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PostFinance

Editorial

From euphoria to the new normal

The rest of the year will not be shaped by the same optimistic mood as the first half-year. Where will interest rates and inflation level out in the new normal?

Daniel Mewes
Chief Investment Officer

The financial markets performed well in the first half-year. Sharp upturns in equity prices, skyrocketing Swiss real estate funds and only slight rises in interest rates despite strong growth figures. Time to take stock: what's the current situation and where are we heading?

There were clear rays of hope over coronavirus in the first half-year. Even though attempts to tackle the pandemic meant a bumpy start to the year for the global economy, rapid progress on vaccinations and the lifting of restrictions during the spring ensured that a lot of lost ground was made up in the USA and Europe. Both fiscal and monetary policy remained very supportive. State transfer payments not only made up for loss of income, but actually exceeded it. The central banks for the major currency areas continued purchasing securities on a large scale.

Levelling-out of the upturn

The second half of the year will not be shaped by the same optimistic mood. There seems to be increasingly less positive news about coronavirus, as case numbers are rising despite progress on vaccination campaigns. As autumn and cooler temperatures approach in the northern hemisphere, it will become apparent that we will have to deal with coronavirus in one way or another for a long time to come.

In relation to the economic outlook, the leading indicators have been showing for some time that the upturn will not continue at the same pace we have seen lately. Fiscal policy support will be phased out as the economy returns to normal, and money will have to be earned again. Monetary policy will also enter the phase where plans are drawn up to scale back or even halt the purchasing of securities.

Focus on interest and inflation

The euphoria will give way to a new normal. The situation remains uncertain but not unattractive for investors. So far, this has also been due to interest rates. While they rose in the spring, they only increased slightly and then fell again, particularly in the last month. The longer-term US government bonds stood at only a little above January's level recently. Low interest rates mean high valuations of assets from which bonds, equities and real estate can benefit.

> «The situation remains uncertain but not unattractive for investors.»

It's worth bearing two questions in mind: where will long-term interest rates settle in the new normal? In the past, long-term interest has stabilized after every crisis at a lower level than before the crisis. Will this also turn out to be the case after the coronavirus crisis? And if so, how much lower will they be? This question is also related to the second key point: will the very high rates of inflation that are currently being experienced in the USA actually fall again towards the end of the year? There are many indications that this phenomenon is only a temporary effect. However, investors must keep an eye on the residual risk that high inflation develops momentum all of its own.

Positioning

Financial markets to face headwind

The economic recovery is levelling out. After a strong first half-year, the financial markets are expected to face headwind in the second half of the year.

Expansive monetary and fiscal policy helped the economy to make a rapid recovery this year. This was also reflected on the financial markets. The global equity markets generated a yield of over 18 percent in the first half-year alone. But the economic recovery has now peaked. This means that higher-risk investments will face increasing resistance. Momentum on the financial markets tailed off significantly last month.

Equity markets falter

The recent spike in coronavirus infection rates seems to be increasingly unsettling the markets. While European equities were still displaying strong momentum in the prior month, this has changed recently. The Asian equity markets also continued to falter, particularly China's. The recent regulatory measures aimed at Didi, the Chinese equivalent of Uber, may have been a contributing factor. Only the US equity market performed well, thanks to its resurgent tech equities. We do not anticipate a repetition of the high equity yields of recent months in the second half-year and are tactically retaining a neutral equity position.

Declining interest rates

The economic recovery meant that further rises in interest rates were anticipated. However, since the sharp rise in mid-February, interest rates have fallen again significantly. Even the US Federal Reserve's recent announcement of plans to start withdrawing from its expansive monetary policy only pushed long-term interest rates up briefly. 10-year interest rates in the USA have declined by over 0.3 percentage points within the last month. Neither the central banks nor high inflation rates seem capable of alarming the markets. As interest rates have diverged more significantly from pre-crisis levels again, we are maintaining our underweighted position in global bonds. We consider further interest rate cuts much less likely than a return to higher interest rates.

«This means that higher-risk investments will face increasing resistance.»

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	–0.5%	0.3%	–0.5%	0.3%
	USD	2.2%	3.7%	2.2%	3.7%
	JPY	2.5%	–2.5%	2.5%	–2.5%
Equities	Switzerland	0.7%	15.6%	0.7%	15.6%
	World	3.3%	18.4%	1.0%	14.2%
	USA	5.1%	20.4%	2.8%	16.1%
	Eurozone	–1.9%	15.7%	–1.4%	15.4%
	United Kingdom	–1.6%	16.8%	–1.9%	11.3%
	Japan	0.6%	6.0%	–1.8%	8.6%
	Emerging markets	0.4%	9.5%	–1.8%	5.6%
Fixed Income	Switzerland	0.6%	–0.7%	0.6%	–0.7%
	World	2.1%	1.0%	–0.1%	–2.5%
	Emerging markets	2.7%	3.1%	0.5%	–0.6%
Alternative Investments	Swiss real estate	1.4%	7.1%	1.4%	7.1%
	Gold	–0.1%	0.2%	–2.2%	–3.4%

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

Data as of 15.07.2021
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Valuation of real estate at record high

Further interest rate cuts have made Swiss real estate seem even more attractive. A premium of around 50 percent is currently being paid on Swiss real estate funds, which means that investors are paying 50 percent more than the net asset value. This premium has now reached an historic high. As a result, the overvaluation has also increased significantly once again. In light of this situation, retaining an underweighted position in Swiss real estate remains the best approach.

Japanese yen strong, gold diversified

Defensive currencies also performed strongly last month, while higher-risk commodity currencies fared less well. The Japanese yen proved extremely strong after previously experiencing weak demand this year. Despite this, it remains undervalued on a trade-weighted basis. The undervaluation and the recent correction support an underweighted position in yen, which – along with the overweighted position in gold – reflects our slightly defensive portfolio alignment. Gold proved attractive owing to its stronger diversification capacity, despite the fact that the gold price suffered sharp losses in mid-June. In a second half-year that is expected to be less rosy, gold could prove an extremely valuable asset in a portfolio.

Positioning relative to long term strategy: Swiss focus

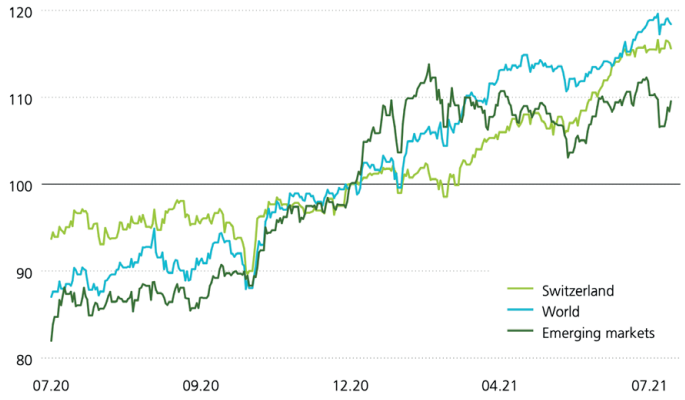
Asset class		TAA[1] old	TAA[1] new	underweighted[3] ––	–	neutral[3]	+	overweighted[3] ++
Liquidity	**Total**	**9.0%**	**9.0%**					
	CHF	8.0%	8.0%					
	JPY	1.0%	1.0%					
Equities	**Total**	**48.0%**	**48.0%**					
	Switzerland	26.0%	26.0%					
	USA	8.0%	8.0%					
	Eurozone	5.0%	5.0%					
	United Kingdom	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%**	**10.0%**					
	Swiss real estate	3.0%	3.0%					
	Gold[2]	7.0%	7.0%					

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

Market overview
Equities

The record-breaking rally on global stock exchanges is slowing down. European securities in particular lost significant momentum last month. By contrast, US equities made further gains.

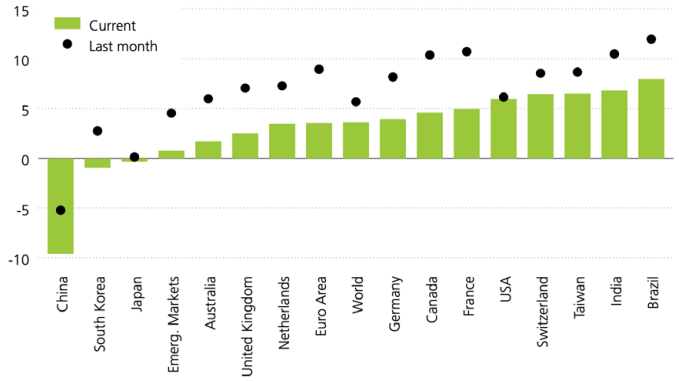
Indexed stock market performance in Swiss francs
100 = 01.01.2021



The international stock exchanges slowed down considerably around the middle of the year, after previously achieving one record after the next. European securities, which had gained significant momentum over the two previous months, fell again slightly. In light of the strong growth trend in the first half-year, however, the increase still stands at 14 percent. Emerging market equities also suffered losses last month. The difficulties with containing the Delta variant may have been a factor in this. By contrast, the Swiss and US equity markets withstood the downward pressure, making further gains last month.

Source: SIX, MSCI

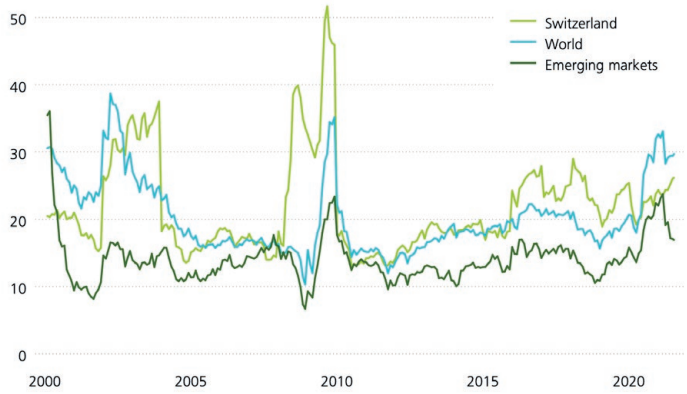
Momentum of individual markets
In percent



The slowdown in recovery momentum last month was evident on almost all equity markets worldwide. The US proved an exception. Its resilience is mainly due to its large share of technology firms. This sector achieved the most growth (8 percent) last month – not least thanks to a further cut in interest rates. As in the previous month, Brazil is currently displaying the strongest momentum. It is followed by India and Taiwan in second and third place. By contrast, the Chinese equity market continues to struggle, with regulatory measures on tech firms still creating headwind.

Source: MSCI

Price/earnings ratio
P/E ratio



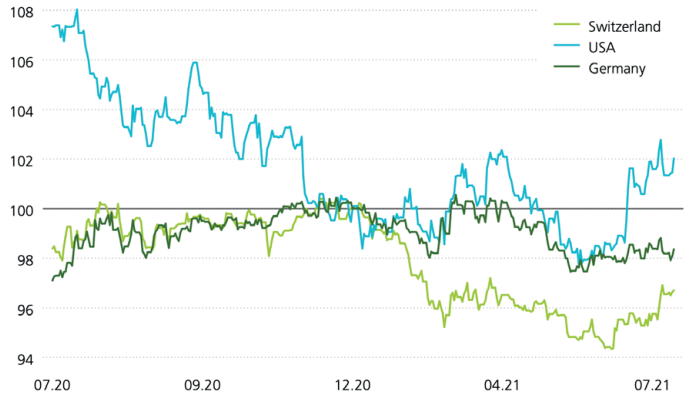
In the wake of the economic upturn, companies' profit performance has also recovered astonishingly quickly from the crisis. Despite this, equity valuations remain at a high level when measured by price/earnings ratio. Dutch, Indian and US equities currently have the highest valuations. The P/E ratio of Swiss equities currently stands at 25, which means that they are still below the valuations from the period 2017 to 2020.

Source: SIX, MSCI

Market overview
Fixed income

US interest is defying high inflation rates and is falling.
There is no indication of greater risk sentiment in the credit spreads on corporate bonds.

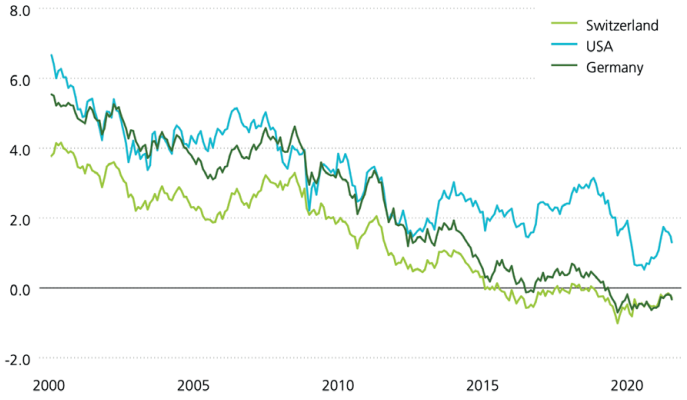
Indexed performance of government bonds in Swiss francs
100 = 01.01.2021



Bonds have made surprising gains in the past month. Despite the generally bright economic outlook, high inflation rates in the USA and the US Federal Reserve's plans to withdraw from its extraordinarily expansive monetary policy, the securities remained in strong demand. US bonds achieved the best returns last month. There was also strong demand among investors for Japanese and UK government bonds. Swiss securities gained slightly less in value.

Source: SIX, Bloomberg Barclays

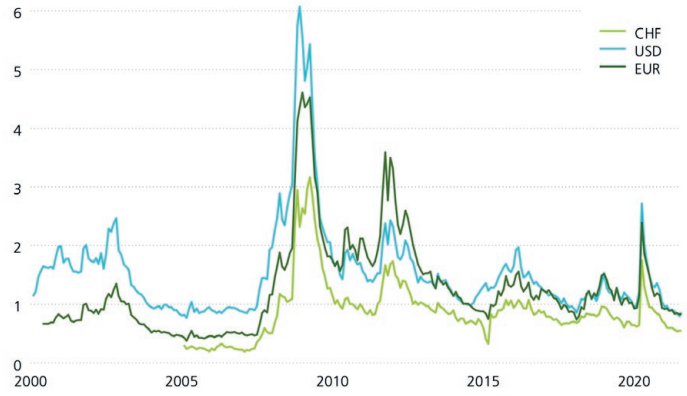
Trend in 10-year yields to maturity
In percent



The strong economic recovery over recent months has sustained optimism on the financial markets and has caused investors to focus more on higher-risk asset classes. But long-term interest rates have recently returned to their long-term downward trend. The yields to maturity on 10-year US government bonds have fallen most dramatically. After the year high of over 1.7 percent, the yields to maturity slipped back to 1.3 percent again in mid-July. There is also increasing downward pressure on interest rates in Europe. As a result, the yield to maturity on 10-year Swiss government bonds fell by two base points to below –0.3 percent last month. The value of their German counterparts declined almost in parallel.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



While investors on the financial markets were somewhat more restrained again last month, the credit spreads on corporate bonds remain at their record-low level. The European Central Bank is continuing its bond-buying programme for the time being, but is increasingly focusing on environmental criteria when selecting companies. In contrast, its US counterpart, the Federal Reserve, recently announced plans to gradually offload corporate bonds it has purchased.

Source: Bloomberg Barclays

Market overview

Swiss real estate investments

The Swiss real estate market is continuing to set records.
This has also triggered a huge rise in premiums.

Indexed performance of Swiss real estate funds
100 = 01.01.2021

Since the brief correction in May, indexed Swiss real estate funds have resumed their upward trend and recently achieved record high levels again. Price gains of 3 percent were achieved last month alone. This means that prices are up by around 7 percent on the year-opening level. In real estate investments, the trend is currently heading in only one direction worldwide – and that's upwards. In the USA, Europe and Japan, real estate investments have gained by more than 10 percent, and some by as much as 20 percent, since the start of the year. These price rises are also driving up valuations to a significant degree.

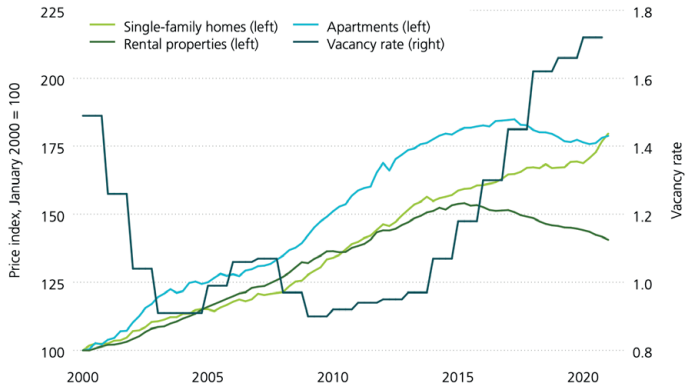
Source: SIX

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

There seems to be no limit to the increase in the prices of indexed Swiss real estate investments at present. The average premiums achieved are also continuing to reach unprecedented highs. Investors have of late been paying a premium of almost 50 percent above the value of the properties contained in the funds. As a result, premiums have soared by 25 percent in this calendar year alone. This development seems surprising in light of the continued low interest levels.

Source: SIX

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



The continuing low interest rate environment is making real estate a very attractive investment. This is compounded by the trend of spending more time at home, which has been triggered by the pandemic and has also put living space in the spotlight. However, the increased demand for living space is not just reflected in the high real estate prices, but also in the demand for mortgage loans, which rose once again last year. In Switzerland alone, the volume of mortgage loans stands at 1,100 billion Swiss francs. That is almost 1.6 times the Swiss GDP. This ratio has increased enormously over the past 20 years in particular. In 2000, it was still 1:1.

Source: SNB, BfS

Market overview

Currencies

Demand for "safe-haven currencies" climbed again last month.
In contrast, commodity currencies posted losses.

Following the US Federal Reserve's announcement of plans to attempt to withdraw from its expansive monetary policy more quickly, the US dollar gained by over 3 percent. The two most popular "safe-haven" currencies – the Swiss franc and the Japanese yen – also saw a spike in demand. In contrast, the commodity currencies – including the Canadian and Australian dollars – suffered significant losses, despite another rise in the oil price last month.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	1.08	1.13	1.05–1.21	Euro neutral
USD/CHF	0.92	0.86	0.75–0.96	USD neutral
GBP/CHF	1.27	1.40	1.21–1.60	Pound neutral
JPY/CHF [3]	0.84	1.03	0.87–1.19	Yen undervalued
SEK/CHF [3]	10.59	11.31	10.22–12.41	Krona neutral
NOK/CHF [3]	10.40	12.41	11.07–13.74	Krona undervalued
EUR/USD	1.18	1.32	1.14–1.49	Euro neutral
USD/JPY	109.84	83.25	68.27–98.24	Yen undervalued
USD/CNY	6.46	6.33	6.08–6.57	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

After a slump in mid-June, the gold price edged up again in July, thanks to higher inflation figures and falling interest rates.

Indexed performance of gold in Swiss francs
100 = 01.01.2021

After breaking through the mark of 1,900 US dollars per troy ounce at the start of June, the price of gold tumbled abruptly by almost 150 US dollars. This slump coincided with the US Federal Reserve's announcement of plans to begin withdrawing from its expansive monetary policy. Interest rates and the US currency both rose as a result. Both have a negative effect on the price of gold. However, the trend has reversed again since early July due to the high inflation rate of 5.4 percent for the month of June and falling interest rates.

Source: Web Financial Group

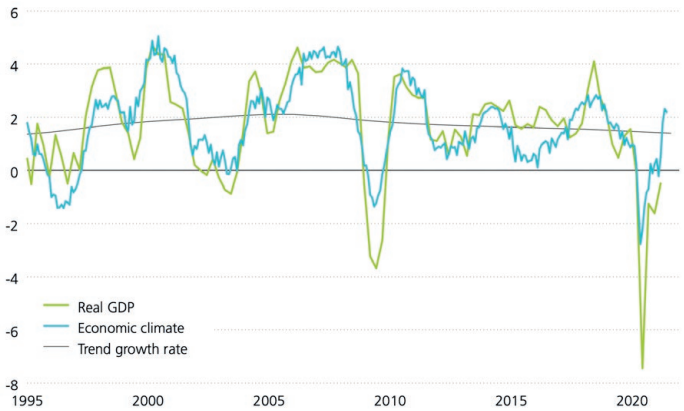
Economy

Turning point in global economic climate

The recovery has peaked in China and the USA. The economy in Europe is still running at full tilt, but the Delta variant could hamper these plans.

Switzerland

Growth, sentiment and trend
In percent

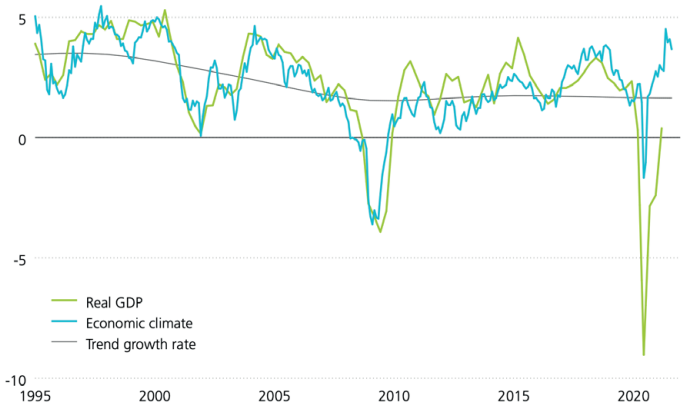


Source: Bloomberg

In the second quarter, the Swiss economy was boosted by the extensive relaxation of coronavirus restrictions. According to SECO's Index of Weekly Economic Activity (WEA), Swiss economic activity had already exceeded the pre-crisis level by 1 percent in June. Optimism in the services sector is particularly high. The labour market is also faring well: the rate of unemployment has continually declined since the start of the year and fell again to 2.8 percent in June. By contrast, the recovery already seems to have peaked in industry. After reaching a new record high in May, sentiment amongst purchasing managers deteriorated slightly in June. Momentum is flattening out, albeit still at a very high level.

USA

Growth, sentiment and trend
In percemt



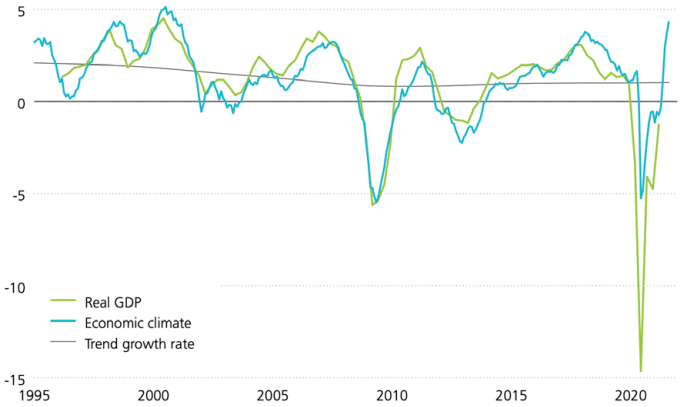
Source: Bloomberg

The US economy has displayed impressive recovery momentum over recent months and overcame the coronavirus-related slump in less than a year. The economic outlook remains bright, but the rapid pace cannot be maintained. The leading indicators in industry are already pointing to a normalization of growth rates. Despite this, the situation on the US labour market remains tight. At 9.2 million, the number of job vacancies reached a new record high in May. However, this has not so far created wage pressure on a broad basis. In contrast, consumer price inflation in June climbed by a further 0.4 percentage points to 5.4 percent. The main factor behind this rise remains the price trend for used cars and energy.

Eurozone

Growth, sentiment and trend

In percemt



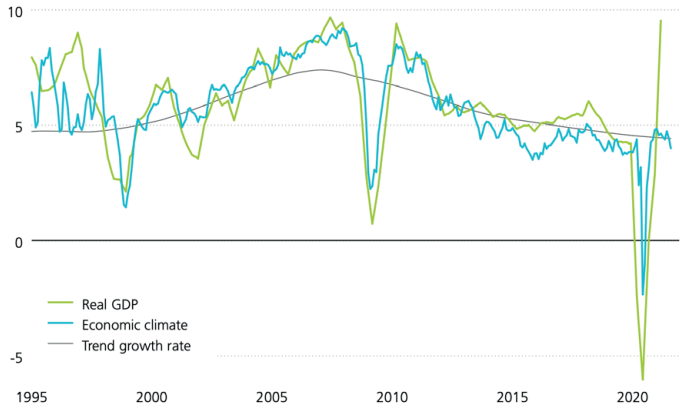
Source: Bloomberg

With the start of summer, the final restrictions have also been removed in the eurozone, lending further impetus to the economic recovery. In contrast to China and the USA, the shortfall compared to pre-crisis levels has not yet been recovered in Europe. This means that there is great recovery potential. The leading indicators for industry and the services sector climbed again recently, reinforcing the prevailing optimism. Not only did order intake at industrial companies hit its highest level for 21 years in June, consumer confidence also reached a level not seen since 1990, 2000 and 2018. Only a further spread of the Delta variant could currently dampen the buoyant mood. Price performance in the eurozone is much more moderate than in the USA. In June, the rate of inflation even fell slightly year-on-year, from 2 percent to 1.9 percent. This is in line with the European Central Bank's inflation target.

Emerging markets

Growth, sentiment and trend

In percemt



Source: Bloomberg

Many emerging markets have been very severely hit by the coronavirus outbreak and the recession it has triggered. The rapid spread of the Delta variant abruptly interrupted recovery growth recently. Countries including Indonesia, South Korea, Malaysia and Russia reintroduced restrictions and social-distancing measures, which may set economic recovery back.

While China has been spared by the Delta variant so far, the Chinese economy also lost momentum recently. In the second quarter, economic growth stood at just 7.9 percent compared to the weak prior year. The Chinese government has already started to take countermeasures, by further relaxing lending requirements on banks. Exports continue to perform well, however. Growth for June came in at around 32 percent year-on-year.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2021Q1	–0.5%	0.4%	–1.3%	–6.1%	–1.6%	1.6%	1.0%	18.3%
GDP Y/Y [1] 2021Q2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	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	0.6%	5.4%	1.9%	2.5%	–0.1%	6.3%	8.4%	1.1%
Key rates	–0.75%	0.10%	0.00%	0.10%	–0.10%	4.00%	4.25%	4.35%

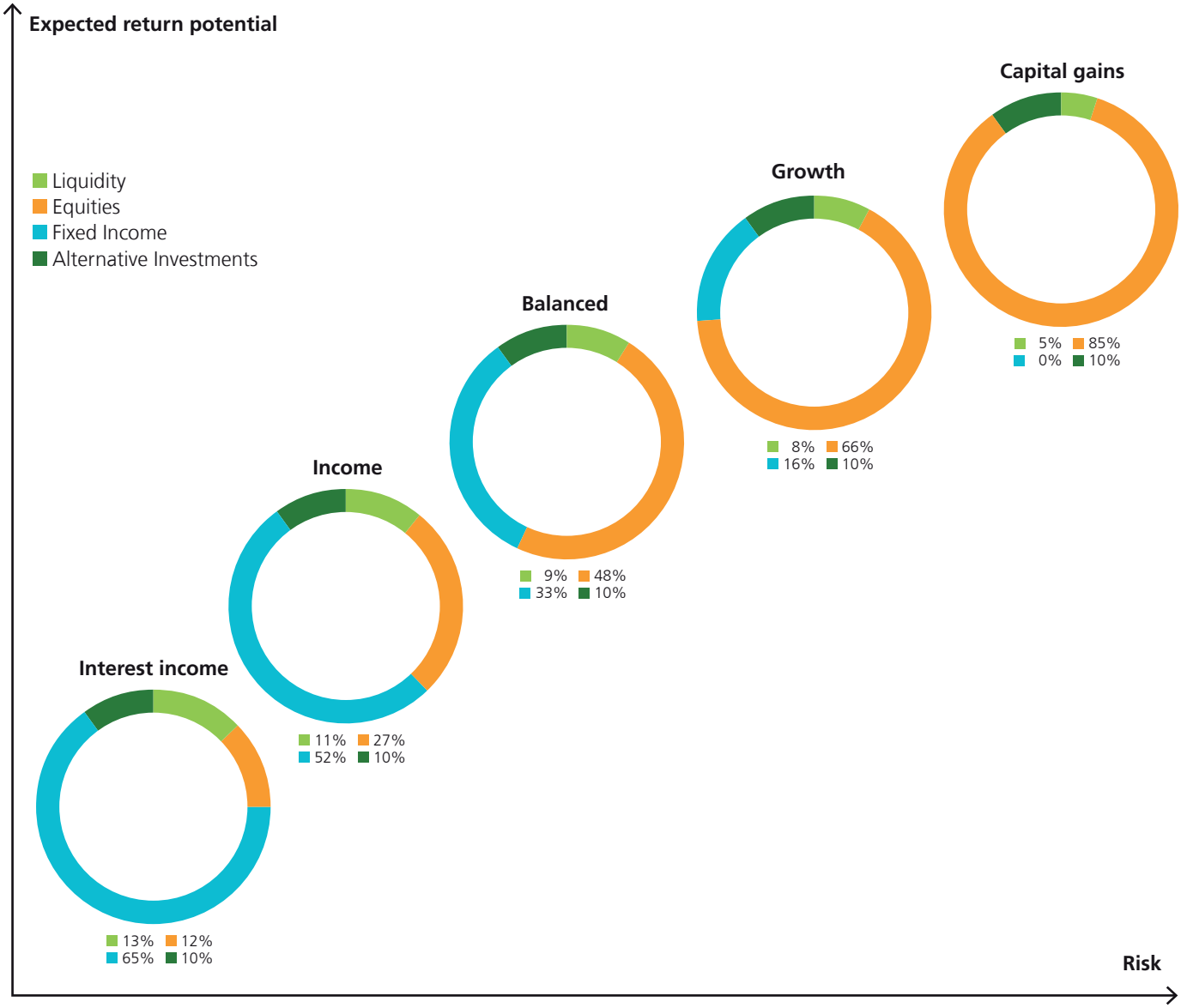
[1] Growth compared to year-ago quarter.
[2] Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP. A green arrow indicates accelerating economic growth, a red arrow indicates a slowing down.
[3] Potential growth. Long-term change in Gross domestic product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

Source: Bloomberg

Model portfolios Swiss focus

Slightly defensive into the second half of the year

Thanks to generous monetary and fiscal policies, the global economy quickly absorbed the Corona-related slump. This is also reflected in the impressive dynamics on the stock markets. Now, however, there are signs of a normalisation of the upswing. A continuation of the spring rally seems unlikely in our view. For this reason, we are tactically maintaining our neutral equity quota as well as our underweight in Swiss real estate. However, we see upside potential in interest rates, which have fallen further in the past month. Our slightly defensive portfolio orientation is reflected in our overweight in the Japanese yen and gold.



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