



CIO OFFICE MORNING MARKET WRAP – 18th July, 2021. ALSO AVAILABLE ON ALEXA.

Global markets were relatively volatile and a bit dispersed last week, which may signal some change in the current narrative. Not that long ago, the scenario was simple and consensual: a booming global economy creates price pressures, and asks a single dominant question for market participants: when and how will central banks react.

No doubt, growth is remarkably fast, and June indicators confirm a broad-based surge in inflation. But with a strong rise in global covid infections, and with interest rates continuing to fall, for a third consecutive week, it may look like markets are starting to question the scenario itself, and especially the future trajectory of the economy.

The US 10 year Treasury yield ended the week at 1.3%, which led to a 0.1% to 0.3% gain across the fixed income asset class, and the same appreciation for gold. Not that long ago, stocks would have applauded as lower interest rates would have justified higher valuation multiples. This wasn't the case. The MSCI World, a benchmark for developed equity markets, lost 0.9% last week. Nothing to worry about, but the sector hierarchy confirmed cyclical concerns. The worse performing sectors were energy, financials, industrials and consumer discretionary, while the best ones were bond proxies such as utilities and consumer staples. Of course, there were some specific reasons. With constructive discussions between OPEC+ members, and a meeting scheduled today at 2PM UAE time, oil prices moderated: the Brent

crude oil ended the week at \$73. With regards to financials, US mega banks started the Q2 earnings season. Numbers were overall solid, reflecting a boom in deal related investment banking, and a strong rebound in consumer spending. But they also revealed that loans didn't pick up and that fixed income trading was as depressed as the expected returns of the asset class. Finally, but importantly, it wasn't a typical "risk-off" week as emerging markets had a brilliant +2% return in equities, and outperformed within fixed income. They are not losers from lower interest rates in the US and from lower oil prices, and China's Q2 GDP was better than many were expecting, largely driven by a robust domestic consumption. By comparison, US markets did not react positively to the brilliant retail sales numbers released Friday, which showed a rebound while the consensus was expecting another decline.

As we just held our mid year update event, our scenario is quite clear: after having been super bullish, we are now constructive. We believe that growth is indeed strong and that neither the virus nor premature withdrawal of central bank support will derail it. Having said that, the upside potential for our central scenario is not very high, and there are pockets of vulnerability. This is why we have started to very progressively reduce our pro-risk stance from June. First by adjusting lower our overweight in equities, and more recently by downgrading high yield from overweight to neutral. Upside is limited because valuations are elevated, especially in the fixed income sphere where interest rates are simply too low for the backdrop. From a behavioral point of view, last week was interesting: markets' concerns can change quite quickly, and this is one of the reasons why we expect volatility looking forward, together with the fact that positioning is unanimously bullish. As we are fundamentally confident, we would probably consider any material correction as an opportunity to put our cash at work by adding to risk. At the current market levels, our overweight in stocks is clear, but funded by our the underweight in the safest segments of fixed income – not by cash, where we are neutral. We are tactically more overweight on developed markets' stocks than on emerging ones. Yes, the developing world is our long term first conviction, as well as our preference within fixed income, but in the short term, the momentum in stocks is in the West.

We wish you and your family Eid Al Adha Mubarak, good health and prosperity. Our daily comment will take a break and be back on Sunday 25th of July.

Stay safe.

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