

February 2021

## Interest rates & bonds

The reflation trade is on

### USA

- While US economic data ran into a soft patch at the end of 2020, the new year begun on a very positive note as the stimulus checks from the December package are now being handed out. Survey data remained upbeat and industrial production continued to recover.
- With the entire government now being in the hands of the Democrats, we see a good chance for an additional round of fiscal stimulus. In combination with the accommodative policy stance of the US Federal Reserve, markets have priced in higher growth and inflation expectations.

### Eurozone

- New coronavirus strains forced governments to introduce even more stringent restrictions. While those weigh on economic activity, the economic damage is far less severe than during the first wave.
- The ECB stayed put in its January meeting, but President Lagarde sounded a bit more hawkish than expected as the economic recovery continues. Given the still sizeable asset purchase programs, we do not expect additional tools to be deployed for now.

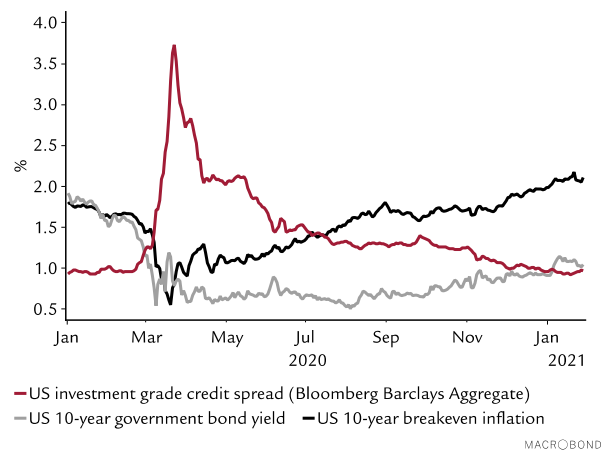
### UK

- The UK and EU managed to settle on a narrow trade agreement at the eleventh hour. The removal of uncertainty in the manufacturing sector could unlock shelved investment plans in 2021.
- Resurgent COVID-19 cases and one of the most stringent lockdown regimes in Europe could entice the Bank of England to ease its monetary policy even further.

### Switzerland

- We expect the Swiss economy to return to pre-crisis levels in 2021 already, faster than most other European countries.
- Due to the positive risk sentiment in financial markets, the safe haven flows into CHF have abated, reducing the need for SNB interventions.

### Inflation expectations are back to normal



The Trump era is over, but in a Trump-like fashion, he did not leave quietly. Following months of unsubstantiated election fraud tweets, he created a heated atmosphere that ended with a storm on the US Capitol by his supporters. However, markets completely ignored the tumult. President Biden's proposal of a fresh USD 1.9 trn fiscal spending package (8.8% of GDP) as well as the confirmation of Janet Yellen – the dovish former Fed Chair – at the helm of the US treasury had markets cheering. US government bond yields moved higher, credit spreads are hovering around their pre-crisis lows and US inflation expectations reached levels last seen in 2018 (see chart). So, where does that leave us for 2021? While credit fundamentals are certainly weak and valuations very elevated, the technical backdrop is still too strong for credit spreads to widen in the near-term. That said, we don't think that markets will experience a smooth ride in 2021. Valuations in almost every asset class look stretched by historic standards and temporary corrections will be inevitable as downside risks are plenty. We therefore believe that one must stay nimble in this environment, and good credit selection is key. For now, we stick to our slight overweight position in credit risk and short duration position, but that can change in a moment's notice.

## Equities

Mutation or vaccination, which one is faster?

### USA

- Despite hopes for additional fiscal stimulus and a US vaccination campaign that is gaining speed, US equities have lagged somewhat the global benchmark year-to-date. The latter was mainly pushed up by a strong performance of emerging market equities.
- We keep a cautiously positive view on US stocks, mainly because the US economy should continue to outperform Europe in the first half of 2021 on the back of fiscal stimulus. The proposed fiscal stimulus package will certainly hit some stumbling blocks, which could lead to short-term volatility, but most observers expect it to be approved by Congress in March at the latest.

### Eurozone

- The Eurozone is paying the price for its half-hearted ordering of vaccines in the form of extended lockdown measures that are weighing on the economy in the first quarter 2021.
- However, an accumulated underperformance of some 25% versus US stocks since the outbreak of the crisis creates some catch-up potential for Eurozone equities. This justifies a neutral to slightly positive view on this market.

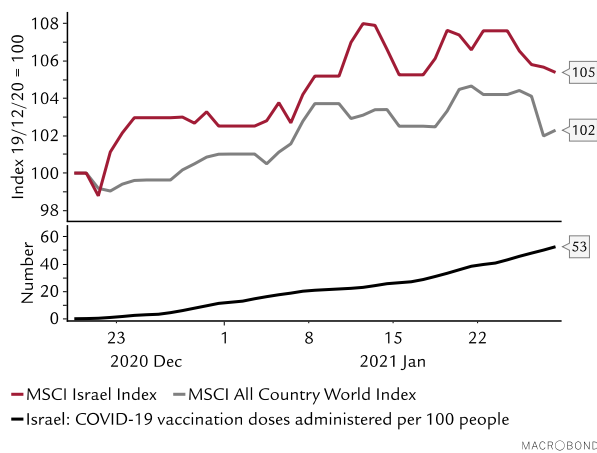
### UK

- The last-minute trade deal between the UK and the EU and the swift progress on the vaccination front have reinvigorated UK equities recently, after a terrible underperformance in 2020.
- Even though UK equities appear more attractively valued than other markets, we remain underweight. Given significant political risks ahead (e.g. Scottish independence drive) and a still bleak near-term economic outlook, we think that an elevated risk premium on UK equities is justified.

### Switzerland

- Swiss equities have started relatively well into the new year, as the economic damage from the second wave is limited and as their defensive nature helped at the end of January when volatility rose again.
- Nevertheless, Swiss equities still appear relatively attractively valued as they were underperforming in 2020. Along with EMU stocks, Swiss stocks thus have potential to catch up going forward, which leads us to a neutral rating.

### Israel: equity market and vaccination outperformance



The vaccination breakthrough in November 2020 was a major catalyst for the impressive year-end rally of global equities. Along with the ongoing fiscal stimulus debate in the US, the news flow regarding COVID-19 vaccination programs will remain a major driver for equity markets. For example, reports of fast-spreading virus mutations and a sluggish vaccination rollout led to another month of significant underperformance of European equities in January 2021. Meanwhile, it seems that the equity market in Israel has benefitted from the record-fast vaccination progress in the country. Since 19 December 2020, when the vaccination campaign took off, already 53 shots per 100 people have been administered and the MSCI Israel Index has outperformed the global benchmark by around three percentage points at the time of writing (see chart). With a lot of positive news already priced in and valuations elevated, the biggest downside risk for global equities would be a scenario where herd immunity does not come fast enough, which increases the probability of virus mutations that would render the current vaccines less effective or even ineffective. While this is not our base case scenario, negative news regarding vaccination progress or virus mutation will likely occur from time to time and lead to bouts of volatility in a market that otherwise still has positive momentum, also on the back of unabated fiscal and monetary stimulus and a lack of alternatives. Hence, we keep a cautiously positive view on equities over the period ahead.

## Currencies

USD appreciation takes a breather

### USA

- As we had expected, the USD sell-off was halted at the turn of the year. Year-to-date, the USD has appreciated against all major currencies, with CNY and GBP being the notable exceptions.
- The US economic outperformance and the respective re-pricing of the monetary policy outlook were the main driver of recent USD strength. As a lot seems to be priced already, we move to a neutral view on the USD against most major currencies.

### Eurozone

- EUR has depreciated somewhat against USD and CHF since the beginning of the year. Worsening growth prospects due to renewed lockdowns have added to the weakness.
- At these levels, we adopt a neutral view on both EUR/USD and EUR/CHF.

### UK

- The last-minute trade deal between the UK and the EU did not lead to a “relief rally” of sterling, as most investors (us included) had expected such an outcome. The rapid rollout of the vaccination program was likely the more important driver of recent GBP strength, as progress on that front has increased the likelihood of a swift economic rebound after a very bleak first quarter.
- Nevertheless, we think that GBP appreciation has run its course. Due to weak economic fundamentals currently and ongoing political risks, we expect GBP/USD to moderate over the coming month.

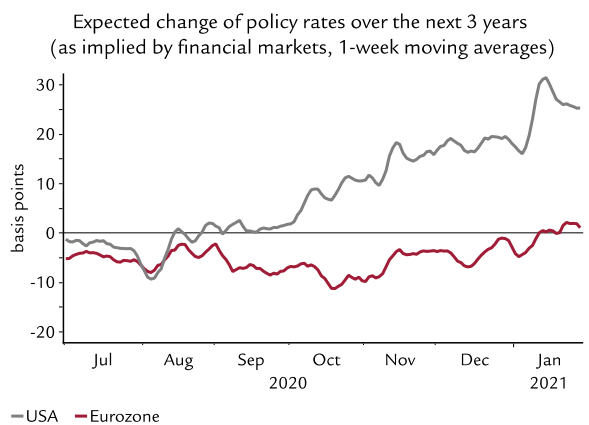
### Switzerland

- The CHF has been stable against USD year-to-date, but has strengthened against EUR and is scratching at the lower bound of the 1.075-1.085 trading range.
- We keep a neutral view on both EUR/CHF and USD/CHF as the SNB likely stands ready to lean against CHF appreciation pressure.

### Japan

- After a 1% depreciation of JPY against USD in January (in line with our view), we expect USD/JPY to be stable in February.

### Markets expect the US Fed to move earlier than the ECB




MACROBOND

The new year started with a bang. The surprising success of the US Democrats in the Georgia runoff elections brought them the slimmest-possible majority in the Senate. This has significantly increased the prospect of another round of fiscal stimulus, even though most observers expect the amount of stimulus to be in the USD 1.0 trn area rather than the USD 1.9 trn proposed by President Biden. While many investors had expected a Democratic majority to be negative for the USD, the opposite occurred. Investors swiftly started to price in better US growth prospects, which led to a steeper yield curve amid slightly more hawkish long-term expectations for the US Federal Reserve. Investors now expect one 25 basis points policy rate hike over the next three years, up from zero six months ago (see chart). Meanwhile, no policy rate action by the European Central Bank is expected over the next three years as the European economy will likely be the laggard in the recovery. The USD carry (i.e. interest rate differential) has thus improved slightly for longer maturities, which has supported the greenback. At the margin positive for the USD was also incoming Treasury Secretary Janet Yellen's comment that the US is not seeking a weaker currency to gain competitive advantage, underlining that the US Federal Reserve will be under much less political pressure to stimulate the economy than under the outgoing administration. Nevertheless, we think that a lot of US economic optimism is now baked into USD exchange rates and expect the USD appreciation to take a breather, at least over the coming month.

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