

September 2021

Interest rates & bonds

Volatility of credit spreads is flatlining

US

- Government bond yields drifted higher in August with intermediate maturities (so-called “belly” of the yield curve) seeing the strongest moves, while the short and very long end of the curve saw only modest gains.
- Although several Fed officials have publicly called for an end of the ultra-loose monetary policy, Fed Chair Jerome Powell gave a dovish speech at the important Jackson Hole meeting.

Eurozone

- German government bond yields also moved higher by a few basis points in August with interest rates in the European periphery largely following the move.
- Several ECB members started to become more hawkish calling for an end to the ECB’s emergency programs as inflation continues to accelerate. We expect, however, the majority of ECB members to advocate continuity of loose monetary policy.

UK

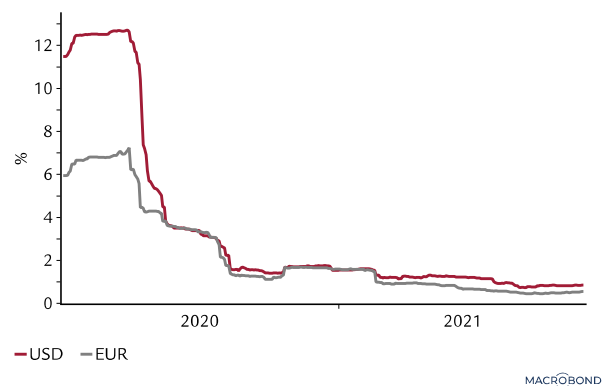
- Yields at the short end of the curve saw a very significant increase over the past month, with the two-year tenor reaching 0.2%, a level last seen before the pandemic.
- While the Bank of England has been more hawkish than other central banks, it continues to see inflation as transitory, expecting it to fall back to the 2% target level after a temporary increase.

Switzerland

- Swiss government bond yields followed their global peers in a move upwards, although less pronounced.
- Economic data out of Switzerland started to weaken with Purchasing Managers’ Indices (PMI) declining and retail sales falling 2.6% year-on-year, while inflation continued to accelerate modestly.

Volatility of credit spreads is flatlining

Realised volatility of investment grade credit spreads
(source: Bloomberg Barclays, Swiss Life AM)



The discussion about a reduction of asset purchases by central banks (“tapering”) is intensifying as even the ECB has joined in. Although US Fed Chair Jerome Powell reiterated its dovish stance at the Jackson Hole meeting, we expect an announcement for a gradual reduction of asset purchases over the coming months. The ECB is likely to act later, as the economic recovery and overall inflation data is still not at the levels seen in the US. That said, we think that we are still far away from normalisation on the policy rate front and from an end to central bank driven markets. Uncertainties about the economic recovery remain and with the next COVID mutation potentially just around the corner, it would be premature to call for an end to the interventions. With the technical support still in place, we therefore see little room for credit spreads to widen materially from here. As credit spread volatility is basically non-existent and too much money is chasing ever declining yields, we nonetheless also feel that there is little to gain from becoming overly bullish. We indeed expect credit spreads to drift slightly wider on the back of more supply and a possible resurgence of the pandemic into the winter. Absent a material risk-off scenario, we expect government bond yields to remain range bound with a tilt to the upside.

Equities

Excellent quarterly results, but high valuations

US

- The US market was up 2.9% in the month of August. After a strong first half there was a mid-month dip due to increasing fears regarding the pandemic and negative news from China. The drop was, however, small and short-lived as investors used the draw-down to (re-)enter the market. The S&P 500 Index reached a new all-time-high and is now above 4'500.
- The earnings season delivered excellent results and the US Fed reassured markets that there will be continued monetary support.
- Overall, the US market is the most expensive of all major markets and we thus see only limited upside.

Eurozone

- In August, the market was up 2.0%. The mid-month correction was smaller than in the US.
- The prospects for the European markets are good. The economy will gain momentum, valuation is more attractive than for other equity markets and the monetary policy by the ECB is more accommodative than in the US.

UK

- Year-to-date, the UK equity market is almost 10% behind the European and the US market. In August, the UK market continued to underperform.
- The UK market has a very high dividend yield and its valuation is amongst the lowest of the major markets.

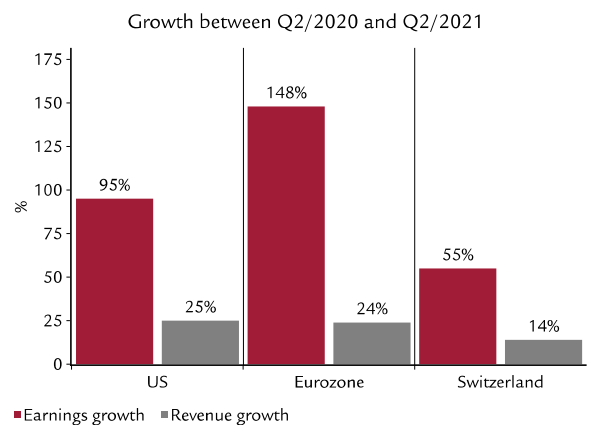
Switzerland

- The Swiss market performed again in line with global benchmarks in August.
- The valuation of the Swiss equity market is lower than the US market, but higher than most other equity markets.

Emerging Markets

- Emerging Markets are the weakest performer this year. Year-to-date, they are up only 3.0%. In August they delivered a performance of 2.6%.
- Emerging Markets suffer from two problems: a delay in Covid vaccinations and a weak Chinese stock market following the regulatory crackdown by the Chinese authorities.

Strong company results in the second quarter 2021



MACROBOND

The earnings season for the second quarter 2021 was impressive and came in above expectations. In the US, earnings almost doubled compared to the previous year while the Eurozone and Switzerland recorded growth rates of 148% and 55%. About 90% of the reporting companies beat expectations and the margin by which they exceeded expectations is one of the highest on record. Revenue growth was impressive as well. In the US, revenues grew by 25% while in Europe and Switzerland the growth rates were 24% and 14%, respectively. The lower growth rates in Switzerland can be attributed to two factors: First, the decline in earnings last year was much less pronounced. Second, cyclical sectors (industrials, energy) that did particularly well in the upswing have a very low weight in the Swiss index. With these strong numbers, earnings are now above (USA) or at (Eurozone, Switzerland) pre-crisis highs.

Despite this positive development we became slightly more cautious in our equity market view. There are three reasons: First, the monetary support for markets is less strong than a few months ago as evidenced by lower growth of money supply. Second, valuations, especially in the US, are very high. The S&P 500 Index is, for example, 40% higher than at year-end 2019, while company earnings are up around 15%. Third, it is already quite a long time since equity markets have experienced a correction of 5% or more.

Currencies

No “taper tantrum” but continued USD support

US

- The USD appreciated in the first half of August as discussions regarding tapering of asset purchases gained traction. The rather dovish remarks by Fed Chair Jerome Powell at his Jackson Hole speech contributed to a weaker USD performance towards the end of the month.
- We stick to our medium-term view of a well-supported USD and see room for renewed USD appreciation in September due to its interest rate advantage (“carry”).

Eurozone

- Eurozone economic activity has surprised positively in August, especially in the periphery, and inflation continued to accelerate. This has caused some alarmism in the media and triggered a few hawkish remarks by ECB officials.
- Nevertheless, we do not expect the mainstream view in the governing council to shift towards a more hawkish stance, which limits the room for any EUR appreciation. For the current month, we have a negative view on EUR/USD.

UK

- GBP/EUR reached a new post-crisis high of 1.18 in the first half of August, driven by upbeat economic data, before losing steam in the second half of the month.
- We have a neutral one-month view on GBP/USD but see renewed GBP upside against EUR.

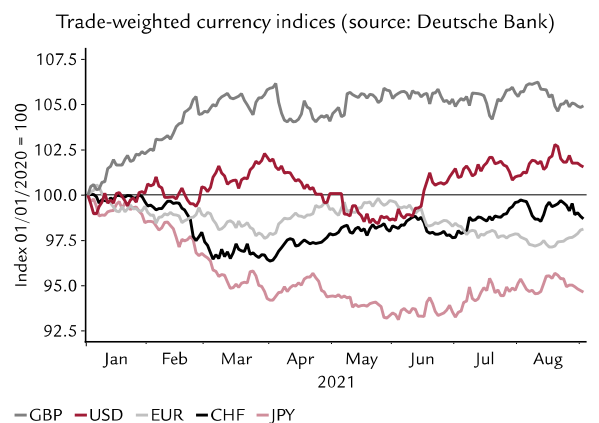
Switzerland

- Following the strong EUR/CHF decline in July, improved risk sentiment among investors led the EUR higher against CHF in August.
- We see, however, no material EUR/CHF upside from here as interest rate differentials are very narrow and as risks surrounding the further development of the pandemic are still significant.

Japan

- JPY/USD had a quiet month of August and fluctuated around the 110 mark.
- In line with our generally positive view on USD, we have a positive view on USD/JPY as well.


USD outperformance to continue over coming month



In August, the main driver in FX markets were the expectations regarding US monetary policy. The “tapering” discussion gained significant traction in August and led to USD appreciation. Hawkish members of the Federal Open Market Committee (FOMC) even advocated in speeches to scale back asset purchases as soon as possible. The minutes of the July 27-28 FOMC meeting, published on 18 August, revealed that “most participants” agreed that the economic conditions required to taper asset purchases will likely be met this year already. This majority view was reiterated by Fed Chair Jerome Powell in his eagerly awaited speech at the Jackson Hole meeting of global central bankers. We thus expect the FOMC to give an “advance warning” on 22 September, when the next FOMC meeting statement will be published, with an official announcement including detailed tapering plans to follow in November 2021. The Fed’s approach of cautiously preparing the markets for reduced asset purchases should prevent another “taper tantrum” that rattled markets back in 2013. Jerome Powell additionally soothed investors’ nerves by mentioning that the tapering decision will not “carry a direct signal regarding the timing of interest-rate liftoff, for which we have articulated a different and substantially more stringent test”. The USD lost somewhat in the wake of these remarks. We indeed only expect the first US policy rate hike to occur in Q2/2023. As this is still earlier than in most other developed markets, the USD should remain supported by a favourable interest rate advantage (“carry”) and remain among the best-performing developed market currencies in 2021 (see chart).

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