BBGI GROUP Global Investments

Investment Strategy

April 2021

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Graph sources: Bloomberg/BBGI Group

INTRODUCTION

Letter to investors – Investment climate

- Bond markets are finally taking into account the improved growth prospects
- The rise in long-term interest rates is intensifying in the US but is partially sparing the euro zone
- Business cycles are gradually converging
- Global growth will be strong in 2021 and 2022
- Financial assets could suffer from the adjustment in interest rate and inflation expectations

The beginning of 2021 was marked by a gradual change in growth expectations that rather negatively affected bond markets and instead boosted investors' already strong enthusiasm for most other asset classes. While bond markets were finally taking into account the impact on interest rates of stronger growth prospects for the year as a whole, risky assets in most cases continued their upward trends of previous months. The weakness of the European economy was becoming increasingly apparent with the return of the variants and the new health measures adopted by most governments. In the UK, the English variant had already caused another strict lockdown, which continued during the quarter, as the country embarked on a particularly rapid and effective vaccination campaign. In the US, the economic downturn was also noticeable, but clearly temporary given the vaccination campaigns conducted by the new Biden administration, whose speed of implementation and effectiveness ended up changing investors' expectations in terms of both growth and inflationary outlook. From Q2 onwards, we are likely to already see the beginning of a convergence of the business cycles of the two leading world economies, China and the United States. At the beginning of Q2, the Covid-19 factor is still influencing governments' political decisions, but financial markets have long since stopped worrying about its evolution. The quarter was therefore essentially a new phase of adjustment of long-term rates in this more positive economic context, which affected all bond markets. The correlation among interest rate markets was once again high, even if the magnitude of the rate increases varied from country to country. March saw an acceleration of the trend in the US and the UK, while in Europe, the ECB's intervention, stepping up its asset purchases, made it possible to contain the rise in yields. While 10-year US Treasury yields rose again from 0.91% to 1.74% in three months, UK Gilts jumped from 0.2% to 0.85%. Canadian and Australian dollar yields followed a similar trend, while European yields declined in March on the back of the ECB's reinforced action and in anticipation of a weakened economy due to the lockdowns. Overall, the action of the central banks no longer seemed really decisive and did not succeed in controlling the bond markets. The latter all suffered corrections of around -4% over the quarter, with the main developed markets falling by -7.4% in the UK, -3.3% in the US and -1.9% in Europe. Markets benefiting from the commodities rally such as Australia (-5.5%) and Canada (-4.9%) suffered the biggest adjustments, while bonds in Switzerland also lost ground (-1.2%), though Japan managed to remain relatively stable (-0.3%). The ongoing interest rate adjustment is already well underway and is likely to soon pause as ten-year Treasury yields approach their 2% target. Q2 is already expected to be stronger, but a further rise in long-term rates may have to wait for a confirmation of inflation expectations. For the time being, inflation expectations remain contained and well below the one-year inflation forecast (3%). However, we believe that the expected convergence of business cycles in H2 will have a clear impact on the overall level of inflation and will subsequently push bond yields a little higher.

For the time being, investors are still comforted by the idea that interest rates will remain low for the long term and are not yet worried about this risk for the future valuation of risky assets. A rise in long-term rates is nevertheless likely to have an effect on the valuations of these assets by lowering the present value of their future cash flows. For this reason, growth stocks and stocks with very high valuation multiples have already suffered some profit taking. The outperformance of a number of value stocks in recent months is also one of the consequences of this growing awareness. March thus ended with a further rise in the equity markets in a stock market climate that remained surprisingly optimistic. The rise in long-term interest rates has had little effect on the markets thus far, and the sector rotation in favour of cyclical and value stocks has continued in part. Growth stocks and the technology sector have suffered the profit taking expected in such an environment. Technical and quantitative factors continue to point to a high risk of trend reversal at the beginning of Q2 and suggest an increased likelihood of correction. However, rising interest rates are still not dampening investor sentiment. Equity markets rose by 5% in March overall thanks to the recovery in share prices and saw valuation levels rise further to 23x 2021 earnings in the US in particular. Valuations have also reached record highs for Swiss real estate, suggesting a certain caution with regard to these two asset classes. The convergence of business cycles is, however, expected to be particularly favourable for commodities, which will benefit from new tensions caused by a net increase in demand.

The overall economic scenario is therefore more positive, but the risks of rising interest rates and inflation that are expected to accompany the economic recovery could ultimately also weigh on the future price growth of risky assets and bond markets.

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