Inflation Revival?

Since the lows in March 2009 during the financial crisis, the S&P 500 index has risen sixfold producing an 18% annualized return (dividends reinvested). Since the March lows of last year, the index has risen 75%. Equities are expensive in P/E terms and red lights are flashing: the US stock market capitalization is close to 2x US GDP, a measure used by Warren Buffett, which indicates a significant overvaluation.

The Swiss National bank posted a CHF 20bn result for the year 2020 and this in spite of the fact that all 5 major currencies depreciated vs the Swiss franc (resulting in a loss of CHF 38bn) – the positive result stems mainly from the fact that parts of the currency reserves were invested in equities (resulting in a CHF27bn gain) and from the postition in gold (CHF 7bn) and interest income of bonds (CHF 12bn).

Usually when the Swiss Franc appreciates against all major currencies this is a sign of risk-aversion and it is surprising that equities fared well in this environment.

But this is not the only relationship which seems to be "upside down". Real interest rates are still negative in the US and there are still no signs of significantly higher inflation – at least until recently. Meanwhile, the Global PMI stands at 53.9% which points to a healthy expansion of the real economy.

The price of oil, which constitutes a large part of inflation-measuring baskets, has risen sharply, recently. Bottlenecks in the global supply chain have emerged: the baltic freight index has reached a level not seen in years and in December more than half of freight ships reached their destination late. All this has led to a spike in US 5-year breakeven inflation which is now at 2.5%, a level not seen since 2012.

Is this just a temporary spike or the beginning of a new inflation-regime? Opinions are divided.

However, 2021 may be a year where equity markets are torn between euphoria and inflation-angst.

February 2021 Review

In February, the “risk-on” sentiment remained intact and the ”reflation trade” continued. Two phrases which define the month best are “rising inflation” and “rising yields”. While inflation may have shown signs of life, it is highly debatable whether this is the beginning of continuously higher inflation. Most agree, however, that inflation will temporarily ”overshoot”. Moreover, the Fed has announced that it will not intervene. This new ”paradigm” had an impact on US Treasuries where the 10-year yield rose from 1.06% to 1.52% over the month. While the move was quick and strong, it still brings us only back to the pre-pandemic level of yields.

While some equity sectors were impacted by this move, equities as a whole did well in February. The S&P 500 rose by 2.6% and the Euro Stoxx 50 4.45%. Once again small and mid-caps were the best performers as measured by the Russell 2000 index which jumped by 6.17%. The Swiss SMI index with its defensive components was a rare exception, ending the month 0.66% lower. For once, interest-rate sensitive sectors such as IT and real estate were among the weaker sectors. Energy and financials, on the other hand, fully benefitted from the «reflation trade» and higher yields.

Higher US yields also led to repercussions in other asset classes. In FX, the euro continued to depreciate slightly versus the greenback. The dollar was generally strong and appreciated 1.85% vs. the yen and 2.05% vs. the Swiss franc. Emerging Market currencies came under pressure in this environment and fell by 0.66% on average vs. the dollar.

As the 10-year yields of core market Treasuries rose between 23bps (Switzerland) and 49bps (UK), credit spreads continued to tighten. In the US, high-yield spreads which tightened by 47bps in February are now flirting with all-time lows. Don’t expect spread tightening to go much further.

Finally, higher yields also impacted commodities. First and foremost, the traditional safe-haven gold corrected sharply falling 7%. As an asset without cash-flow and with a cost of carry, it decreased its relative attractiveness to other assets.

The rest of the commodity-complex benefitted from higher inflation expectations: The Bloomberg Commodity Index rose by 6.69%. Oil rose sharply on the back of some supply constraints while expected demand rose on the back of «reopening» headlines. WTI added almost 20% in February.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3 811	-0.48	-2.46	2.60	1.47	1.47	19
Nasdaq	13 192	0.56	-4.50	0.93	2.36	2.36	27
Russell 2000	2 201	0.04	-2.32	6.17	11.45	11.45	26
Euro Stoxx 50	3 636	-1.33	-2.07	4.45	2.36	2.36	15
Stoxx 600 EUR	405	-1.64	-2.38	2.31	1.49	1.49	15
FTSE 100	6 483	-2.53	-2.12	1.19	0.35	0.35	13
SMI	10 522	-1.28	-1.71	-0.65	-1.69	-1.69	16
NIKKEI 225	28 966	-3.99	-4.20	4.71	5.55	5.55	21
CSI 300 China	5 337	-2.43	-7.65	-0.28	2.41	2.41	14
MSCI EM Index	1 384	0.51	-3.23	4.08	7.17	7.17	14

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	3 811	0.19	-1.80	3.29	2.14	2.14	19
UTILITIES	302	0.37	-2.89	-4.41	-5.33	-5.33	16
ENERGY	358	-2.99	3.59	20.61	24.98	24.98	18
TELECOM	234	1.04	-0.40	7.25	5.63	5.63	19
CONS STAPLES	654	-0.97	-2.06	-0.83	-6.11	-6.11	18
REAL ESTATE	235	-0.70	-0.89	2.59	3.08	3.08	43
CONS DISCRET	1 299	0.91	-4.58	-0.68	-0.29	-0.29	26
MATERIALS	464	-0.82	-1.62	4.21	1.72	1.72	18
HEALTH CARE	1 318	-0.31	-1.10	-1.72	-0.47	-0.47	15
INFO TECH	2 312	1.43	-3.16	1.91	0.92	0.92	24
FINANCIALS	538	-1.51	0.11	11.89	9.73	9.73	13
INDUSTRIALS	769	-0.50	0.02	7.19	2.54	2.54	19

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	90.813	0.75	0.50	0.25	0.97	0.97
EUR-USD	1.2094	-0.67	-0.21	-0.35	-1.00	-1.00
USD-JPY	106.65	0.41	1.13	1.85	3.19	3.19
USD-CHF	0.9089	0.45	1.39	2.05	2.61	2.61
EUR-CHF	1.0993	-0.22	1.18	1.66	1.64	1.64
GBP-USD	1.3949	-0.47	-0.48	1.76	2.04	2.04
EUR-GBP	0.8670	-0.19	0.23	-2.14	3.08	-3.08
JP EM FX Index	56.69	-0.49	-2.21	-0.66	-2.13	-2.13

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	1.50	-2	16	43	58	58
Germany	-0.26	-3	4	26	31	31
UK	0.82	4	12	49	62	62
SWITZERLAND	-0.19	-4	4	23	36	36
Japan	0.16	1	5	11	14	14
US IG Spread	99	0	3	-6	-3	-3
US High Yield spread	277	12	6	-47	-50	-50
EUR High Yield spread	314	-3	-3	-31	-37	-37

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	85.5	-1.91	0.18	6.69	9.48	9.48
Gold Spot $/OZ	1721.4	-2.77	-3.52	-6.83	-9.32	-9.32
Crude Oil WTI	62.5	-1.73	5.45	19.67	28.75	28.75

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	26.9	-2.04	4.80	-6.24	18.02	4.10

Source Bloomberg: 26.02.2021

Macro Update : Evidence of recovery... and inflation

1- Macro Update

The recovery in global economy is becoming more and more evident and despite geographical inequalities, we assist at a brisk bounce back.

Vaccination programs allow now Covid-related restrictions to be lifted in some areas with real perspectives for a full re-opening soon.

In this context, real GDP growth forecasts for 2021 have lift up by most economists with emerging economies among China and India, leading the way.

The US economy is not in rest and continues to surprise on the upside. The recent surge in US retail sales suggests that Americans are beginning to spend their stimulus cheques and the increase in industrial production suggests that industries are filling that demand. In the absence of any new deadly variant that would induce new sever lockdown, it becomes more and more likely that the global economy will recover much of last year's losses within the next 12 months

The recent validation of the 1.9 trillion US dollar spending plan proposed by Joe Biden comforts our view for a brighter economic outlook in 2021.

2-Rising growth... and inflation forecasts

Encouraging signs on the virus containment, resilient economic data, efficient vaccination campaign combined with additional generous fiscal stimulus have not only underpinned expectations for stronger recovery, growth and higher corporate earnings, it has also create a sentiment of a global economy "over-stimulated" that has fed higher inflation expectations, leading to higher interest rates.

Manufacturing PMIs: Ongoing recovery.

	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21
Global	50.6	51.8	52.4	53.1	53.8	53.8	53.6	53.9
USA	53.7	55.6	55.7	58.8	57.7	60.5	58.7	60.8
Europe	51.8	51.7	53.7	54.8	53.8	55.2	54.8	57.9
Switzerland	49.6	51	52.8	52.9	54.5	57.3	59.4	61.3
UK	53.3	55.2	54.1	53.7	55.6	57.5	54.1	55.1
China	51.1	51	51.5	51.4	52.1	51.9	51.3	50.6
Emerging	51.4	52.5	52.8	53.4	53.9	52.8	52.1	51.5

Source Bloomberg

Services PMIs: perspective of re-opening.

	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21
Global	50.7	52	52	52.9	52.2	51.8	51.6	52.8
USA	56.6	57.2	57.2	56.2	56.8	57.7	58.7	55.3
Europe	54.7	50.5	48	46.9	41.7	46.4	45.4	45.7
Switzerland	50.9	50.5	53.6	50.3	48.4	49.5	49.1	52
UK	56.5	58.8	56.1	51.4	47.6	49.4	39.5	49.5
China	54.2	55.2	55.9	56.2	56.4	55.7	52.4	51.4
Emerging	49.4	51.5	53.2	54.5	54.4	53.9	51.6	51.7

Source Bloomberg

Expectation in price rises

Source: Bloomberg/CGE

Macro Update : Evidence of recovery… and inflation

As of today, inflation in developed economies looks well contained. However, we all know that thanks to base effects, there is no doubt that inflation on a year-on-year basis will rise above target in the second quarter. The rise in inflation has been well anticipated last year, and was expected to be temporary.

However, the recent rise in commodities including oil prices, base metals and agricultural commodities and shortage in some industry supply-chain (semi-conductor) have triggered fears of underlying inflation picking up on a more structural path.

As a result, global yields have been repriced brutally higher triggering a sell-off in stock markets with growth stocks particularly targeted.

We nevertheless continue to think that the inflation overshoot, expected in May this year will only be temporary. The base effect from last year drop in inflation combined with the brisk rebound of the economic activity will fuel the CPI index on year-on year basis above central bank's target, however, this should be short-lived as persistent slack in the economy will drag inflation down below 2% in the second half of 2021.

3- Overshooting inflation is likely to be only temporary.

Despite interest rates have already anticipated an inflation spike, we acknowledge the risk of an overshoot in rates and steeper curve as well. In this context, doubts about central banks 'ability and willingness to remain accommodative will arise and a chapter of higher volatility should be expected. While we remain broadly optimist on the stock markets, rotation will likely continue with some of the high leveraged growth stocks under greater pressure.

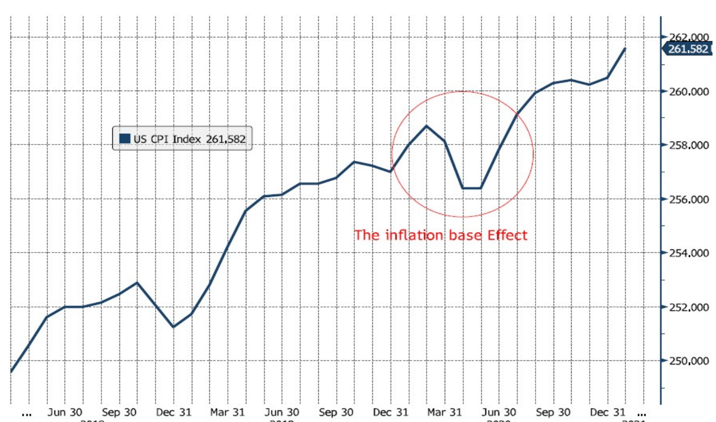
Commodities will fuel inflation

Source Bloomberg

Fed funds unchanged until 2023.

Source Bloomberg

Inflation: the base effect



Source Bloomberg

Fixed Income Strategy : A tantrum, without a taper

It should not come as a surprise that a stronger global economy and the specter of rising inflation are not particularly welcome signal for fixed income. Higher yields and steeper curve have been observed since October last year and so far the amplitude and the rapidity of the move appeared under control and in line with the current economic cycle. However, rising growth and inflation forecasts, boosted by generous stimulus and commodity boom triggered an acceleration this year with US 10 year yield rising 50 bps with the 5-30 year part of the curve steepening by nearly 40 bps.

The move has likely been amplified by some large steepening positons from the hedge fund community but also by some rising doubts about central banks 'ability to remain accommodative in the face of strong growth and rising inflation expectations.

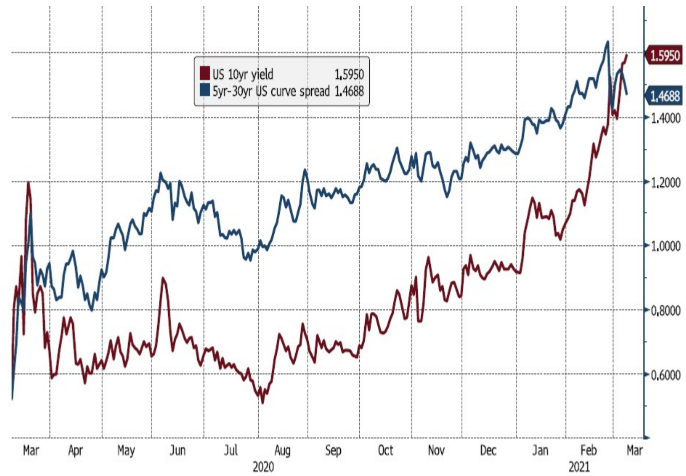
Similar yield moves were observed in 2013 when the Federal Reserve announced a reduction in the pace of its purchases of Treasury Bonds. The surge in yields at the time has been described as the "taper tantrum", as the US 10 year yields rose by nearly 130 bps in 4 months. Despite the constant and perpetual narrative from the Fed to keep the policy accommodative and Fed fund rates anchored until 2023 underlying a risk of temporary inflation overshoot, market participants managed to push the US 10 year yields 70 bps higher since the beginning of the year: A tantrum without taper.

While there is a decent probability that the move extends further, at least to "clean market positions", we believe the inflation spike should be temporary and therefore expect the pick-up in yields should be close to an end for now.

While the recent surge in sovereign yields had a negative impact on equities and gold, corporate spreads have barely moved. Investment grade spreads is virtually unchanged year-to-date while High Yield spreads are even tighter by nearly 50bps.

While we could see such immobilism in spreads as a positive signal of the ongoing recovery, reality is that liquidity in those assets remains poor and therefore likely explains the facts that spreads remain steady. We see a risk of spread widening that could be brutal should the move in yields overshoots. After all, High yield spreads progress in territories close to incompressible levels.

Higher Yield and Steeper Curve



Source: Bloomberg

Higher Yields : A headwind for growth stocks

Source: Bloomberg

High Yield spreads near incompressible levels

Source: Bloomberg

Equity strategy

As the Q420 earnings publications gradually approach their end, the last quarter of 2020 emerges as one of the strongest in a while: the YoY EPS growth for the S&P 500 index is 3.9%, the highest since 4Q18. 76% of S&P 500 companies so far beat sales estimates and on average, the surprise was 2.94%. 79% of companies beat earnings estimates and on average the earnings surprise was 17.66%.

All sectors of the S&P 500 managed to surprise positively on the earnings side and the last quarter of 2020 is thus the first quarter since 4Q19 with a positive EPS growth.

This comes, of course, after a particularly difficult year. Most sectors posted a negative EPS growth rate for the whole calendar year. Consumer Discretionary for example saw their EPS fall by 54%.

The results were extremely heterogenous as loser and winners from the pandemic emerged: within «consumer services», on one hand Amazon posted sales up 44% to $125bn with a YoY operating income growth of 77% to $6.87bn. On the other hand, Expedia (online travel services) published sales down 67% to $920mn with a net loss of $383mn in 4Q20.

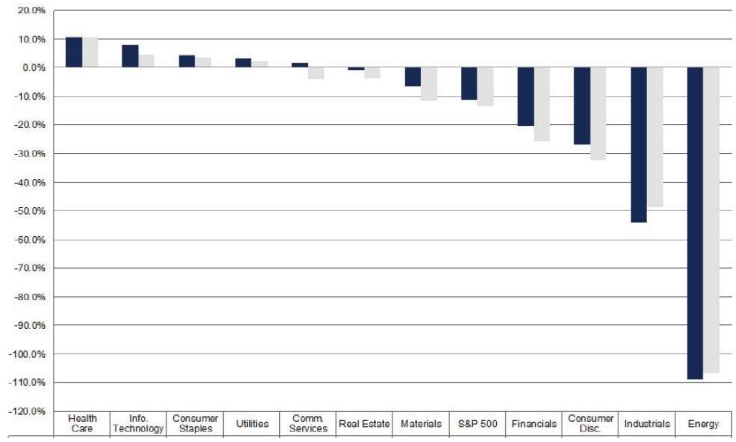
In Europe, the results were weaker as more sectors missed estimates and posted negative surprises. Nevertheless, with an average positive sales surprise of 1.57% and an average positive earnings surprise of 11.87% the situation seems to improve there, too.

In Switzerland, defensive names and specifically healthcare, weighed on the earnings season. Heavyweights Roche and Novartis missed on sales and struck a cautious tone in their 2021 guidances.

In spite of everything that happened last year, corporate America is not only alive but highly profitable. Sectors such as real estate and IT which benefit from low real interest rates have net profit margins of 35% and 24%, respectively.

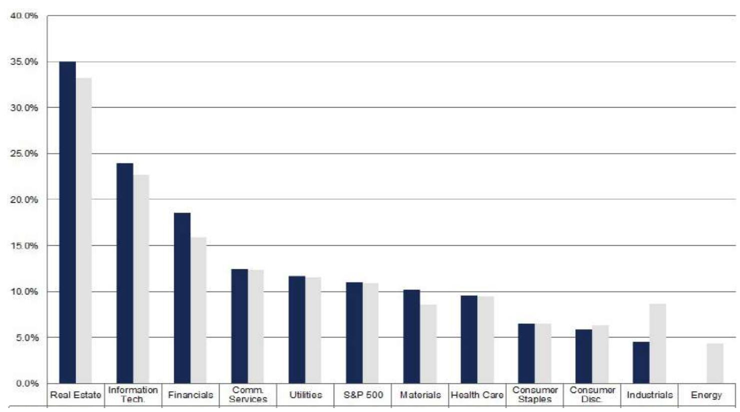
With the recent rise in yields, we see some opportunities in big tech and communication services. They have lagged and look less expensive now. Some European Health Care & Consumer Staples also look attractive at current levels (see table).

S&P 500 earnings growth CY 2020 26.2.21 (blue) vs. 31.12.2020 (grey)



Source: Factset

S&P 500 net profit margins Q420 (blue) vs. Q419 (grey)



Source: Factset

Single line ideas from the Cité Gestion equity univers

Technology & Communication Services	CRNCY	Upside	eP/E
BAIDU INC - SPON ADR	USD	17%	25.2
FACEBOOK INC-CLASS A	USD	32%	18.2
NETFLIX INC	USD	18%	41.9
APPLE INC	USD	30%	26.9
CISCO SYSTEMS INC	USD	9%	13.5
MICROSOFT CORP	USD	21%	28.8
SALESFORCE.COM INC	USD	18%	67.5
SPOTIFY TECHNOLOGY SA	USD	5%	-
UBISOFT ENTERTAINMENT	EUR	22%	24.5
SAP SE	EUR	22%	20.8
Health Care & Consumer Staples	**CRNCY**	**Upside**	**Perf. vs. index**
L'OREAL	EUR	3%	-4.8
NESTLE SA-REG	CHF	22%	-7.2
PERNOD RICARD SA	EUR	3%	-1.3
MERCK KGAA	EUR	12%	-6.8
NOVARTIS AG-REG	CHF	18%	-5.1
ROCHE HOLDING AG-GENUSSCHEIN	CHF	19%	-3.3
SANOFI	EUR	0.3	-7.7

FX & Commodity strategy

Over February Sterling and Australian Dollar have been the best performer vs USD. GBP rose on the back of vising optimism related of the Covid-19 vaccination. The two safe haven currencies: JPY and CHF have declined both by nearly 2% vs the greenback. A sustained Dollar buying was seen as one of the key factors driving both USD/JPY and USD/CHF higher.

Australian Dollar	1.98
British Pound	1.92
Canadian Dollar	1.62
Euro	-0.09
Japanese Yen	-1.71
Swiss Franc	-1.99

Source Bllomberg

Optimism and Interest Rates

Interest rates stabilized after the February surge, which should put USD under less pressure in March. Despite intentions of the FED to not hike interest rate through 2023, the market is sensitive to any indications regarding a potential tightening of monetary policy. In the same vein, every action to battle rising inflation, could be followed by a boosting of the Dollar.

On a Covid-19 recovery perspective, the market is still pending a strong signal on immunization success, with US already vaccinating more than 15% of its population. If the immunization moves forward, markets are likely to continue their uptrend and the EUR/USD its ascension. However if the vaccination does not meet the success hoped for, we could likely see a regain of interest for the safety of Dollar.

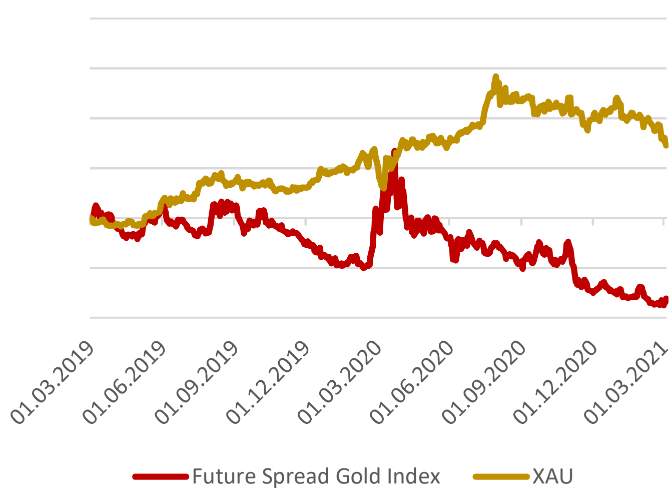
US dollar has further room for appreciation

Source Bllomberg

UK: new paradigm?

The reopening UK will definitely makes thing better for the GBP. The UK is currently on the top of vaccination strategy, with 30% of its adult population already vaccinated. But there is still rooms for sterling to move in a new, higher paradigm. If the GBP/USD manages to settle in a range between 1.39 and 1.40, it could be likely to gain additional momentum by the upcoming months.

Future Spread anticipation trend vs Gold



Source Bloomberg

Gold Bearish Signal?

After reaching a new high in 2020, the yellow metal has been in a downtrend for two months in a row, and there are still potential drivers that make us keep a bearish view for the upcoming months. By analyzing the positions on future contracts, there is a lack of appetite in detaining future position on Gold in comparison to last year. A selling trend in contract holding is starting to arise, which could lead to accentuate the negative trend on Gold. Moreover, by having a look on the Spread on the future contract, it shows a downward trending, if the technical view on it realizes, it could anticipate a down pressure on the yellow metal. Also carefully watch the real interest rate direction. If the February trend seems now stabilized, a new surge in interest could be fatal for the Gold.

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