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Editorial

The economy is simple really

Everything revolves around supply and demand in the economy. Understanding this principle helps in the current situation when it comes to anticipating how US inflation will develop, but is not enough on its own.

Daniel Mewes
Chief Investment Officer

The law of supply and demand is key to understanding the economy. Some people mischievously say it's the only thing you need to know about economics. The economy is actually a bit more complex than that as we'll discover. But it's fair to say that plenty of attention is being focused on supply and demand in the current economic situation.

The supply of various goods remains scarce owing to the sharp rise in demand. A lack of upstream services is holding back production at many companies. But it's not just companies that are complaining about delivery bottlenecks – many readers will have had similar experiences. If you've been carrying out building or renovation projects, you'll have found it difficult to avoid delays due to a lack of supplies. If you want to purchase an e-bike, you'll need a great deal of patience.

Bottlenecks triggering higher inflation – temporarily

In the USA, the bottlenecks in automotive production and limited supply of new cars has seen a sharp rise in demand for second-hand cars. Supply has been outstripped to such an extent that the higher prices for second-hand cars have pushed inflation to over 5 percent.

The coronavirus crisis has triggered many extraordinary developments. But who would have imagined prior to the crisis that the second-hand car trade in the US would become so important to financial market players and central banks! Significant rises in US inflation can have an impact on interest rates, currencies, asset prices and the economy worldwide.

But bottlenecks are certainly not a constant – where there are bottlenecks and rising prices, there are clearly also opportunities for profits. Supply will be increased as quickly as possible, which will cause prices to return to normal. This is expected to be the case for second-hand cars in the US in time, even though producers won't be able to overcome the shortage of semiconductor chips straight away due to the level of complexity. This means automotive production will remain restricted for a certain time.

When things get more complex – expectations

Bottlenecks can cause high inflation – which is the situation we're currently seeing in the USA – but lasting high levels of inflation are unlikely. The bottlenecks would have to worsen for this to happen. This is the basis behind the assumption that the current very high rates of inflation in the US won't remain at this level.

> «Where there are bottlenecks and rising prices, there are also opportunities for profit.»

It's particularly the case if the US Federal Reserve withdraws from its ultra-expansive monetary policy soon as this would help to stabilize the inflation expectations of participants in the economy. Prices don't just depend on supply and demand, but also on the expectations factored into pricing by economic participants. If a company anticipates that it will have to pay higher salaries next year, it will increase the prices of its products regardless of demand. This takes us into more complex territory beyond the law of supply and demand – the economy isn't always quite so straightforward after all.

Positioning

Limited concern about the Delta variant

The Delta variant is unlikely to have a long-term impact on the financial markets. We are maintaining our overall neutral alignment. Despite heavy losses, now isn't the time to buy Chinese equities.

What's the best way to position a portfolio in view of the more contagious Delta variant? Overall, the global economic picture is bright despite the Delta variant. As expected, the economic recovery is currently progressing gradually after the strong upturn in the spring, but only a small part of this is due to the Delta variant. This is still having little impact economically in the industrialized nations. The spread of the Delta variant is only being reflected in the economic data in Asia and countries with a zero-tolerance coronavirus strategy. This means consumption and economic growth remain well below pre-coronavirus levels in China.

Interest rates continue to fall

The response of the financial markets to the Delta variant has been mixed up until now. On the one hand, we saw a slightly higher degree of anxiety. For example, interest rates have fallen significantly again in Europe, following the trend in the US. But US rates have fallen again despite the very strong US labour market figures, and stand at a much lower level than in the spring. Continued high inflation rates in the US are having little impact either. While there seems to be a consensus on the market – in view of these economic figures – that the US Federal Reserve will soon start to scale back its bond-buying scheme, this has had little impact on the development of interest rates to date. The recent cut means the scope for reducing interest rates is now even smaller. This is why we are maintaining our underweighted position in global bonds for the time being.

«Overall, the global economic picture is bright despite the Delta variant.»

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	–0.2%	0.2%	–0.2%	0.2%
	USD	0.9%	4.3%	0.9%	4.3%
	JPY	0.8%	–2.4%	0.8%	–2.4%
Equities	Switzerland	2.5%	19.4%	2.5%	19.4%
	World	2.6%	22.0%	1.7%	17.0%
	USA	2.8%	24.1%	1.8%	19.0%
	Eurozone	3.4%	21.0%	3.6%	20.7%
	United Kingdom	1.8%	20.9%	1.4%	14.7%
	Japan	0.7%	6.7%	–0.1%	9.3%
	Emerging markets	–1.6%	5.7%	–2.5%	1.3%
Fixed Income	Switzerland	0.7%	0.0%	0.7%	0.0%
	World	1.0%	1.6%	0.1%	–2.6%
	Emerging markets	0.9%	3.5%	0.0%	–0.8%
Alternative Investments	Swiss real estate	–0.8%	7.3%	–0.8%	7.3%
	Gold	–1.6%	–3.4%	–2.5%	–7.4%

[1] Year-to-date: Since year start
[2] Local currency

Data as of 12.08.2021
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Chinese equities under regulatory pressure

Anxiety over the Delta variant had little impact on the equity markets in industrialized nations. Both European and US stock market indexes hit new record highs. European equities in particular picked up good momentum recently. In contrast, the bad news about the further spread of the Delta variant dominated events on the Asian stock markets. This negativity is expected to subside over time, which is why we are maintaining our neutral equity market positioning.

In addition, Chinese equities came under regulatory pressure again. After the announcement of a review of cyber security at the transport service provider Didi in early July, the Chinese authorities imposed extensive measures in the education sector at the end of July. As a result, Chinese equities had more than 10 percent wiped off their value within a short space of time. With their recently published five-year plan on the rule of law and control of the economy, the Chinese authorities have now put their regulatory overhaul on an official footing. This plan has to be seen as the start of the introduction of a comprehensive regulatory framework. This means the financial markets will have to adapt to further measures.

Gold too expensive as a hedging instrument

There was demand for more defensive assets, such as bonds and the Japanese yen, but not for gold. Gold proved volatile last month. After the publication of the strong US labour market figures, both US interest rates and the US dollar rose, while the price of gold slipped below the 1,800 US dollar mark. The flash crash shortly afterwards led to a further significant downturn. While the gold price has now almost completely recovered from these setbacks, gold is now too expensive as a diversification option. We are neutralizing our overweighted position.

Positioning relative to long term strategy: Swiss focus

Asset class		TAA[1] old	TAA[1] new	underweighted[3] ––	–	neutral[3]	+	overweighted[3] ++
Liquidity	**Total**	**9.0%**	**11.0%**					
	CHF	8.0%	10.0%					
	JPY	1.0%	1.0%					
Equities	**Total**	**48.0%**	**48.0%**					
	Switzerland	26.0%	26.0%					
	USA	8.0%	8.0%					
	Eurozone	5.0%	5.0%					
	United Kingdom	2.0%	2.0%					
	Japan	2.0%	2.0%					
	Emerging markets	5.0%	5.0%					
Fixed Income	**Total**	**33.0%**	**33.0%**					
	Switzerland	19.0%	19.0%					
	World[2]	8.0%	8.0%					
	Emerging markets[2]	6.0%	6.0%					
Alternative Investments	**Total**	**10.0%**	**8.0%**					
	Swiss real estate	3.0%	3.0%					
	Gold[2]	7.0%	5.0%					

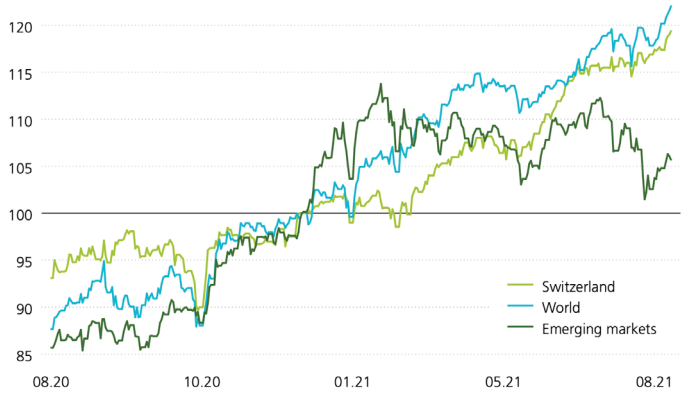
[1] Tactical Asset Allocation: short to mid-term orientation
[2] Currency hedge to CHF
[3] Positioning relative to our long-term asset allocation

☐ Adjustment compared to last month

Market overview
Equities

The global equity markets are continuing to make gains. The exception is the Chinese stock market, which has seen further turbulence due to the regulatory measures imposed by the authorities.

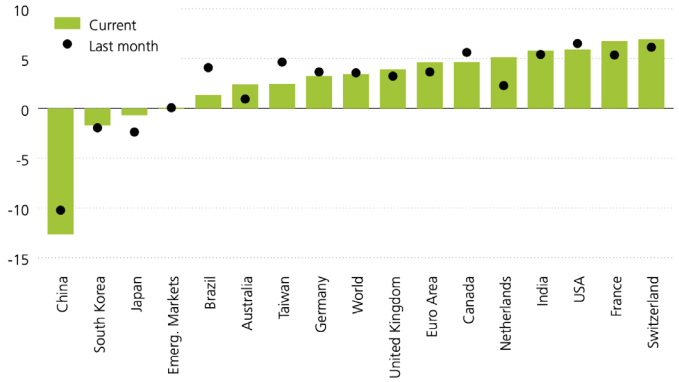
Indexed stock market performance in Swiss francs
100 = 01.01.2021



After a brief pause in the middle of the year, the upward trend has continued on the international stock markets – albeit at a much slower pace. Global stocks have still risen more than 20 percent overall in just eight months. Emerging market equities are an exception. South-east Asian countries in particular are now contending with the rapid spread of the Delta variant. Regulatory measures in China have also caused market turbulence.

Source: SIX, MSCI

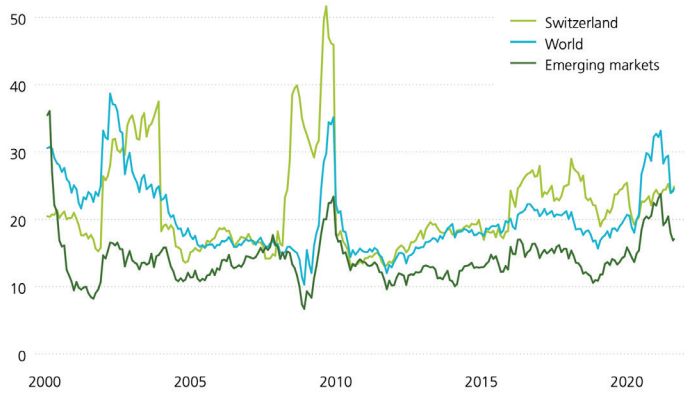
Momentum of individual markets
In percent



The global equity markets have experienced a significant loss of momentum over the summer. Whereas levels of between 20 and 30 were achieved at the start of the year, momentum values have now returned to the single-digit range. Compared to the prior month, France, the Netherlands and Switzerland are now showing greater momentum. The Chinese stock markets are amongst the losers again. Further government regulations have hit tech and education stocks particularly hard, leading to price losses of 10 percent last month alone.

Source: MSCI

Price/earnings ratio
P/E ratio



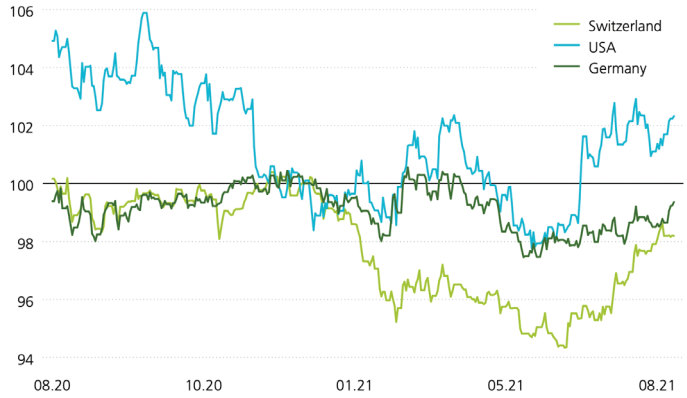
Equity valuations have skyrocketed owing to the rapid recovery rally since last spring. Price/earnings ratios of up to 35 were recorded temporarily. Valuations have fallen again after the recent price losses in emerging market equities and positive earnings surprises from US stocks. Swiss equities are an exception. To date, their valuations have only reached the pre-crisis level of 24.

Source: SIX, MSCI

Market overview
Fixed income

After a decline in US interest rates, European rates have now also fallen. The Delta variant is causing some anxiety on the financial markets, which is supporting government bonds.

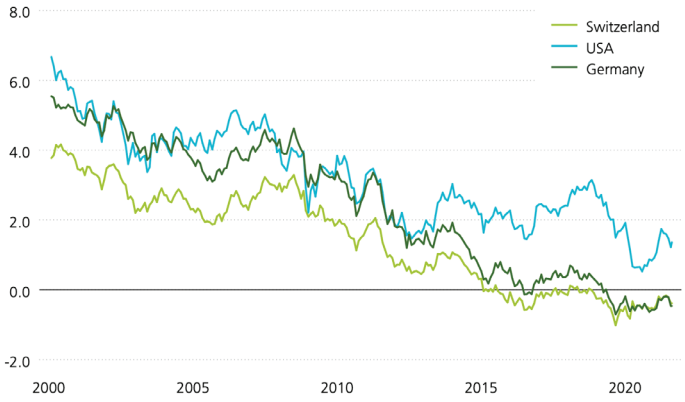
Indexed performance of government bonds in Swiss francs
100 = 01.01.2021



The economic outlook remains very bright, even though recovery momentum has peaked. Unlike Asia, Europe and the USA have so far been spared the economic impact of the Delta wave, but it is causing some anxiety on financial markets. As a result, investor demand for government bonds increased again last month. Yields rose internationally. European and UK securities benefited in particular. The value of Swiss government bonds climbed by 1.5 percent.

Source: SIX, Bloomberg Barclays

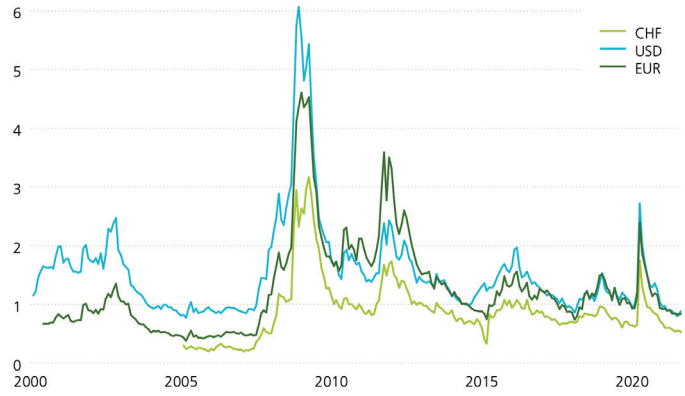
Trend in 10-year yields to maturity
In percent



After the global post-coronavirus rally, yields to maturity on government bonds rose sharply in the first half of 2021. In March this year, yields to maturity on 10-year US bonds reached a temporary high of 1.7 percent. However, a downward trend has since taken hold again globally, which is difficult to explain. The strong economic situation and the prospect of the US Federal Reserve withdrawing from its ultra-expansive monetary policy would support higher interest rates. The yield on 10-year US government bonds even briefly dipped below the 1.2 percent mark in early-August. This downward trend was also recently apparent in yields to maturity on Swiss and German securities.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



While investor demand for government bonds was higher last month, there was greater movement again in credit spreads on higher-risk corporate bonds. They had previously continually narrowed since last spring, falling below pre-crisis levels. However, a more differentiated picture is now emerging. For US corporate bonds in particular, the market is pricing in a slightly higher credit spread of just under 1 percent.

Source: Bloomberg Barclays

Market overview

Swiss real estate investments

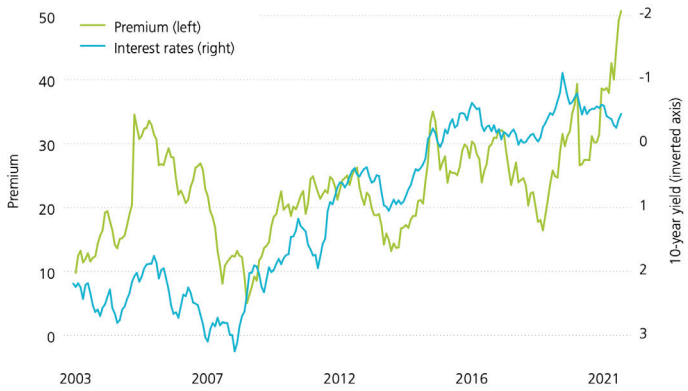
Swiss real estate funds showed little momentum during the summer break. However, their valuations are more expensive than ever before due to the fall in interest rates.

Indexed performance of Swiss real estate funds
100 = 01.01.2021

Indexed Swiss real estate funds predominantly trended sideways last month and failed to build on the price gains of the previous month. However, they have climbed in value by 8 percent since the start of the year alone. As a result, their valuations have also risen further. Even higher price gains were achieved by US (+30 percent), UK (+22 percent) and European real estate investments (+18 percent).

Source: SIX

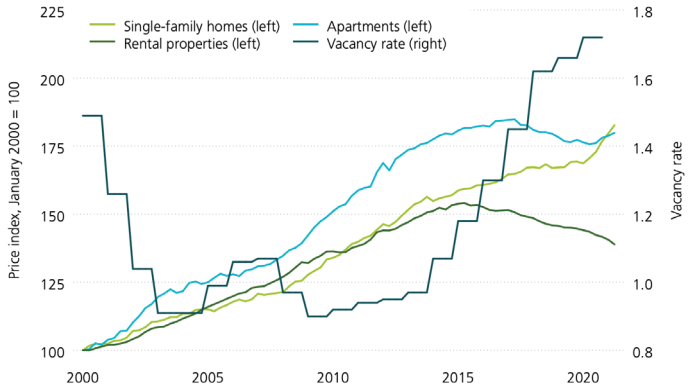
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



The average premiums on Swiss real estate funds broke through the 50 mark for the first time in August. This means investors are willing to pay an average premium of over 50 percent above the value of the properties contained in the funds. At the same time, the yield to maturity on 10-year Swiss government bonds fell further to –0.4 percent. They were still at –0.1 percent in early-June. This means the overvaluation measured by interest rates has hit new record-highs.

Source: SIX

Vacancy rate and real estate prices
100 = January 2000 (left) and in percent (right)



Residential living remains an important issue for the Swiss population in the year after the start of the coronavirus crisis. Demand for real estate remains high. As a result, prices are continuing to rise and currently stand at around 8 percent above the pre-crisis level. In contrast, rents on residential properties also fell slightly in the second quarter (–1 percent). This has increased the disparity between house prices and rental prices, which now stands at more than 30 percent above the long-term average.

Source: SNB, BfS

Market overview

Currencies

Investors are seeking security on the currency markets, with strong demand for the Swiss franc, yen and dollar. Commodity currencies are currently suffering further losses.

Despite the positive momentum on the financial markets, investors sought security. Safe-haven currencies rose as a result. The Swiss franc climbed by 2 percent, and both the Japanese yen and US dollar by 1 percent. Losses were mainly suffered by commodity currencies, including the Australian and Canadian dollar and the Swedish krona and Norwegian krone. Except for the food sector, commodities only performed moderately last month. Downturn risks from the spread of the Delta variant also dampened the outlook.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	1.08	1.11	1.04–1.19	Euro neutral
USD/CHF	0.92	0.85	0.74–0.95	USD neutral
GBP/CHF	1.28	1.40	1.21–1.59	Pound neutral
JPY/CHF [3]	0.84	1.02	0.86–1.18	Yen undervalued
SEK/CHF [3]	10.63	11.33	10.23–12.43	Krona neutral
NOK/CHF [3]	10.43	12.40	11.07–13.74	Krona undervalued
EUR/USD	1.17	1.32	1.15–1.49	Euro neutral
USD/JPY	110.44	82.77	67.84–97.70	Yen undervalued
USD/CNY	6.48	6.28	6.04–6.53	Renminbi neutral

[1] Purchasing power parity. This metric calculates an exchange rate using relative inflation rates.
[2] Range of historically normal fluctuations.
[3] Francs per 100 Yen or Krona.

Source: Web Financial Group

Gold

Precisely one year after the all-time high of USD 2,068, a flash crash saw the gold price plummet by 100 US dollars in early-August.

Indexed performance of gold in Swiss francs
100 = 01.01.2021

Gold was hit by a flash crash at the beginning of August. The price per troy ounce plunged by 100 US dollars overnight. The reasons for this remain unclear. While the price has recovered, it still remains well under the 1,800 US dollar mark, despite the fact that inflation is expected to remain high in the third quarter – the US inflation rate again stood at 5.4 percent in July. While the precious metal has historically been seen as a way of hedging against inflation, this has not yet proven to be the case this year. The price is just under 5 percent down on the year-opening level.

Source: Web Financial Group

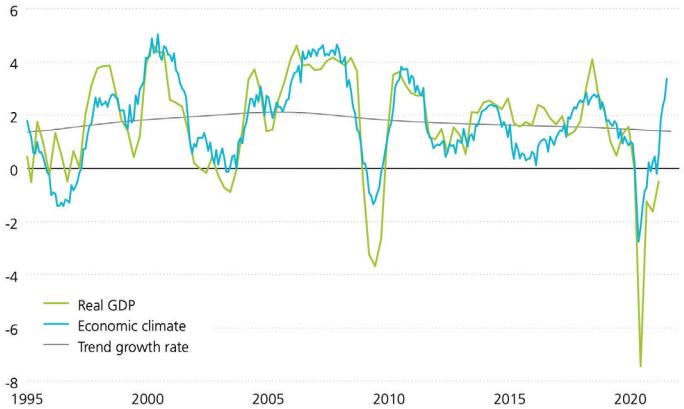
Economy

Strong global economic performance despite Delta variant

The rapid spread of the Delta variant has only had an economic impact in Asia so far. Europe and the USA have largely been spared as of yet.

Switzerland

Growth, sentiment and trend
In percent

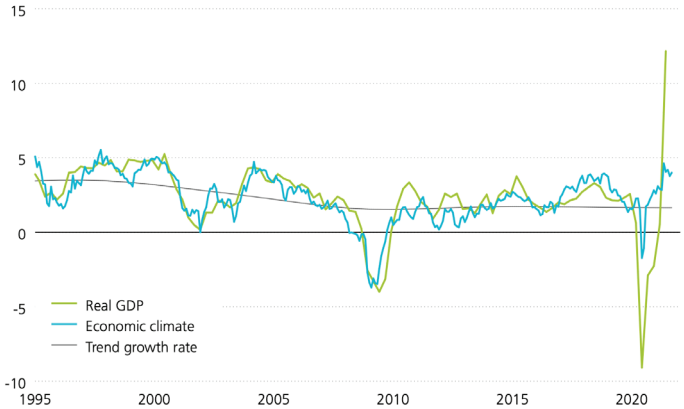


Source: Bloomberg

The Swiss economy looks in very good shape at the start of the third quarter. Both industry and the retail sector are producing pleasing figures. An expansion of production saw Swiss exports hit a new record high of 60 billion francs in the second quarter. An enduring strong order situation has created an optimistic mood: in July, the leading indicator PMI climbed to its highest level since data collection began in 1995, reaching a reading of 71.1. Around a fifth of Swiss companies have now started expanding personnel capacity once again. Consumption also posted record figures. Consumer confidence and retail sales both reached their highest level in a decade. Despite coronavirus-related store closures at the start of the year, record revenues were posted in the first half of 2021. They now stand at around 5 percent above the pre-crisis level.

USA

Growth, sentiment and trend
In percemt



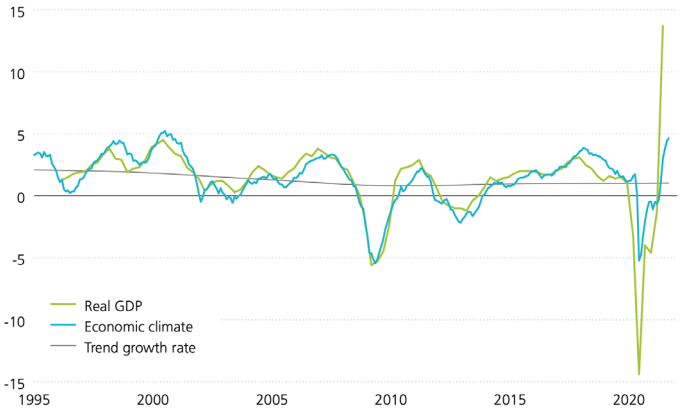
Source: Bloomberg

The US economy produced impressive recovery momentum. After quarterly GDP growth of 6.5 percent in the first quarter, the US economy expanded by a further 6.5 percent during the second quarter. The main driver behind this trend was consumer spending, which amounted to a total of 27 billion US dollars for the first half-year. But industry made strong headway, too, with investment reaching unprecedented levels. Finally, the situation on the labour market appears to be returning to normal. In July, the rate of unemployment fell further to 5.4 percent. Leading indicators still point to an optimistic mood but are not quite as high as they were in the spring. However, at 5.4 percent, the price trend remains high, mainly due to higher contributions from energy, second-hand cars and transport services.

Eurozone

Growth, sentiment and trend

In percemt



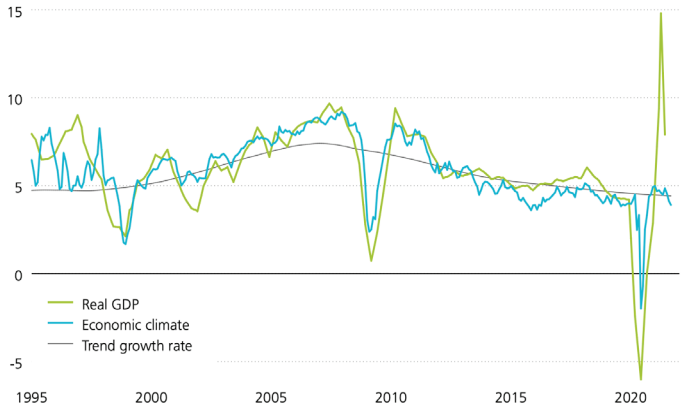
Source: Bloomberg

The eurozone economy is continuing to gain momentum. After two negative quarters, positive GDP growth of 2 percent was recorded in the second quarter. But there is still some way to go before the pre-crisis level is reached, which means that there is still considerable recovery potential for the third quarter. This explains the high level of optimism in the eurozone economy. The Purchasing Managers' Index (PMI) for industry reached a level of 62.8 in July, just slightly below June's record high. Order intake in particular continued to rise sharply. Companies also continued expanding personnel capacity in July. The services sector, meanwhile, recorded its strongest growth since 2006, boosted by the lifting of coronavirus restrictions. The buoyant mood amongst consumers is also consistent with these trends. Surveys produced a brighter picture than before the start of the crisis.

Emerging markets

Growth, sentiment and trend

In percemt



Source: Bloomberg

China in particular is currently being hit hard by the rapid spread of the Delta variant. After becoming the first country to reach and exceed its pre-crisis level, China's growth has slowed since the end of last year. Despite the strong economy, Chinese consumption has not yet returned to its pre-crisis level. New restrictions mean this remains unlikely.

Other emerging markets are also struggling to bring coronavirus under control. Brazil and Russia are contending with another sharp upward inflationary trend. To counteract inflation rates of 9 and 6.5 percent respectively year-on-year, both central banks raised the key rate by 1 percentage point.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2021Q1	–0.5%	0.5%	–1.3%	–6.1%	–1.6%	1.6%	1.0%	18.3%
GDP Y/Y [1] 2021Q2	n.v.	12.2%	13.7%	22.2%	n.v.	n.v.	n.v.	7.9%
Economic climate [2]	↗	↘	↘	↗	↗	→	→	↘
Trend growth [3]	1.4%	1.6%	0.8%	1.6%	1.0%	5.0%	1.1%	4.2%
Inflation	0.7%	5.4%	2.2%	2.5%	0.2%	5.6%	9.0%	1.0%
Key rates	–0.75%	0.10%	0.00%	0.10%	–0.10%	4.00%	5.25%	4.35%

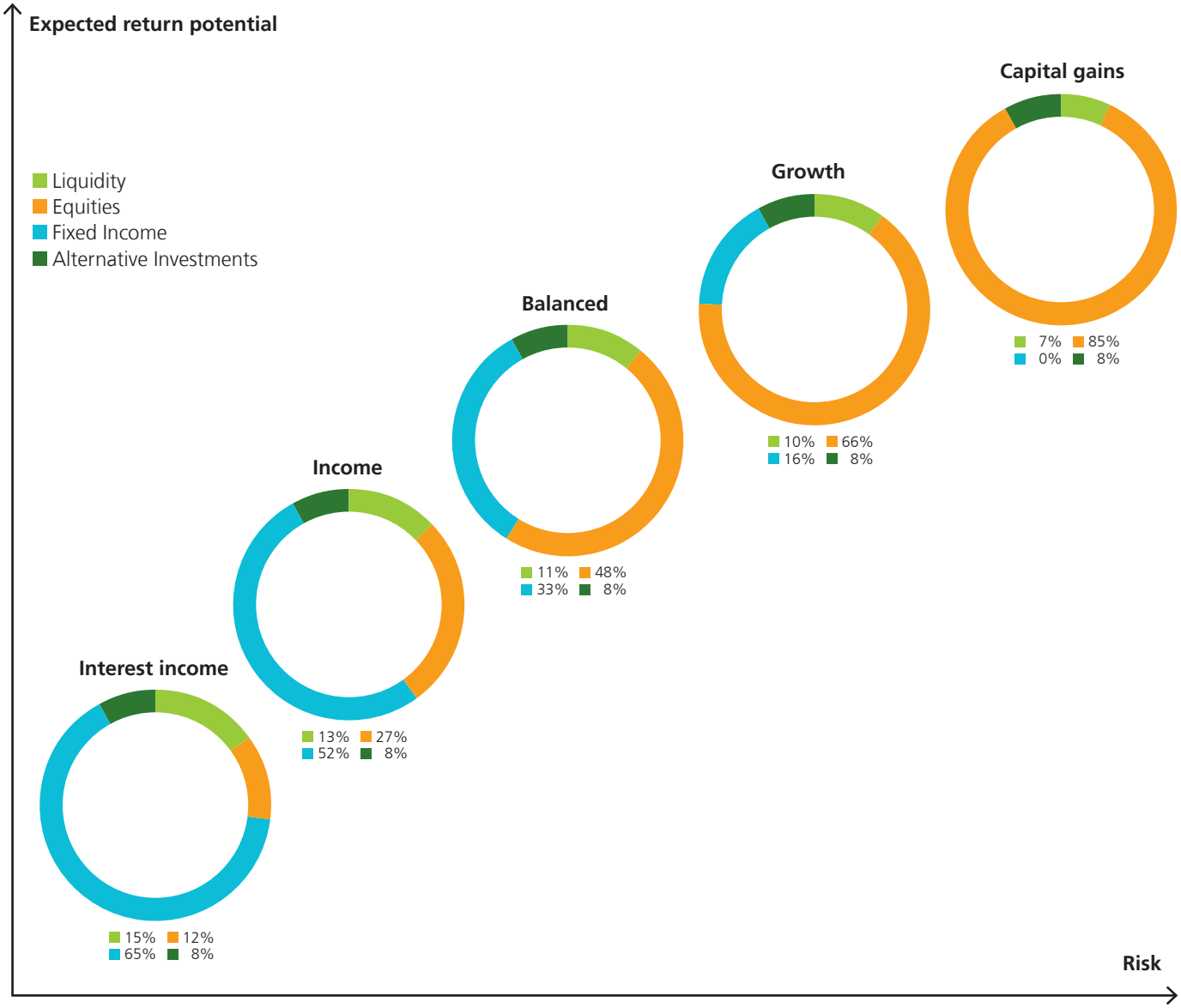
[1] Growth compared to year-ago quarter.
[2] Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP. A green arrow indicates accelerating economic growth, a red arrow indicates a slowing down.
[3] Potential growth. Long-term change in Gross domestic product with sustainable capacity utilization.

Source: Bloomberg

Model portfolios Swiss focus

Unstable gold

The economic outlook remains good despite the delta variant. Although the economic recovery is currently proceeding in smaller steps, as expected, after the strong recovery in the spring, this is only due to a small extent to the delta variant. In view of these economic figures, there seems to be a consensus in the market that the US central bank will soon begin to reduce its bond purchases. So far, however, this has hardly had any influence on the development of interest rates. With the latest cut, the downward potential of interest rates has now been reduced again. We are therefore maintaining our underweight in global bonds for the time being. While new government regulations caused turbulence on the Chinese stock market, European and American stock indices reached new highs. We remain neutral on the equity market. Gold proved to be volatile last month, which is why we are neutralising our overweight.



Source: PostFinance Ltd

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