Volatile, but resilient.

- **Volatility rose last week, as global infection rates rose with the "delta wave"**
- **Nervosity was palpable but stocks in developed markets ended the week at record highs**
- **This is not inconsistent with our views for the second half of the year**

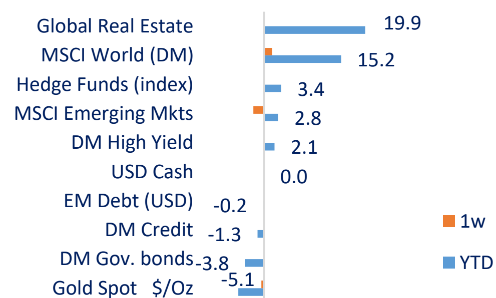
Last week started with the spread of the delta variant triggering a sell-off in risk-assets, but they recovered in the following sessions. Stock indices delivered a positive +1.6% weekly return in developed markets, and -2% in emerging markets. Bond yields ended the week marginally lower, with the US 10-year Treasury closing at 1.28%. Gold lost -0.5%, just above the $1800 mark. Oil prices followed the same pattern as other cyclical assets and ended the week at $74 for the Brent.

No doubt, the fourth wave of the pandemic is aggressive. Infections rates follow the reopening dynamics, and if hospitalizations rates are currently low, the risk is that they may rise significantly in the coming weeks. However, from the data we look at, we remain reasonably confident especially for regions with a high share of their population vaccinated. What matters for the economy is the risk of radical restrictions being reimposed, which happen when tensions on healthcare systems become extreme. This does not seem to be the case where vaccination rates are high. What matters for markets in the short-term may be different, which is one of the reasons why we expect volatility ahead. The summer will bring answers: our view, and hope, is that hospitalizations will remain under control and that global infections reach their peak.

Stocks are resilient for a reason: so far Q2 earnings are way better than expected. This is the best way to deflate the currently elevated valuation multiples and comforts us in our overweight on the asset class.

Next week will be rich in corporate earnings and will also provide Q2 GDP for both the US and the Euro area. The US Federal Reserve will hold their monthly meeting, which is not expected to be eventful. Stay safe.

ASSET CLASSES USD % TOTAL RETURN, YTD 2021 LAST WEEK



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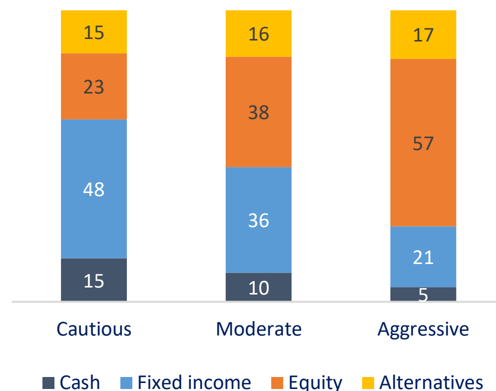
Cross-asset Update

The bifurcation between equity and cryptocurrency markets which started in May this year has continued, with the former in a bull trend as against the latter still leaning bearish. Both stocks and digital currencies are cyclical macro assets driven by liquidity, hence one would not have expected this ongoing divergence. Bitcoin, as an alternative form of payment, derives its social utility, hence its intrinsic value, from the number of transactions executed on the blockchain and since these fluctuate in line with the economic cycle bitcoin itself is tied to the cycle, hence its pro-cyclical nature. Bitcoin yearly returns tend to track the Goldman Sachs Global Risk Appetite Indicator, a cross-asset measure of market sentiment ultimately driven by economic growth, which has recently dropped to close to the zero level. The bottom line is that further deterioration of this investor sentiment gauge into negative territory would see bitcoin continue to crash to lower levels, with 20,000 the next key support area. Demand from institutional investors has so far failed to kick in, in spite of the depressed pricing, as indicated by the poor inflows into listed bitcoin funds and futures - also, the bitcoin futures curve remains inverted, not a bullish sign. Hence, the current rebound, which sees bitcoin up by more than 10% since the 20th of July, may be put down rather to technically oversold conditions which support a temporary recoupling with equities, than to the start of a new bull trend. It is a question mark whether this recoupling will persist once digital currencies reach shorter-term overbought levels, which could happen sooner than later given their volatility.

On equities, the jury is still out as far as a deeper drawdown, year-to-date avoided by markets, is concerned. We hold the view that stocks are likely to remain resilient in the current environment, which justifies the buy-dip-mentality for the asset class. The business confidence advance prints released on Friday for the month of July in the major developed countries, technically the flash PMI prints, in general confirm the rotation from the manufacturing to the services sectors to lead the recovery, underpinning the constructive growth outlook. For instance, in the United States services activity slipped a bit, but the Services Index remained at historically elevated levels after reaching a record in May. In Europe the Composite PMI was just slightly above expectations, but the Services Index reached new records, more than offsetting sluggishness in manufacturing.

Last week crude oil rebounded alongside global equities, in spite of a deal being reached by OPEC+ to add back 400,000 barrels per day of production each month from August. This actually makes sense, as markets are discounting that the additional capacity will not be enough to keep the market balanced even in the face of new supply. On the supply side it all hinges on the disciplined behaviour of shale oil producers, which are still refraining from increasing drilling activity in spite of elevated crude prices. And, once more, this makes sense, as the futures oil curve is inverted, with spot prices well above distant-maturity contracts, far from an ideal backdrop for investments whose returns can be gleaned only far out in the future.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

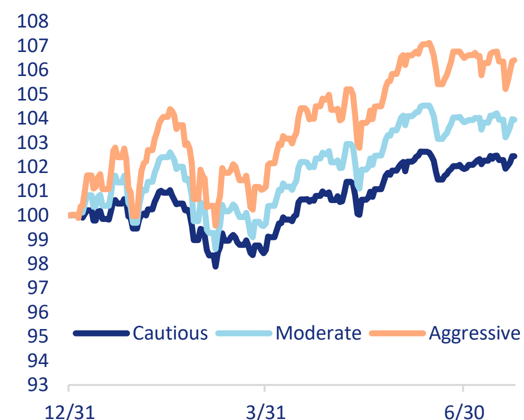


TAA – RELATIVE POSITIONING – MODERATE PROFILE

	UW	N	OW
Cash		=	
DM Gov.	<<<<<<		
EM Debt			>
DM Credit			>
DM H. Yield		=	
DM Equity			>>
EM Equity			>
Gold		=	
Real Estate			>
Hedge Funds		=	

UW/N/OW:Underweight/Neutral/Overweight

TAA – 2021 INDICATIVE PERFORMANCE



Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

Fixed Income Update

Longer-dated US Treasury yields closed little changed for the week, although they touched their lowest level since February as economic growth assumptions were called into question on fading momentum in the latest business activity releases. Treasuries retain their higher-yielding appeal amidst a dearth of opportunities across DM Governments and demand from institutional investors remains robust overseas alongside the ongoing buying from the Fed. The US Treasury market took Mohammed El-Erian's remarks in its stride, who said that "inflation is not going to be transitory", joining the growing chorus of skeptics. The ECB concluded its monetary policy strategy review and revised its forward guidance on interest rates, adding conviction to our view that policy divergence with the Fed is still set to grow. Although the ECB is officially following in the Fed's footsteps, being more tolerant of inflation overshoots around a 2% target, there is little conviction that it will be able to raise inflation expectations given its chequered track-record.

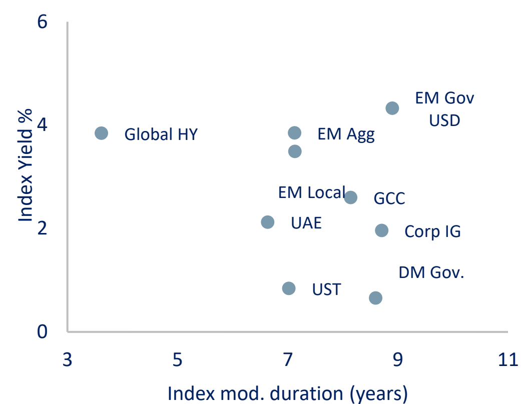
Corporates saw very modest gains in the US and basically no change in EM. In EM, we retain our bias towards Corporate overweights, which have solid fundamentals and offer more value than their DM peers, and would keep on adding on Sovereigns weakness. With no obvious catalyst in sight for US yields to rise fast from current levels and fading economic momentum in the United States, we would expect US yields to rise only gradually, posing no significant threat to longer duration EM Sovereigns. Chinese local high-quality bonds are becoming increasingly attractive, following the 50bp cut of the Reserve Requirement Ratio by the PBoC and the more benign credit report, both signaling a subtle shift towards more accommodative financial conditions following the recent tightening.

If for the shorter term the inflation debate is polarized between the 'temporary' and 'not-so-temporary' views, for the longer term there is still doubts as to whether more elevated price pressures are here to stay, or will rather subside to usher in a renewed deflationary era. In our view inflation has now become a policy choice, with central banks and governments pursuing it actively, much in the same way that killing inflation had become a policy choice with Fed chair Paul Volcker in the early '80s. At the time inflation was tamed, by a central bank, this timed it will be reawakened, by governments. By continuing to guarantee loans, even in post-pandemic times, made by commercial banks, governments can boost credit creation and create growth and inflation, absolutely necessary to deflate high debt levels. Since the effects of Quantitative Easing on the economy have been rather muted, it will have to be fiscal stimulus to play the lion's share in kickstarting economic growth. It would be a natural course of action for governments to become more prominent and occupy the void left by central banks that seem to have pretty much exhausted their policy options.

FIXED INCOME KEY CONVICTIONS

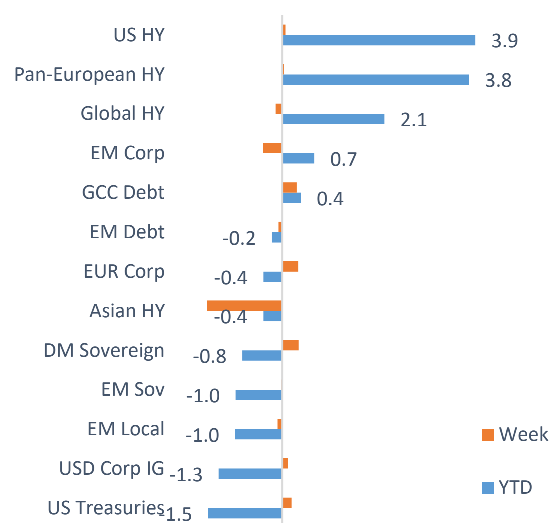
DEVELOPED MARKETS
UW Government bonds
Selective on Credit
Now NEUTRAL High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
OW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

FIXED INCOME SUB ASSET CLASS RETURNS (YTD, LAST WEEK)



Source: Bloomberg

Equity Update

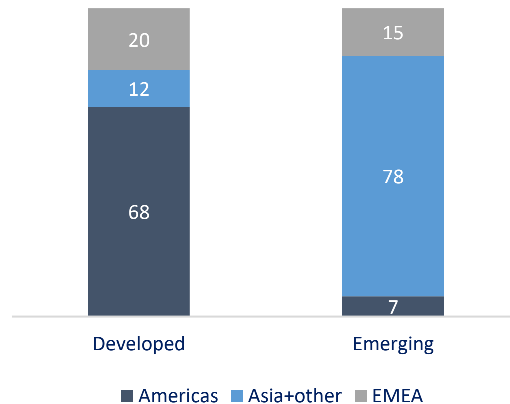
Last week, equities gained as corporate profits pushed stocks to a new record that started a concern about a peak in earnings and a coronavirus resurgence. According to Bloomberg, 87% of the S&P 500 companies reported results so far this season have beaten Wall Street estimates. The S&P 500 is now up 97% from the depths of the pandemic. Companies such as Twitter and Snapchat led a rally in social media as sales blew past forecasts. Investors are optimistic that a robust economic recovery will fuel corporate America, despite the delta variant. The Q2 earnings seasons has allowed investors to look through the uncertainties.

Some of the biggest Chinese firms listed in the U.S. slumped as concerns surrounding further regulatory scrutiny deepened. The Nasdaq Golden Dragon China Index is posting its longest stretch of weekly losses since May 2019, while ride hailing giant Didi Global Inc. (an Uber-like service in China) tumbled as much as 22% on Friday. Other Chinese firms listed in the U.S. also plunged including Chinese tech giants (Alibaba, JD.com, NetEase, Nio, Baidu) as well as Education stocks. The Nasdaq Golden Dragon China Index includes stocks that are publicly traded in the U.S. and the majority of whose business is conducted within China. The index fell by 8.5% on Friday.

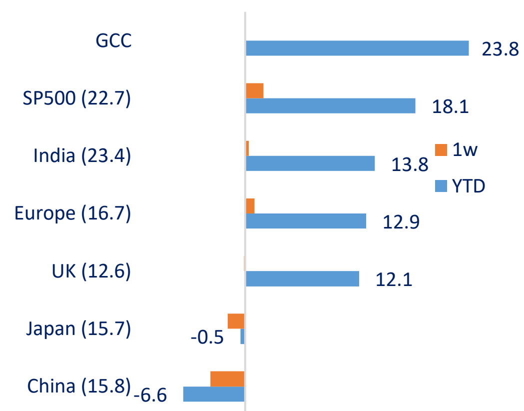
In Europe, stock prices continued to rally in Q2, although at a slower pace than in the first quarter of the year, with the aggregated market up close to 7% over the period. Continued rallies over the quarter have meant the market as a whole has now risen by more than 30% over the last 12 months, with much of this rise concentrated in a handful of sectors, including industrials and basic materials, both of which are up around 45%. Healthcare and consumer defensive sectors were the top of the month, up 11.5% and 9% respectively over the last quarter, a sharp acceleration from the price movements in the first quarter. The anticipated reopening of commerce and reduced concern about future potential lockdowns have spurred the market rally. Also, markets are buoyed by the progress many large Western European countries have made in rolling out their respective coronavirus vaccination programs. The STOXX Europe 600 index is up 15.7% YTD.

The auto industry got hit with another major setback, a massive shortage of semiconductors. While the demand is still there, the industry just needs more inventory. Also, this is a setback as global automakers are rapidly adding electric models to meet government-imposed targets. Rising demand from electric vehicles and challenges in securing raw materials will deliver a battery crunch for automakers that are already grappling with a chip crisis. Availability of sufficient lithium products, copper foil and some cathode materials could become a constraint on the battery sector's efforts to keep pace with demand. According to BNEF, all key battery metals have seen prices advance over the past year, with lithium carbonate in China more than doubling. Gains in cobalt sulfate prices indicate a bottleneck in production of the material. Some analysts expect that batteries could be the next EV component facing a potential shortage.

EQUITY RECOMMENDED REGIONAL POSITIONING

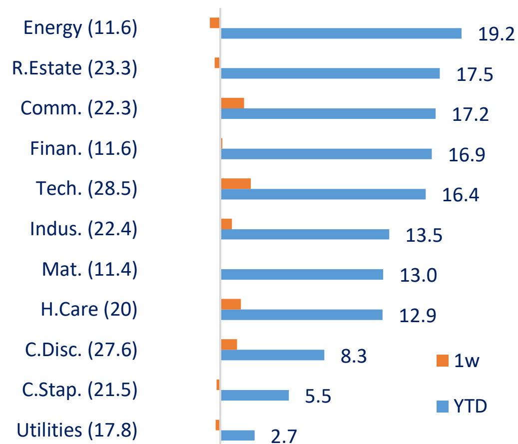


MAJOR INDICES PERFORMANCE (TR, US$) AND 2021PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2021PE



Source: Bloomberg consensus. MSCI All Country World sectors US$.

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