of fear went back so we near 1.38 again as we approach month end. Analysts across the market are split into bulls and bears in GBP, presenting a true market for once! We are in the bullish camp, but respect that GBP is already trading quite strong given the background story.

CHART 5: GBP/USD, ROUND THE 1.30S IN 30 DAYS



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

INVESTMENT SCENARIO AND ALLOCATION

INVESTMENT SCENARIO

MACRO TRENDS

- Advanced economies continue their recovery but along uneven and somewhat bumpy trajectories, with a substitution of demand constraints by supply-side issues.
- The expected softening of growth in the US in Q3 2021 was simultaneously confirmed by supply slide constraints and demand-side incomplete recovery due to remaining restrictions.
- China's more pronounced slowdown has also been confirmed by an economy barely growing in Q3 compared to Q2 due to four key factors: the zero COVID-19 policy which creates both supply and demand constraints, the energy crisis, supply chain disruption, and the real estate slowdown affecting fixed asset investments.
- GDP growth in 2022 should return to more normal levels than FY 2021 growth but is clearly increasingly threatened by higher energy prices and supply side imbalances, leading to downward revisions on the global growth trajectory.

GDP GROWTH should return to normal levels in 2022

INFLATION AND CENTRAL BANKS

- In the past months, we expected inflation to remain elevated in the second half of 2021. We maintain that view on the back of recent figures as well as higher energy prices. The return of inflation towards central banks' targets could take more time and should be seen only in spring or summer 2022, as the causality of inflation now goes beyond base effects and energy.
- Nevertheless, we think that central banks will adhere to their plan for a progressive tapering starting at year end in the US and in March in Europe.

FISCAL POLICY

- Fiscal policy will remain supportive as well, with the emergency measures of 2020/2021 progressively leaving the floor to structural investment plans in the US and Euro Area.
- However, investors will pay attention to the proposed increase of corporate taxes in the US.

PROFIT CYCLE AND CORPORATE FUNDAMENTALS

- After record earnings growth in Q2, the Q3 earnings season could be a bit more contrasted although first earning releases is showing some good surprises especially in the most cyclical sectors. More granularly, we should see a polarisation between price power champions and reflation winners on the one hand, and companies more affected by the rise in energy and commodities prices on the other. This development could start to affect margins combined with persisting wage tensions in the US.
- Default rates will remain limited in developed markets and should represent a support for credit spreads, while the anticipated restructuring of the Chinese property sector has been increasingly priced as per the recent widening of credit spreads in Asian high yield.

ALLOCATION CONVICTIONS

EQUITIES

- Neutral view overall on equities with a positive view on developed markets, backed by strong fundamentals and supportive policy-mix but with more limited potential in the short term after a strong performance year-to-date.
- We have a preference for European equities and are neutral in US equities, with a positive long-term view maintained on technology. We remain relatively constructive on Chinese equities on the long run, without adding much risk despite attractive valuations, given the level of volatility and uncertainty related to regulatory crackdown and real estate restructuring which weigh on investors' sentiment.
- Positive view maintained on Value and on secular growth stories still offer an appealing shelter against inflation impact on margins, while the value style should continue benefiting from a strong rerating of earning growth and still offer attractive valuation.
- We are still cautious on defensive sectors such as utilities, telecom, and real estate, which are more rate sensitive and are affected by idiosyncratic issues on their business model to a greater degree.

FIXED INCOME

- Underweight maintained on government bonds; the expected steepening has materialised and probably still has further to go, but the pace slows down and gives the way to more upward pressure on the short end of the curve.
- We remain positive on inflation breakevens that have performed positively and proved to be a good hedge against inflation.
- Constructive view maintained on credit in mature markets and particularly on corporate high yield, although tight spreads and higher bond yield could lead to some repricing. Financial and subordinated debt should continue to perform. From now on, carry will be the main source of performance as we do not expect further tightening of spreads.
- Emerging debt: selectivity is key as attractive valuations being offset by very weak sentiment and increasing regulatory uncertainty. Dislocation in Chinese credit starts to offer opportunities in quality names.

CURRENCIES AND PRECIOUS METALS

- US dollar should remain supported as we are getting closer to tapering, which is expected by year-end. However, any renewed strengthening could be used to diversify to other currencies.
- Japanese yen is still seen as a good hedge within portfolios despite recent weakness.
- Besides, we remain constructive on the renminbi on the longer run, but the recent appreciation (especially against EUR) offers less potential and could be vulnerable to a potential monetary easing or macro weakness.
- Gold is suffering from higher real yields but remain attractive as inflation hedge, and tactically on weakness, but is capped by the upcoming normalisation of the Fed policy.

RISK FACTORS

- Inflation staying higher for a longer period affecting growth outlook and corporate margins.
- China deleveraging impact on global growth.

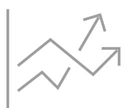
KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
Core EUR 10Y (Bund)	=/-	=
EUR Periphery	=	=/-
USD 10 Y	=/-	=
EUR Breakevens Inflation	=	=
USD Breakevens Inflation	=/+	=
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	=	-/=
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 20 OCTOBER 2021



GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10Y	1.66%	35.61	74.35
France 10Y	0.21%	20.20	55.40
Germany 10Y	-0.13%	19.80	44.50
Spain 10Y	0.50%	19.20	46.00
Switzerland 10Y	-0.08%	17.40	47.30
Japan 10Y	0.09%	5.40	7.20

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Governments Bonds Emerging Markets	42.33	-1.54%	-6.45%
Euro Governments Bonds	219.07	-0.85%	-1.40%
Corporate EUR high yield	212.74	-0.93%	2.75%
Corporate USD high yield	329.44	-0.58%	3.54%
US Government Bonds	320.39	-1.02%	-1.68%
Corporate Emerging Markets	51.58	-1.19%	-2.86%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	1.07	-1.10%	-0.97%
GBP/USD	1.38	1.48%	1.13%
USD/CHF	0.92	-0.73%	3.81%
EUR/USD	1.17	-0.31%	-4.63%
USD/JPY	114.31	4.13%	10.71%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	15.49	-5.38	-7.26

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	4'536.19	3.20%	20.77%
FTSE 100 (United Kingdom)	7'223.10	1.97%	11.80%
Stoxx Europe 600	470.07	1.48%	17.80%
Topix	2'027.67	-0.78%	12.36%
MSCI World	3'147.70	2.39%	17.01%
Shanghai SE Composite	4'910.18	1.83%	-5.78%
MSCI Emerging Markets	1'301.13	3.04%	0.76%
MSCI Latam (Latin America)	2'228.97	-4.51%	-9.09%
MSCI EMEA (Europe, Middle East, Africa)	299.22	6.47%	24.02%
MSCI Asia Ex Japan	831.83	3.18%	-1.32%
CAC 40 (France)	6'705.61	1.03%	20.79%
DAX (Germany)	15'522.92	0.10%	13.15%
MIB (Italy)	26'581.77	3.36%	19.56%
IBEX (Spain)	9'017.90	2.38%	11.69%
SMI (Switzerland)	12'013.15	1.48%	12.24%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	5'573.00	-5.14%	32.06%
Gold (USD/Oz)	1'782.08	0.79%	-6.13%
Crude Oil WTI (USD/Bbl)	83.87	16.12%	72.86%
Silver (USD/Oz)	24.40	6.89%	-7.45%
Copper (USD/Tonne)	10'185.50	9.69%	31.16%
Natural Gas (USD/MMBtu)	5.17	7.60%	103.62%

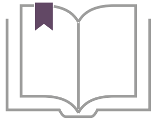
Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

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

	JULY 2021	AUGUST 2021	SEPTEMBER 2021	4 WEEKS CHANGE	YTD (20.10.2021)
BEST PERFORMING (+)	2.27%	3.26%	3.54%	6.47%	24.02%
	1.97%	3.14%	1.26%	3.20%	20.77%
	1.72%	2.90%	0.30%	3.18%	17.80%
	-0.07%	2.42%	-0.47%	3.04%	17.01%
	-0.49%	2.35%	-3.41%	2.39%	12.36%
	-2.19%	2.08%	-4.25%	1.97%	11.80%
	-4.24%	1.98%	-4.29%	1.83%	0.76%
	-7.04%	1.24%	-4.36%	1.48%	-1.32%
	-7.76%	0.21%	-4.76%	-0.78%	-5.78%
WORST PERFORMING (−)	-7.90%	-0.12%	-11.39%	-4.51%	-9.09%

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.
The Indosuez Wealth Management Group is following all of these reforms very closely and has a specific framework to cover all related legal, commercial, and operational impacts. For now, you are not required to do anything in relation to your financing operations or investments indexed to the benchmark rates concerned by these changes. You will receive further information once a better picture surrounding the details of the replacements are known. Please feel free to contact your account manager if you have any questions.