



## **CIO OFFICE MORNING MARKET WRAP – Monday July 12<sup>th</sup>, 2021. ALSO AVAILABLE ON ALEXA**

Last week long-dated yields sank to five-month lows amidst disappointing data and the release of Fed minutes, which saw Fed officials planning to go ahead with tapering, perceived in the end as a deflationary development by investors. Never mind the Fed disclosing strong growth forecasts for 2021-end and longer-term consensus projections of US growth being above trend for most of 2022, yields moved counter to expectations. Unless growth will surprise badly to the downside, catching the Fed, consensus and ourselves unaware, we will stick with our new year-end fair value of 1.75% for 10-year Treasury yields. Market-implied gauges are starting to disagree with this view, as the 5-year forward 1-month overnight-swap rate, which is where the collective wisdom of investors sees policy rates sitting 5 years from today, is now trading at 1.5%. This is in stark contrast with the Fed median forecast at 2.5% in the longer term. The market currently sees the Fed not achieving its longer-term target rate, basically discounting a deflationary scenario in spite of repeated stimulus efforts. That same forward contract in March briefly traded above 2.2%. If bond bulls are

proven right, it will be one more case in point of secular deflationary forces, from high debt loads to aging populations, gaining the upper hand, no matter what. But if bond bulls are proven right, risk asset markets could also be caught unaware as corporate earnings do not love stubborn deflation.

Let's on the other hand continue to go by our base case - yields will be rising by year-end, as it has historically occurred up until the start of the winding down of bond-buying programs, expected for early 2022. A legitimate question is how the emerging markets will be reacting this time, going back in our minds to the past tapering episode in 2013 when EM assets ended up in a bear market. Our expectation is that the emerging countries should be faring much better. In the past rising US real rates triggered capital outflows, forcing EM central banks into a tightening mode to avoid the ballooning of the dollar-debt position and the importing of inflation via a collapse of the domestic currency. Today unlike then, especially the Asian economies are better off, having in general a bigger cushion in terms of foreign reserves, current account positions and more benign inflation dynamics. Of course, a prolonged period of rising US rates would be a disaster anyway, but not for the EM governments only, given the impressive debt-load Washington has managed to accumulate.

The full launch of commercial operations for taking people in orbit and let them enjoy space flight seems to be drawing closer, following Richard Branson's Sunday test flight. A space craft, with the Virgin Galactic's founder and five crew members onboard, was carried to an altitude of 50,000ft and then propelled, by its rocket engine at three times the speed of sound, to the edge of space. Branson called it "the experience of a lifetime"; undoubtedly, considering that it cost him more than \$1bn of his personal fortune! Two more test flights are planned by Mr Branson. Jeff Bezos is expected to follow suit and go even higher, competing with his private space company Blue Origin. These billionaires are to an extent risking their lives to prove the feasibility of what only a decade ago seemed to be like a distant dream. Once they succeed, they will not be remembered for their huge wealth only.

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