MARKET VIEW

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“Sugar Rush”

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The U.S. economy currently experiences a “sugar rush”. Despite scientific skepticism, there is a widespread belief that eating sweets leads to short-lived hyperactivity. A phenomenon often referred to as Sugar Rush. Several economists have used this expression lately to describe the economic situation in the United States where some short-lived hyperactivity is expected in the coming months. The main drivers to this hyperactivity are the USD 1.9 trillion Biden stimulus program and the forced savings during the Covid-19 crisis (USD 1.85 trillion) which are going to flow back in the economy when it reopens. Economic growth in Europe will also accelerate, but at a slower pace as the more successful vaccination policy in the U.S. allows a faster reopening of the economy there than in Europe. Recently, the FED has increased its projections and now believes that the U.S. real GDP will grow by 6.5% in 2021 (December 2020 projection: 4.2%), by 3.3% in 2022 and by 2.2% in 2023.

Our clients ask us how inflation will develop under this scenario. We believe that inflation in the U.S will increase sharply in 2021 but will then fall in 2022 and beyond (see Exhibit 1). Don’t forget, it is a short-lived Sugar Rush. As a result of higher inflation, the yield curve is steepening. We increased our yield expectations for 10-year interest rates in the U.S. from 1.8% to 2.0% at the end of 2021.

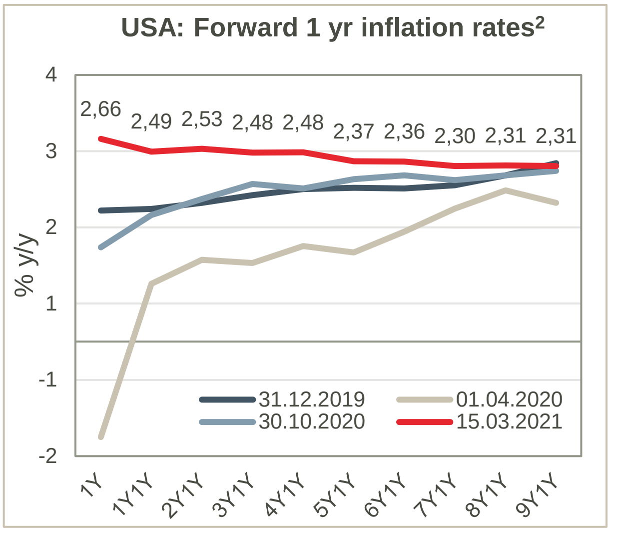
The risks to these forecasts are clearly on the upside as the ECB and the FED have both announced in March 2021 that they will continue their expansionary monetary policies. The ECB has declared on March 11 to conduct asset purchases at a significant higher pace, and the FED stated on March 17, that it will continue to increase its holdings of securities by USD 120 billion per month despite an improved growth outlook and falling unemployment rates. The consensus among (most) politicians is that it is better to do too much than too little, a lesson learned after the global financial crisis in 2008. Larry Summers expects that the economy possibly overheats due to expansionary monetary and fiscal policies and that inflation could increase to levels not seen in a generation. While this is not our main forecast, the risk to real GDP growth, inflation and interest rates is clearly on the upside and not the downside.

The implications of these forecasts to our investment strategy are as follows:

1. Avoid so-called hyper growth names, i.e. overvalued growth stocks which will continue to suffer from increasing yields. Hyper growth stocks are priced for perfection and will fall substantially when yields increase further. But the main risk to hyper growth stocks are the excessive valuations not the increase in yields.
2. Duration risks[1] will not pay off. Within fixed income, we prefer high yield bonds which will most likely benefit from the macroeconomic outlook described above.

3. We still prefer cyclicals over defensives. However, this trend will come to an end soon. Internally, we started to discuss when it is time to accumulate defensive consumer stocks with exceptional brands which are neglected as investors concentrate on growth. We prefer an anticyclical investment style. It is better to be too early than too late.
4. Within financials, we like insurance companies with increasing free cash flows from operating activities.
5. Emerging markets suffer when investors allocate capital back to the United States – allured by higher interest rates. We see substantial risks in China where equity markets are no longer cheap and where growth – unlike in the developed world – has most likely peaked already.

Exhibit 1:



[1)] The duration risk describes the risk of price losses on bonds due to interest rate rises.
[2)] Source: Refinitiv Datastream, as of 15.03.2021; 1y. forward contracts: forward contracts with a one-year term (example: 3Y1Y = forward contract starting in three years with a term of one year)

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