Q3 2021

# Investment View
**Unplug vs. unanchor**

# Content

# Unplug vs. unanchor

- **There is a slightly scary side to being at both peak policy and peak growth. Do not exaggerate it, however. The policy unwind will be slow, while economic growth will stay above potential in 21H2.**
- **US inflation has surged. The shock is partly transitory, yet we have good reasons to believe that inflation will not return to the very muted pre-Covid trends. The Fed will navigate between the opposite risks of unplugging policy support too quickly and losing control of inflation expectations.**
- **The Fed's new AIT mandate lacks clarity, and occasional re-interpretation will cause hiccups: beef up hedges. Yet the June FOMC is testimony to its communication skills; expect the cautious approach to support a *slow* transition from early to mid financial cycle. In particular, we find it premature to chase yield curve flatteners.**
- **The rising stock-bond correlation is bad news for diversification. We retain a positive risk stance, but scale down our equity overweight, both in size and structure (long Value vs. Growth, but less keen on Cyclicals vs Defensives). Credit remains a good carry trade, even at that level of spreads. Stay short Govies and duration. Reduce USD bearish trades.**

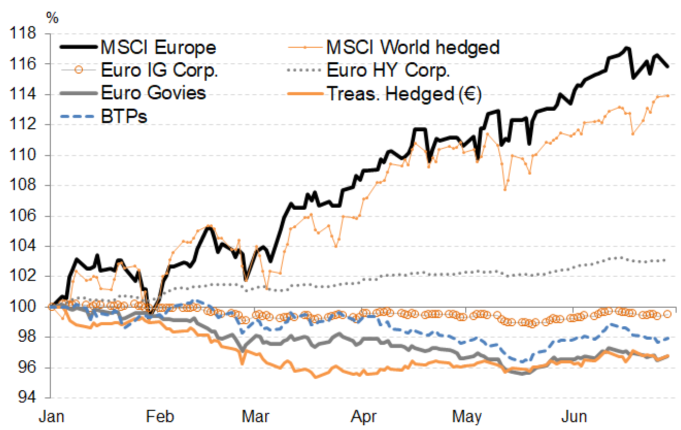
Mixed trading since June FOMC is pointing to tougher conditions ahead, but we argue against turning "all defensive" too early

**Peak growth, peak policy? Don't exaggerate it**. The economic boom announced three months ago ("Some like it hot") is upon us, with western economies likely experiencing peak growth in 21Q2. Peak policy is also about to pass, and the Fed dared to mention 'tapering' at the June FOMC meeting. Other developed central banks are already taking steps towards the exit (Canada, Norway, Sweden, United Kingdom, South Korea, and New Zealand). There is a slightly scary side to being at both peak growth and peak policy, and performance of risk assets will not keep up with the strong pace recorded so far this year (Graph 1). Following a very poor Q1, fixed income assets have managed to navigate surging US inflation numbers in Q2, with 10y Treasury yields even pulling back by some 25bp. Developed Market (DM) equities have surged to new record high. Mixed trading since the June FOMC is pointing to tougher conditions ahead, but we argue against turning "all defensive" too early. Global growth will continue to run above potential in H2, while the policy exit is set to be a very cautious and slow process.

## This recovery has legs

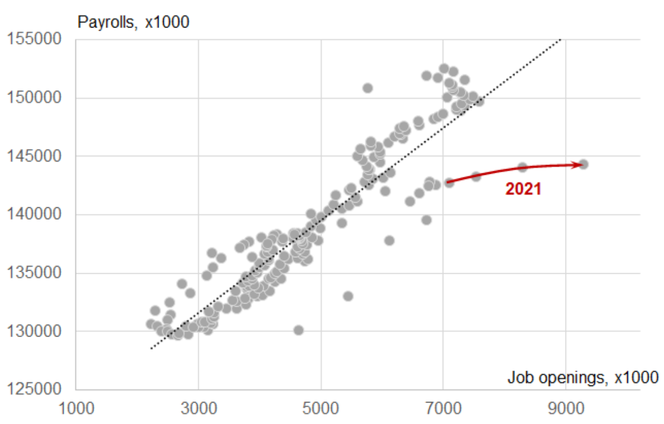
**Economic boom**. Q2 saw the investor mindset switch from "recovery" to "boom". Expectations about future economic conditions have remained sky high, particularly in Europe, while sentiment about current conditions has quickly improved and turned positive. The fast reopening of the developed economies is providing a massive boost

Graph 1: YEAR-TO-DATE TOTAL RETURN




12/31/2020 = 100

Graph 2: US EMPLOYMENT LAGGING JOB OPENINGS




Since 2005, monthly

to Services, while the manufacturing sector's primary problem is to address supply constraints, in the face of persistently strong demand. Peak policy is reflected in the OECD DM fiscal deficit reaching a huge 17% of GDP in Q1, while the average OECD policy rate has just started to bottom out from a record 0.50% low. Central banks globally have barely started to taper bond purchases, but the extra liquidity boost coming from the reduction in the Treasury cash balance at the Fed (about $1 trillion in the four months to early June) is coming to an end. This means global financial markets – including the Treasury market – will not be flooded to the same extent in H2.

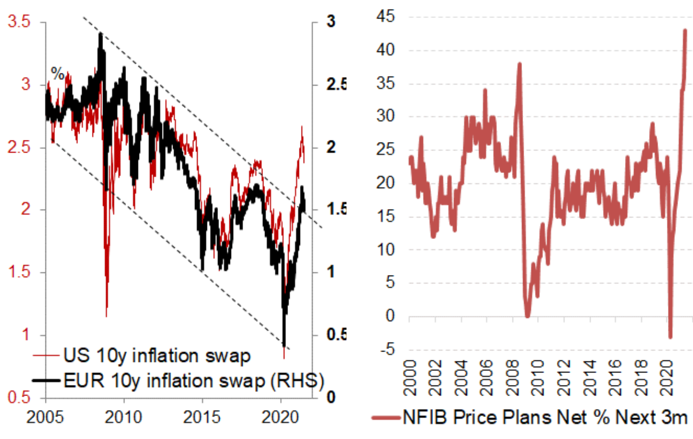
US employment is set to surge and/or wages will rise, providing more fuel to the US consumer

**Still, the global economy will still grow above-potential in H2**. We see signs that the slowdown in China is finding a base, while the broader EM world has yet to enjoy the rebound seen in the DM world. Consumers around the world have accumulated a war chest, which will support demand even though not all savings are spent. Some of the supply constraints will be lifted, not least in the US labour market. Graph 2 shows that US job creations have lagged job openings by a spectacular margin. Residual school closures, Covid anxiety and generous benefits are all part of this puzzle. Expect some normalisation in H2 however, as the enhanced unemployment benefits expire in September: US employment is set to surge and/or wages will rise, providing more fuel to the US consumer. Meanwhile the recovery is still young in Europe, and far from complete: 21Q1 GDP was still 5% below pre-crisis level. Expect revenge spending this summer to keep the economy on a strong path.

## Inflation shock: only partly transitory

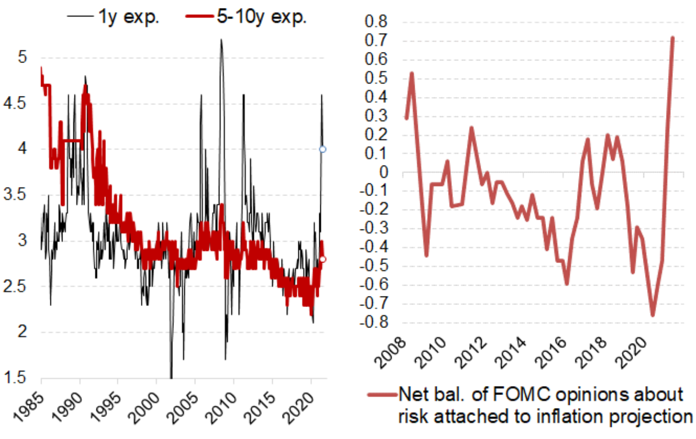
**Are inflation expectations de-anchoring?** The surge in inflation was relatively easy to predict; it has been fairly muted in the euro area (EA), but stronger than expected in the US, where headline CPI inflation surged to 5% in May, and core inflation to 3.8%. The manufacturing sector proved very resilient through the crisis, which indeed

Graph 3: INFLATION BREAKEVENS BREAK THROUGH DESCENDING CHANNEL; US SMEs PLAN PRICE HIKES




Source: Bloomberg data; NFIB survey

Graph 4: US CONSUMERS START TO WORRY ABOUT INFLATION; FOMC MEMBERS SEE INFLATION RISK UP




Source: Michigan survey; FOMC material

We find it unlikely that US inflation would quickly re-turn to the pre-Covid (sub-dued) trends

made the Covid recession very unusual, and additional policy impulse to demand has caused overheating. Meanwhile Services have struggled to cope with the social normalisation, with supply not adjusting as fast as demand, especially in the sectors that had been battered through the lockdowns. These temporary factors, as well as the catch-up from falling prices in Spring 2020, have amply contributed to the inflation surge. (Almost) no one is expecting US inflation to keep running at the pace of the past three months (core CPI running at an 8.3% annualised pace over the March-May period), but the inflation debate has various shades of grey. We find it unlikely that US inflation would quickly return to the pre-Covid (subdued) trends.

- First, the **manufacturing cycle (ISM) tends to lead the inflation cycle** by some 12-18 months. From this angle, the recent surge in inflation has been particularly early, and partly related to non-cyclical factors; the inflation impulse coming from the growth cycle itself is still likely to be felt over the coming year or two.

Three reasons for inflation to trend higher than before Covid: inflation lags growth; expectations are picking up; structural forces are turning

- Second, **expectations play a central role in the inflation process**. Graph 3 and 4 indicate that expectations have surged across the board: market measures of future inflation have surged (though this reflects both a pure inflation measure and a risk premium that tends to rise along with uncertainty); companies are planning price hikes; and consumers have started to revise their expectations higher. Remarkable, a much greater majority of FOMC members is now plainly admitting that the risks attached to their inflation projections are skewed to the upside.

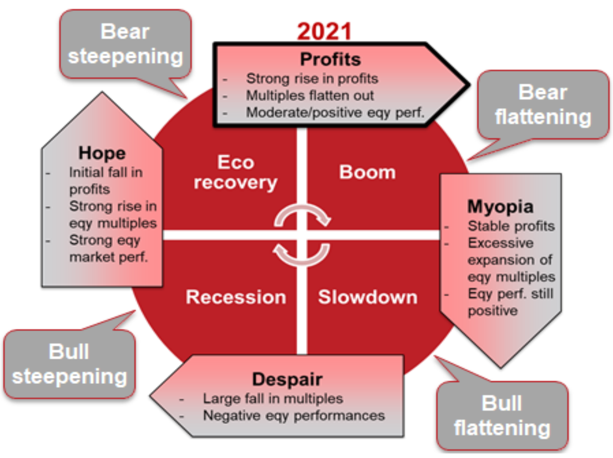
- Third, some of the **structural disinflationary forces may be turning**. Not only is the monetary and fiscal mix extremely expansive, but the increased policy focus on inequality may also support inflation. Globalisation is in retreat, and so is the global workforce. The regulatory focus on the level-playing field, e.g. the US bi-partisan push to rein in big tech, may tame digital disinflation. ESG trends, not least climate change, imply that going forward externalities on energy consumption will need to be paid for; the energetic transition may also cause near-term supply-imbalances supporting selected commodity prices (oil, base metals etc.). Arguably, some of the disinflationary forces remain (automation, competition, excess savings etc.), but at the very least offsetting forces are now rising.

## Sliding, rather than rushing, from early- to mid-cycle

Risk management approach to monetary policy will see the Fed talk up tapering at Jackson Hole, and offer details in September

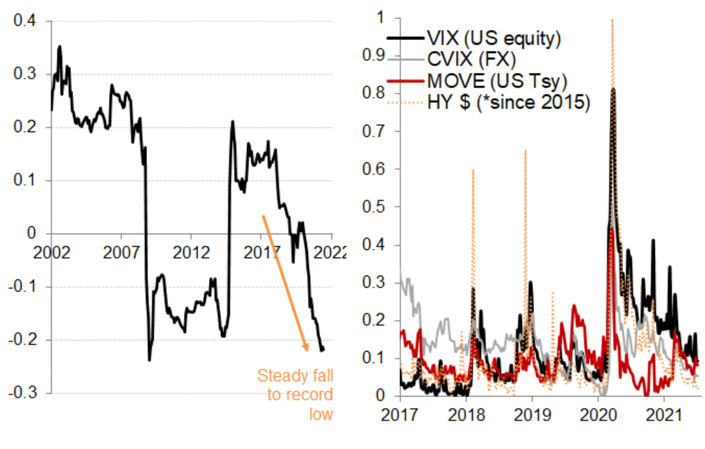
**Unplug vs. unanchor.** Central banks, not least the Fed, are facing a new dilemma: unplug policy support to prevent overheating or keep policy easy for longer and risk an unanchoring of inflation expectations. Following a long period of inflation undershooting, we expect the Fed to respect its new Average Inflation Target (AIT) mandate and proceed cautiously. Surely, they want to avoid a repeat of the 2013 'taper tantrum', which saw a 150bp rise in 10-year real yields in just five months. That said, the risk management approach to monetary policy, and the rising inflation risk, will see the Fed talk up tapering at Jackson Hole (26-28 August), and offer details in September, for implementation by the turn of the year. Communicating this transition will not be easy. The new mandate lacks clarity: how much inflation overshooting is acceptable, and for how long? When will inclusive employment gains be deemed sufficient? This lack of clarity may cause occasional re-interpretation, like the one seen after the June FOMC, and bouts of volatility.

Graph 5: THE (ACCELERATED) ECONOMIC AND FINANCIAL CYCLE




The economy, equities, and yield curves

Graph 6: 5-YEAR (60M) CORRELATION: US 10Y REAL YIELD VS. MSCI WORLD PRICE-EARNING RATIO; IMPLIED VOLATILITIES




Volatility chart: position relative to MIN & MAX since 2003*

Reluctance to embrace flatteners too early reflects our expectation of a slow transition to mid-cycle

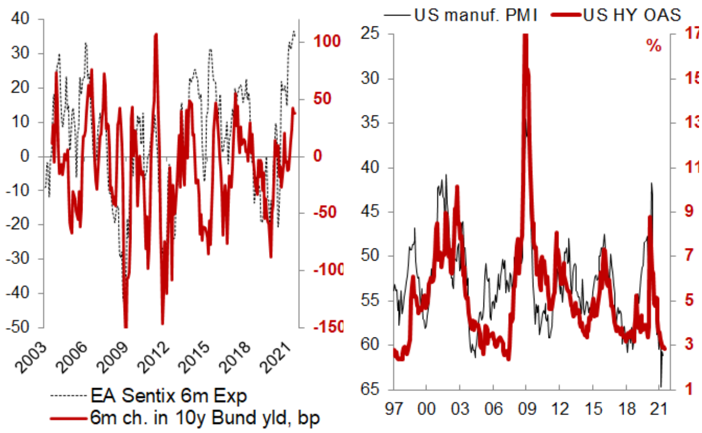
Premature to sell cyclical stocks, commodities, EM equities and the FX carry trade

**Slow transition from early- to mid-cycle.** Graph 5 shows a typical economic and financial cycle. The transition from “recovery” to “boom” usually sees equity multiples flatten out, while strong earnings growth keeps equities supported (but less so); the yield curve tends to flatten as investors start to price the policy rate “lift-off”. We expect the switch to “bear-flattening” to be slow, however, and find it premature to follow through the post-June FOMC flattening. The fall in long rates was somewhat puzzling, but partly reflecting the unwinding of crowded reflation trades. We see long yields skewed to the upside, more so in USD than EUR, as inflation expectations still have upside room and long real yields rise slowly from very depressed levels as we get closer to tapering. This reluctance to embrace flatteners reflects our expectation of a slow transition to mid-cycle, with policy support being unwound very cautiously. A quick transition instead would warrant a negative view towards cyclical stocks, commodities, EM equities and the FX carry trade – which we see premature.

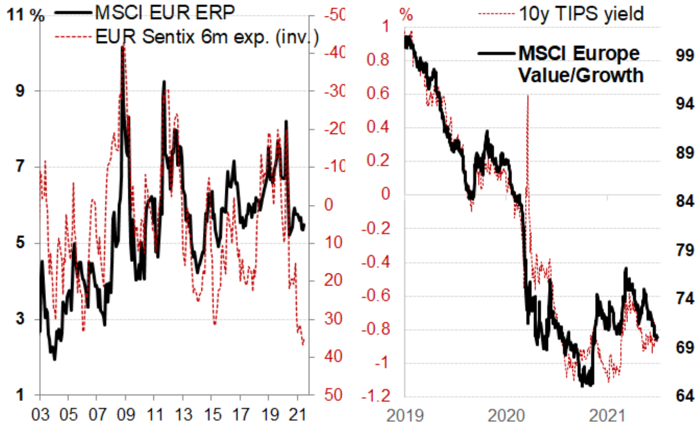
## Tactical asset allocation recommendations

**Still risk-on, but less so**. Fundamentals (earnings), valuation (Graph 8) and policy still support an equity overweight (OW), but we are scaling it down. Equities have become more sensitive to real yields in this cycle (Graph 6), and this correlation is bad news for portfolio diversification; this supports a more cautious approach as ‘tapering’ gets closer. Risks are not necessarily well priced (Graph 6) yet are getting slightly fatter, including: a reversal of USD weakness (we stay bearish but less so), an unwinding of positioning (less extreme than in early April, but still consensual and positive) and Covid variants making vaccines potentially less effective this autumn (low probability but high-impact risk). Hence we increase cash to OW, and switch to a less aggressive equity OW, both in size and structure (retain a long Value vs. Growth, and prefer Europe, Japan and to a lesser extent EM over the US, but downsize the bet Cyclicals over Defensives). We still like Credit as a carry trade, with thinner tail risks there than in equities given the improving fundamentals (rating, default, ongoing CSPP support): we recommend being long in Hybrids, AT1, BB and BBB. We see further upside for nominal bond yields, even in Europe (Graph 7), and retain an underweight (UW) in government bonds. We position for a further curve steepening, particularly in EUR where the lift-off is still a very far distant threat.

Graph 7: BUND YIELD LAGGING ECONOMIC OPTIMISM; CORPORATE HIGH-YIELD SPREADS REFLECT ECONOMIC STRENGTH




Graph 8: EUR EQUITY RISK PREMIUM (ERP) STILL GENEROUS; PREFERENCE FOR VALUE VS. GROWTH STOCKS




ERP = Equity Risk premium, based on 12m forward earnings and average EA 10y bond yield

Keep a prudent OW Equities and maintain OW in Credit. Extend UW Core & Covered Bonds, with a short stance on duration. OW Cash. Bearish USD but less so.

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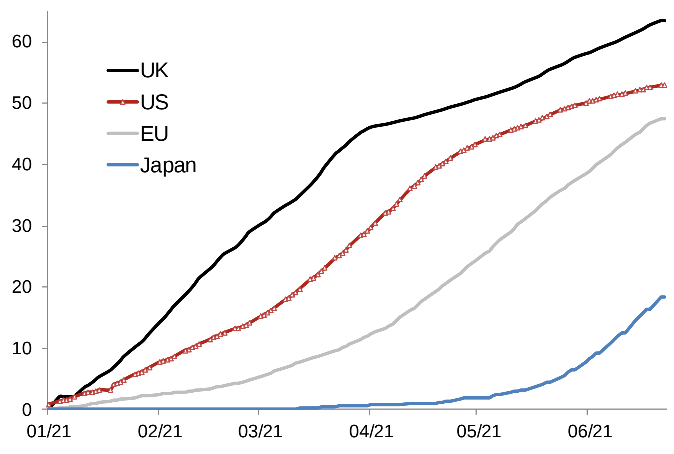
# Macroeconomic Outlook

- **The advanced economies will continue to lead the 2021 recovery amid fast Covid-19 vaccination progress. The growth momentum is shifting from the US to reopening Europe.**
- **Supply constraints are curbing growth in global manufacturing. But reopening services, pent-up consumer demand and strong global trade will support a healthy summer rebound.**
- **We stick to our above-consensus 7.5% US growth forecast while upgrading euro area growth to 4.6% amid easing pandemic risks. Following a V-shaped rebound, China's growth is set to slow gradually amid a fading credit impulse.**
- **Central banks face a balancing act in preparing markets for the unwinding of emergency measures. The Fed will keep flagging the transitory nature of inflation. But following its hawkish twist in June, it will reinforce its commitment to keep inflation expectations anchored and gradually signal the tapering of asset purchases from early 2022 onwards.**
- **By contrast, the ECB is unlikely to significantly reduce its PEPP purchases any time soon, as it will remain keen to preserve favourable financing conditions amid rising US yields and muted underlying price pressures.**

The economic growth momentum will shift towards Europe, where fast vaccinations allow for a reopening of the economies

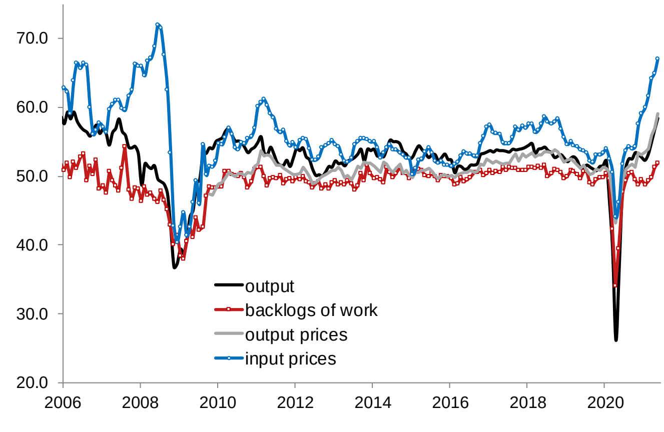
The global economy is headed for a strong summer expansion. A joint boost from re-opening services amid eased Covid-19 restrictions and persistent fiscal support will sustain a strong recovery in most advanced economies. The US is leading the boom, thanks to an outsized fiscal stimulus and early inoculations. That said, US vaccinations have been slowing visibly since April, with large parts of the population still reluctant to get a jab. This prolongs the path towards herd immunity. By contrast, vaccination is proceeding fast in the euro area, with just about half of the population now inoculated with at least one dose.

Graph 1: UNEVEN VACCINATION PROGRESS




% share of population having received at least one dose; Source: *Datastream, Our World in Data*

Graph 2: GLOBAL REBOUND IN ACTIVITY, BACKLOGS AND PRICES




Subcomponents of global composite PMIs, with values >50 indicating increases

## Upside risks to the outlook from large excess savings

Consumers are sitting on large excess savings accumulated over the pandemic, entailing upside risks to the recovery. Manufacturing and global trade have been enjoying strong global demand for health care items and IT equipment both from households and businesses. Amid low inventories, this has resulted in supply bottlenecks e.g. in microchips, that may continue to curb the further rebound in manufacturing, with the car industry particularly affected. That said, as demand is shifting from consumer goods to reopening services, the overall growth rebound will still prove strong.

Virus mutations still pose the biggest risks to the global recovery

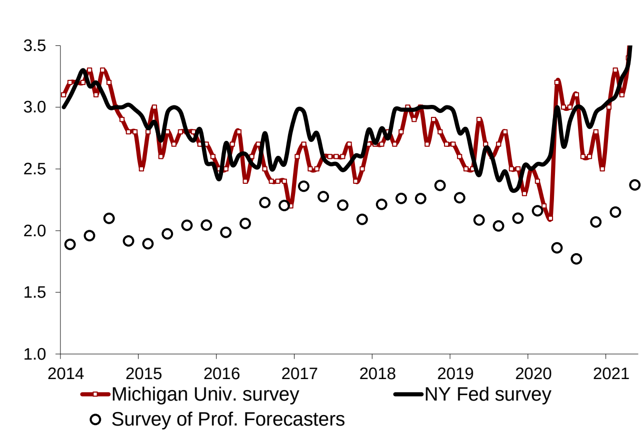
The biggest risk to the spending spree would be a fast spreading of more contagious mutations. For instance, the so-called Delta variant has just triggered a one-month delay in lifting restrictions in the UK despite advanced vaccination. Fortunately, most vaccines (mRNA jabs in particular) still seem effective against this mutation. But the race between vaccinations and this variant needs to be won by late summer before colder weather in the Northern hemisphere will favour the spreading of this virus into autumn. And the risk of emerging new, even more aggressive variants persists.

Emerging markets (excl. China) will lag the global recovery on vaccine shortages and less generous fiscal support

In emerging economies, the still poor vaccine availability is hampering a quick lifting of Covid-19 restrictions. Fiscal support measures have been much less generous than in the advanced world. Rising food and energy prices dent consumers' purchasing power more strongly. And the pace of expansion is slowing in China as the government pares back policy support, with a fading credit impulse weighing on investment. Nevertheless, EMs still benefit from supportive global financial conditions and healthy export demand, with global trade bouncing back especially in EMs. Commodity exporters are enjoying higher revenues on increased demand and prices. Most EMs (excl. China) will thus follow the global rebound, though more mutedly and with some lag vs the advanced world.

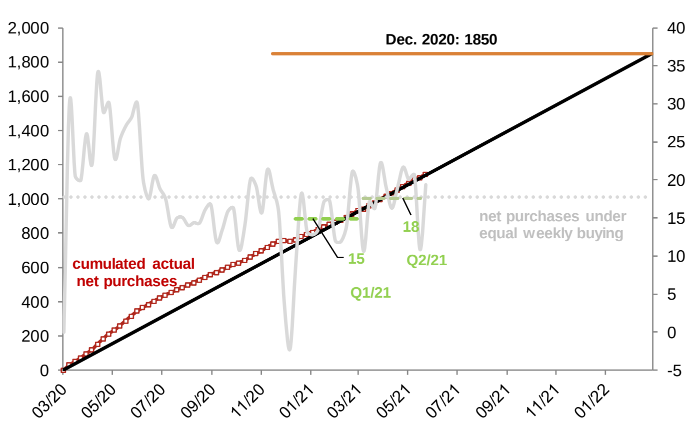
Base effects from last year's price slump, sizeable pent-up demand and high commodity prices will keep inflation rates high into summer and will fade only gradually over H2. Outright overheating risks, however, remain mostly a concern for the US.

Graph 3: US EXPECTED INFLATION ONE YEAR AHEAD




The Michigan and NY Fed survey measure consumer's expectations

Graph 4: THE ECB'S PEPP




bn EUR, weekly data on net purchases under the PEPP (rhs) and cumulated ones (lhs)

## US: growth rebounds, Fed turns more hawkish on inflation

The reopening of the economy is providing the widely expected boost to the US economy. After a 6.4% ann. increase in Q1, nowcast estimates point to even a 10% expansion in spring. Growth will peak during the summer and will moderate on a fading fiscal stimulus. We still project an above-consensus 7.5% growth for 2021, thanks also to healthy consumption and strengthening capex. The stark contrast between below-expectations employment growth and record-high job openings point to the presence of bottlenecks in labour supply, such as residual COVID related restrictions, constraints for parents due to school closings and disincentives from unemployment benefits. These factors should disappear over the coming months, leading to faster employment growth.

The spike in inflation triggered by the release of pent up demand has exceeded expectations, with headline and core inflation reaching 5% and 3.8%yoy in May.

Inflation is set to moderate during the summer, but the core CPI rate will likely end the year at just below 3%. Elevated inflation is the result of more sticky bottlenecks and the rebalancing of demand from goods to services, which pushes up prices of the latter. Uncertainty on the durability of this dislocation is high. Not surprisingly, households' inflation expectations are now at the highest level in seven years (according to the University of Michigan survey, Graph 3). Structurally higher inflation expectations alongside a tighter labour market may raise wage pressures and incentivise companies to protect margins, leading to higher actual inflation.

The Fed strengthened it anti-inflationary commitment as to anchor rising reflation expectations

Against this backdrop, the Fed surprised with a hawkish twist at its June meeting, bringing forward projected rate hikes already to 2023 in its 'dots' despite only a very mild (0.1pp) expected overshoot of its preferred 2% core PCE measure by then. This move signalled that the new monetary policy framework is obviously less reflationary than widely perceived so far and seems intended to prevent any de-anchoring of reflation expectations. Our own macro scenario is consistent with a first rate-hike in mid-2023. Shorter term, the Fed will intensify the tapering discussion: we expect an announcement at the September meeting, followed by an implementation at early 2022. Markets expect bond purchases to end in Q4 2022, but the Fed has repeatedly stated that there is not a pre-set schedule and monetary normalisation will depend on realised employment and price outcomes.

## ECB eager to preserve favourable financing conditions

Strong euro area recovery underway

The euro area recovery is taking off. Half of the population has received at least one inoculation and Covid-19 cases have come down sharply. Therefore, lockdown measures have been reduced already significantly and will come down further. The reopening of the services sector amid ongoing strong tailwinds from global activity will likely push growth to close to 3% qoq in Q3/2021. Also, a broadly unchanged fiscal impulse helps to push GDP up by 4.6% in 2021. Thereafter we expect expansion to stay well above normal but to moderate. In 2022 the fiscal impulse will become negative but be cushioned by the disbursement of means from the European Recovery Fund. Mainly for technical reasons (strong statistical overhang), annual growth in 2022 will be broadly unchanged from this year.

ECB not to announce tapering of PEPP purchases

Monetary policy will continue to support the recovery. The ECB made clear that preserving favourable financing conditions is a priority. At its June meeting, the Governing Council (GC) did not announce any reduction in its weekly PEPP purchases. and now seems more likely to leave the pace of purchases largely unaltered for the remaining lifetime of the programme until March 2022. There is still enough money in the PEPP envelope (€1850 in total) to sustain the current pace of purchases (Graph 4). Reaching the pre-pandemic inflation path is critical for the ECB, which will not happen even by 2023 according to latest ECB projections. But even if the updated December projections were to show this, announcing tapering would come at a time when the Fed is just about to start reducing asset purchases. The GC would be concerned about any material deterioration of financing conditions or a significant EUR strengthening. Finally, there is a risk that herd immunity will not be reached due to new Covid-19 mutations. This would also argue for unchanged pandemic support measures.

Against this backdrop, ECB will likely try to avoid a PEPP tantrum by announcing higher ordinary QE purchases via its APP program (of currently € 20 bn/month) from April 2022 onwards and make them more flexible (e.g. across asset classes) in order to engineer an orderly monetary support withdrawal rather than a policy cliff when the PEPP expires in spring 2022.

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# Government Bonds

- **Amid the ongoing economic recovery and the still not adequately priced inflation outlook we regard the pullback in US yields in the second quarter as a technical correction, rather than a change in trend.**
- **We expect government core yields on both sides of the Atlantic to rise again. This is particularly the case for US yields as both inflation expectations and real yields have leeway to surge going forward.**
- **Euro area non-core bond spreads are forecast to tighten moderately in the third quarter. Among others, the ECB's commitment to keep bond purchases at a significantly higher pace and the reduced supply will support peripheral bonds. Looking further down the road, the environment is likely to become less benign, not least amid surging issuance by the European Union.**

In the second quarter, US yields diverged quite substantially (and unusually) from those in the euro area. While long-dated US yields fell, and the 2-year/10-year curve flattened significantly exactly the opposite happened in the euro area. In contrast, inflation expectations developed similarly. Initially, they continue to creep upwards but have moderated since mid of May. On balance, long-dated inflation expectations hardly moved.

## Path of least resistance for government bond yields is upwards

Decrease in inflation expectations at odds with current inflation rates and expansionary policy mix

As a result of the extreme policy mix, the constellation that has been established does not appear sustainable. On the one hand, the expansionary fiscal policies globally and the accommodative monetary policies by central banks have created a textbook environment for higher inflation pressure. On the other hand, long-dated inflation expectations do not appear high considering the spike in inflation in recent months. For the time being, financial markets continue to believe in the central banks' view that the rise in inflation is only transitory.

Sooner or later, one view will prevail, and we think there are reasons at least in the US for a longer lasting increase in inflation. The economic momentum is very strong, and our economists expect the above trend growth to continue well into 2022. This will exacerbate the situation on the US labour market. While there were two disappointing labour markets reports in a row the quit rate is at historically high levels. This indicates a strong bargaining power of workers and future wage increases.

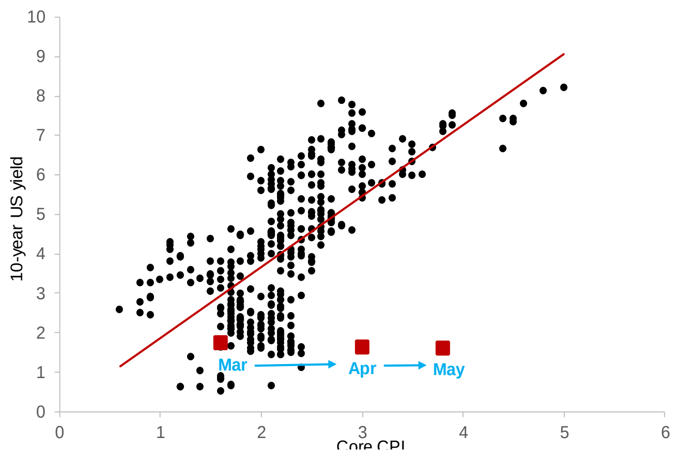
High level of uncertainty not adequately priced by financial markets

Additionally, actual inflation rates have risen sharply over recent months without any impact on bond markets. Financial markets have only partially considered the upward move in consumers' inflation expectations. According to the University of Michigan long-term expectations are in line with the pre-2015 period, but priced inflation expectations are still well below this level. This is even more striking as the uncertainty about the new monetary strategies is rather high. The Fed's more hawkish statement in June caught markets on the wrong foot and the subsequent volatile yield development indicates that uncertainty about the Fed's reaction is high. Hence, there is more leeway for the inflation risk premium to rise from still moderate levels going forward. It appears unsustainable that financial markets expect inflation rates to return to central bank targets (or even below, in the euro area) from 2023 onwards.

Moreover, real yields in the US and in the euro area are in deeply negative territory. This is at odds with the evidence of an economic rebound. This applies even more as financial markets expect that real yields will remain negative in the years to come. The hawkish shift by the Fed in June (and the subsequent rise in real yields) made clear how shaky such an assumption is. While a 'taper tantrum' (as in 2013) is less likely a rise in real yields further down the road appears necessary.

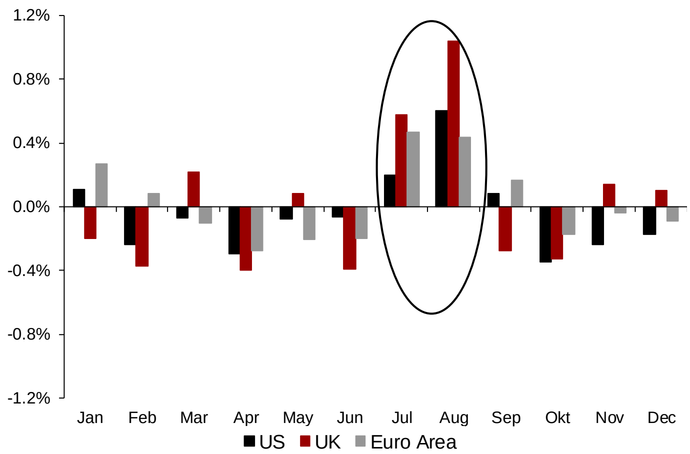
Overall, 10-year US yields are seen to rise to 1.70% on a 3-month horizon and to 2.15% until mid of 2022. We also expect an increase because the stealth QE will not continue in Q3 (the US Treasury cash balance at the Fed declined from more than US$ 1.6 tr to less than US$ 0.8 tr and a further fall is not on the cards).

Graph 1: 10-YEAR US YIELD AND CORE INFLATION




In %

Graph 2: AVERAGE PRICE RETURN SOVEREIGN BONDS




Since 01/1999

Transatlantic yield spread to widen in a generally bearish bond market environment

Many of the above-mentioned factors apply to the euro area as well. But the inflation environment looks less tense and the ECB appears to be even more strongly committed to an accommodative policy stance than the Fed, which has started to prepare markets for a partial withdrawal of support. The ECB looks anxious to talk about tapering only noticeably after the Fed. The technical environment will be rather benign in Q3 as euro area treasurers have issued already almost 60% of the annual volume. Hence, in contrast to H1 (and to the US) the net supply in the euro area will be negative going forward. Finally, seasonality will also slow the forecast increase in yields during summer (not only in the euro area but also in the US). Particularly in July and August yields tend to fall (see graph 2). All in all, we see 10-year euro area yields to rise to -0.10% until the end of Q3 and to 0.20% on a 12-month horizon.

## Favourable environment for non-core bonds – for the time being

ECB the dominant driver in the months to come, but less benign environment further down the road

The ECB is expected to be the most important factor for euro area non-core spreads in Q3. The central bank signalled to keep bond purchases at a significantly higher pace (regardless of the usually reduced purchases in August). In combination with the slowing down of issuance in summer this implies a negative net issuance of around €85 bn in Q3. Additionally, volatility is (and is expected to remain) low amid the reassuring ECB statements and the increasing maturity of PEPP purchases (from 6.3 years in May 2020 to 7.6 years in May 2021). This creates a favourable environment for carry trades. Finally, rating agencies back the current focus of fiscal policy to create growth (and not to focus on debt reduction). All in, we forecast euro area non-core spreads to tighten slightly in Q3.

Longer term, the environment is seen to become a bit choppier as some load factors will emerge. The EU has started to issue bonds: In 2021 around €80 bn will be placed and almost €150 bn on average until 2026. Moreover, financial markets will speculate about slowing ECB purchases. While we doubt that there will be a meaningful reduction in 2021, the downward trend is already predefined in 2022. Accordingly, we expect euro area non-core spreads to widen moderately on a 12-month horizon. But the higher coupons should still be sufficient to secure a (small) outperformance against euro area core bonds.

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# Credit

- **Spreads are at multi-year tights, but we continue to see modest tightening potential for European credit spreads.**
- **We expect the ECB support to credit markets to remain beyond 2022, making corporate bonds relatively resilient to the tapering debate in Europe.**
- **Moreover, the fundamentals recovery is still at play, with the upgrade rate running high and the default trajectory returning fast to its long term average.**

Credit spreads have evolved in a very tight range since the beginning of the year and are currently trading at three-year tights.

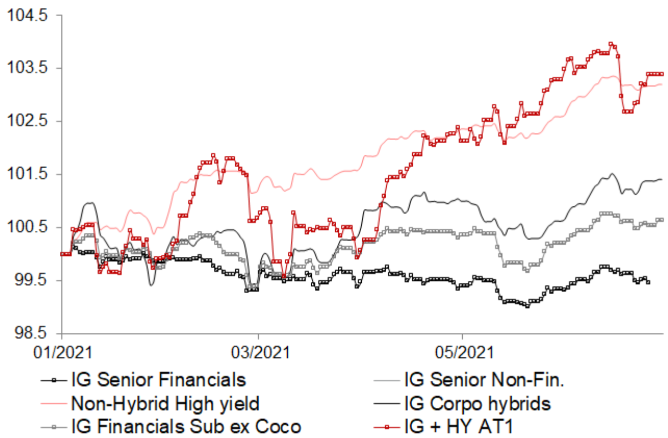
## Low volatility likely to remain in IG

ECB will keep limiting volatility beyond 2022

First, because central banks, particularly the ECB, have a strong focus on financing conditions and will try to keep volatility low. Indeed, the ECB is making most of its credit purchases in the CSPP, as part of the APP. Within the APP, it has full flexibility to allocate purchases across asset classes. If needed, there is a case for a higher share of credit purchases within the APP since the marginal euro invested has a greater stabilising power on private bonds than on public ones.

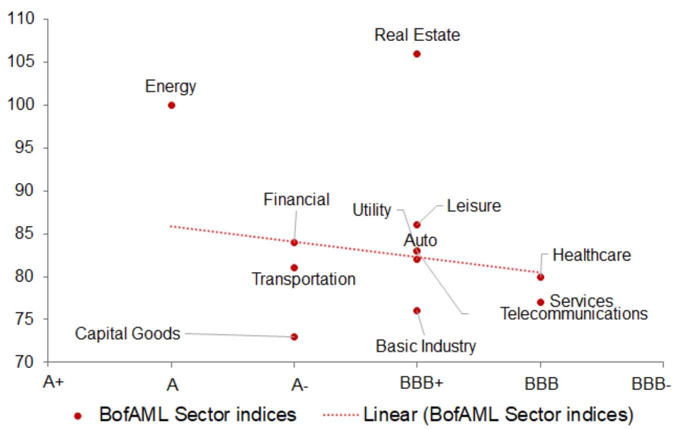
The ECB should keep the APP alive at least until 2023, unlike the PEPP that will gradually be stopped in 2022. Hence, we expect the ECB to maintain credit spreads volatility low for months to come both because it has the will and the power to do it.

Graph 1: CREDIT MARKET YTD TR PERF




100= 01/01/2021

Graph 2: EUR IG SPREAD VS RATING




OAS bp

The ECB support is critical at a time when IG credit spreads will likely post negative total returns in the months to come. It is mainly the case in the long end of the market where total returns have been close to –5% year-to-date when the Bund has peaked.

Fast improving fundamentals imply better ratings and lower defaults

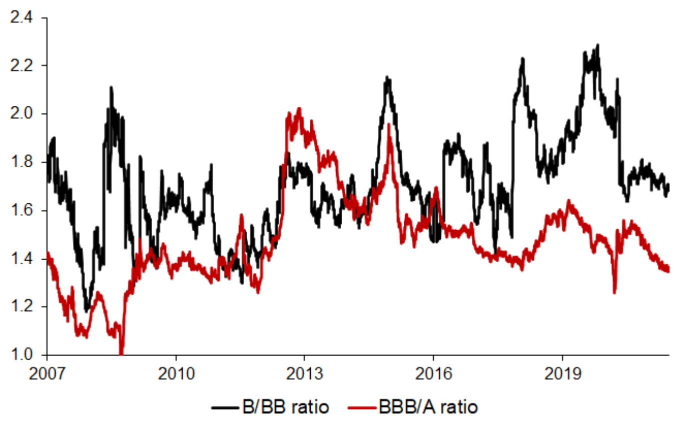
HY is theoretically less sensitive to interest rates than IG, thanks to larger spreads and shorter duration, but it is more sensitive to flows and they have been more volatile recently on interest-rate volatility.

Secondly, the fundamentals are improving extremely fast, and rating agencies already acknowledge this. There are already more upgrades than downgrades in Europe and in the US HY as shell gas producers are supported by higher oil prices.

Thirdly, we continue to expect default numbers to decline to about 3% by the end of 2021, while bankruptcies in SMEs should remain elevated throughout 2021, but not to the extent that would be a threat to the European banking sector.

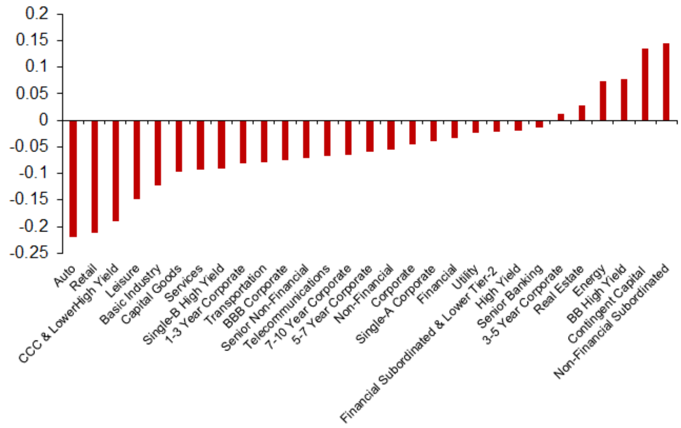
Finally, the resilience of credit spreads to interest rate volatility can mostly be explained by the still low level of real rates. They matter more to credit than nominal rates.

Graph 1: IG VS. HY VALUATION RATIOS




in Govt OAS terms

Graph 2: SPREAD PERFORMANCE VS. PRE-COVID




OAS Spread vs 22 Feb 2020 %

## Low volatility and tight valuations call for intermediate risks

Credit spreads are trading at three-year tights, and we expect them to return to the 2018 lows. We expect 10bp tightening in IG, 30bp in HY by year-end. Indeed, both technicals and fundamentals will remain very supportive.

EUR credit spreads should be more resilient than US peers as the rate move should be more contained and the support from the ECB is stronger. As we expect further upside move in UST, there might be better entry points on USD credit swapped back in EUR in September.

Within IG, BBB should remain the sweet spot as it is among the highest carry products backed by the ECB.

We continue to favour sub-ordination risk to credit risk

We remain neutral on financials versus non-financials, and we keep an OW recommendation on cyclical sectors to benefit from the robust recovery, including most Covid-affected sectors.

Among HY, we retain our preference for BBs, as they seem to be more attractive from a valuation standpoint, and may benefit from new LDI inflows.

Hybrids are probably the best quality yield in European credit markets, as they have been much more resilient than pure HY throughout Covid. Corporate hybrids trade very close to senior BBs, while AT1s are almost in line with single-Bs.

In terms of duration, we favour a neutral positioning to benefit from potential spread tightening with limited exposures to steeper rate curves.

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# EM sovereign credit

- The tug of war between higher core rates and the EM environment is more balanced, but total return prospects for EM external debt in H2 will be meagre.
- Spreads will tighten further but only modestly. Risk premia is low, and most of the tightening has occurred. We would expect volatility to increase in mid-Q3 with the Fed Taper discussion.
- Thus, we reduce risk further and continue to favour EM BB and EM BBB in a rising rate environment. In the IG space, we continue to favour short duration names and high cash price bonds that offer a higher convexity.
- Region-wise, we maintain our OW EMEA, MW Asia while LatAm should remain under pressure.

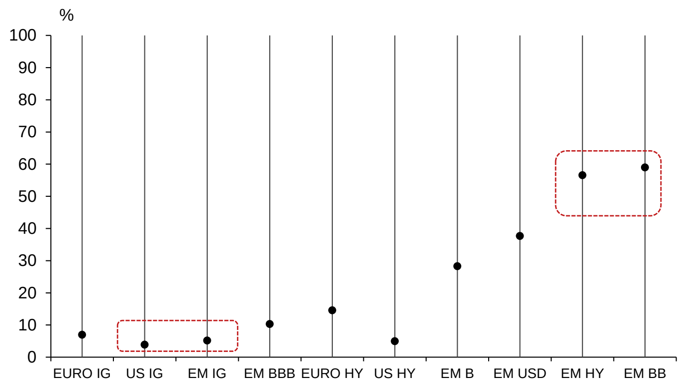
Valuations are tight and room for further spread compression is limited

The EM environment has been improving with the acceleration of the vaccine rollout and a noticeable growth pickup in EMEA and LatAm. Most of the negative news has been priced in, and the tug of war between the rise of the US rates and the EM environment is more balanced than in Q2. However, the total return for EM external debt until the end of the year will be meagre: the bulk of the spread tightening has already passed, and EM spreads are only a few basis points from our year-end target. The surprising stabilisation of US rates has essentially driven the recent performance of EM EXD. The expected rise of US rates will be the ultimate judge of the final performance given the current low-risk premia. The low level of spreads provides a limited buffer against a rise in core rates. With the growing probability of more discussion about a Fed Taper, we would expect volatility to increase in mid-Q3.

## Mind the core rate rise: favour EM BB and EM BBB

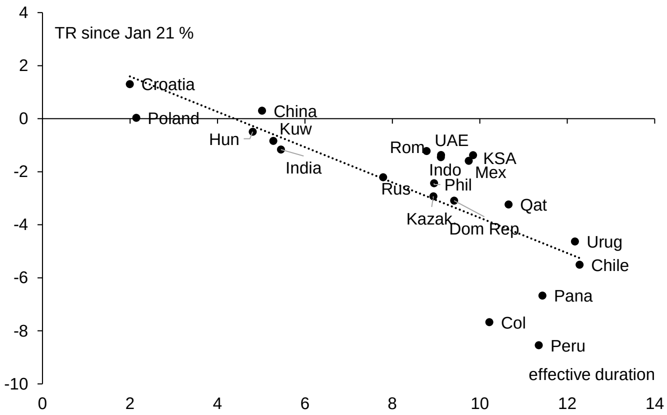
In a riskier and higher rates environment, EM external debt remains more a carry play than a directional play, and so we will continue to favour relative value trades.

Graph 1: LOW RISK PREMIA FOR EM EXD




Percentile since 2010, OAS

Graph 2: LONGER IG DURATION NAMES UNDERPERFORM




EMBIG-D, YTD total return

We reduce risk and favour EM BB and EM BBB

Firstly, we favour EM BB. EM HY valuations are less tight than EM IG, and it offers a larger buffer in a rising rate environment. However, EM HY should not be completely immune to a rise in yields driven by the real yield component. Thus, we reduce risk, focus on the EM BB's best-rated names, and avoid CCC and below names. Fiscal issues are still relevant and, almost half of EM countries will see a wider fiscal deficit in 2021. G20 Common framework will also continue to fuel anxiety in the low-rated space as the process remains unclear. Secondly, the EM IG-HY will lose momentum, and we increase our exposure to EM BBB given the expected risk rise. EM BBB has been lagging year-to-date, but the selection must be rigorous given the duration risk.

LatAm is facing a busy political cycle and a weak fiscal outlook

Thirdly, in the IG space, we continue to favour short-duration names and high cash price bonds that offer a higher convexity and thus better protection to higher core rates. More specifically, we still like Romania 10Y EUR in the IG space, benefiting from better fiscal prospects. Likewise, Mexico is cheaper in terms of spreads than its peers, and the downgrade risk is more remote. In Asia, the Philippine long-end has been lagging. Finally, EM USD bonds have turned more attractive in yields, but we still prefer EM EUR bonds. Duration is lower, and the risk of higher EUR rates is less critical. For a similar issuer and maturity, EUR bonds still offer a larger pickup over USD bonds.

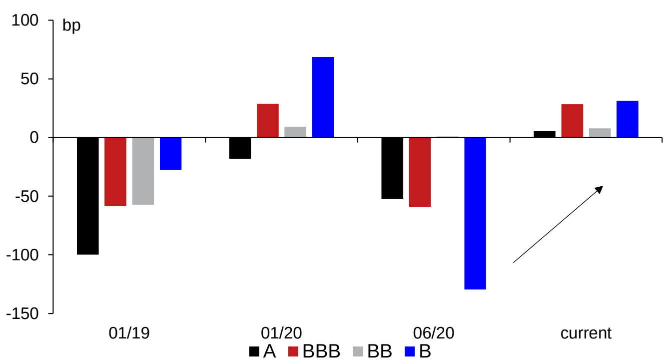
## EMEA in favour while LatAm is under pressure

Region-wise, we are OW EMEA, MW Asia, exhibiting tight spreads and a growth slowdown following China. More importantly, we are UW LatAm facing a busy political cycle that can negatively impact economic and fiscal policies. The fiscal outlook is still challenging while the sanitary situation has been deteriorating. In Peru, it is too early to initiate long positions, in our view. Uncertainty is too high on the election results and the subsequent fiscal policy. We continue to avoid Colombia. The latest fiscal developments are not yet enough but valuation starts to be attractive. In Chile, the Constitutional reform is a protracted risk only, but tight spreads and long duration are not supportive. On the positive side, it is worth highlighting Mexico, where constitutional reforms and rating downgrade risks have declined. Even in Brazil, the fiscal situation has been improving temporarily, but structural issues remain.

## Welcome help from technicals

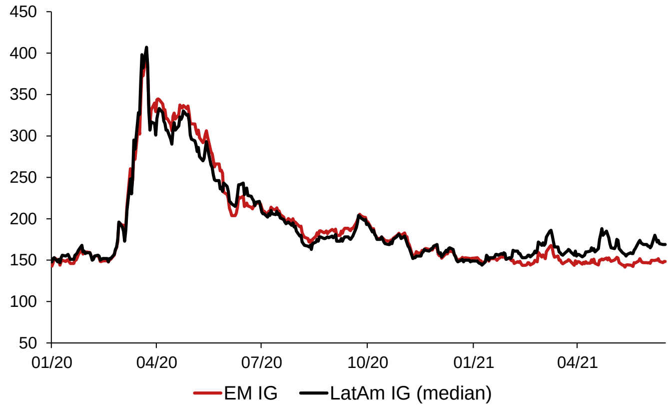
Technicals will provide welcome support. Sovereign issuance will likely come lower, around USD200bn, driven by MENA countries (higher oil prices) and lower fiscal deficits than expected. Surprisingly, the latest HY issuances have been well absorbed, and secondary market performance was strong despite the new Fed's rhetoric. Investors' appetite has been resilient, and fund inflows have modestly abated. Even if a rise in core rates could lead to outflows from opportunistic investors, we expect structural and long-term EM investors' demand to remain.

Graph 3: EUR BOND OFFER A BETTER PICKUP




ASW FX hedged issuer and maturity matched, 375 bond pairs

Graph 4: LATAM DIVERGENCE DRIVEN BY LOCAL FACTORS




EMBIG-D, OAS bp

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# Currencies

- The Fed's hawkish twist in June has reanimated the USD. Indeed, the reinterpreted AIT policy framework no longer adds to our case for a weaker USD; we trim our EUR/USD targets.
- Yet, the USD bounce is unlike to prove a trend reversal. The global recovery still has legs, bearing more headwinds for the countercyclical USD.
- Conversely, we see some upside for the still cheap euro into the economic reopening. The trade-weighted EUR has been trending sideways since last summer, despite the removal of tail risks like a hard Brexit. Conversely, the issuance of commonly backed safe bonds for the Recovery Fund will strengthen the euro's international role.
- We are not too worried about a renewed taper tantrum hitting EM FX, thanks to more solid valuation, more robust external positions and a more cautious Fed than in 2013. We see value in CEE currencies.

The hawkish twist by the Fed in June makes us trim our targets of USD weakness…

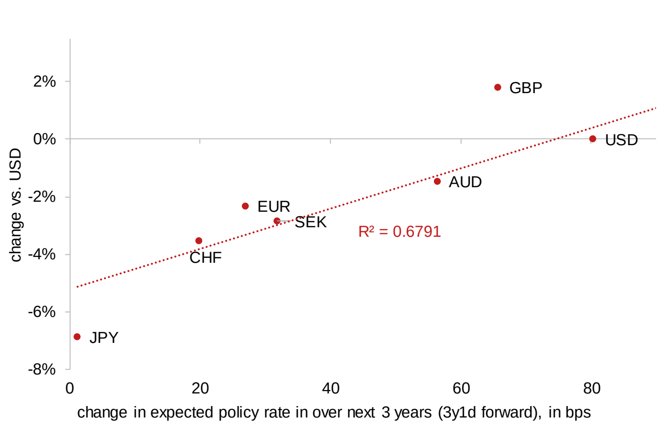
After the USD pared most of its Q1 gains over spring, the Fed's hawkish twist in June has breathed new life into the USD, underpinned by a more than 10 bps jump in 2-year US rates. The FOMC's more hawkish interpretation of its flexible average inflation target (AIT) has removed one of our pillars for our bearish USD view. A stickier spike in US inflation rates over the coming months could trigger even another move forward in the Fed's projected lift-off. With G10 FX particularly sensitive to rate expectations (Graph 1), USD bulls may count on further support from the Fed.

## Fed's hawkish twist eases, but not reverses headwinds to USD

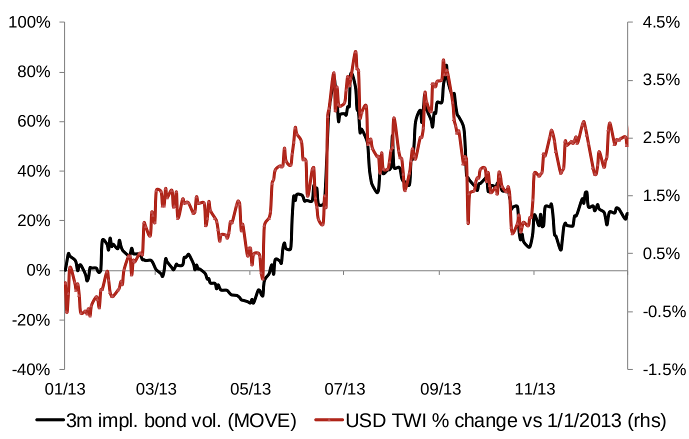
… while the FX effects from the tapering discussion should prove more transitory.

That said, the two rate hikes now embedded in the Fed's projections match our own expectations. This is later than the lift-off in late 2022 price by markets, limiting the further rate surprise potential. The USD may benefit from the nascent debate about tapering the Fed's monthly US$ 120 bn asset purchases over summer. The 2013 experience, however, suggests that USD support will peak with rates uncertainties, not yield levels (Graph 3). Thus, the more carefully the Fed will communicate its taper

Graph 1: G10 RATES EXPECTATIONS AND FX




Graph 2: USD PEAKED WITH BOND VOL IN 2013 TAPER TANTRUM




Performance/changes are year-to-date (as of June 23)

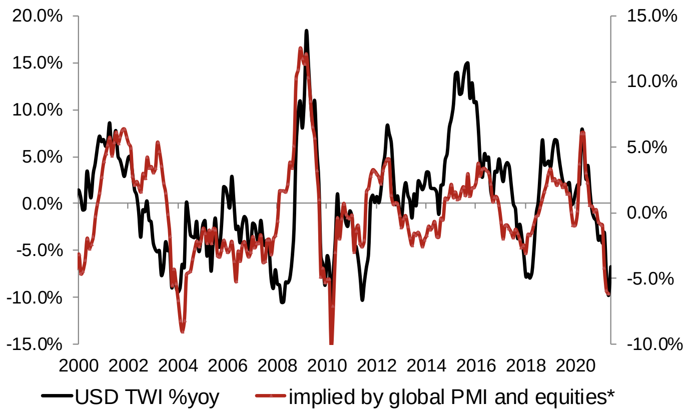
intentions over the coming months, the less pronounced and lasting we expect the resulting USD support.

Yet USD crosscurrents from other angles will still prove strong over the coming months. The global economic rebound will be a powerful headwind for the anticyclical USD over the coming months (Graph 3) just as the safe-haven appeal of the greenback may erode further amid easing of policy uncertainties under the Biden administration. We also expect continued diversification of global FX reserves out of the USD while the US exceptional twin deficit (fiscal & C/A) of almost 15% of GDP neither bodes well for the USD. Thus, despite a less dovish Fed, we do envisage some further USD weakness (about -2% for the USD TWI over the next 12 months). This should also be reflected in a lower USD/JPY in the medium term on more favourable Japanese real yields. Short term, however, a delayed recovery and higher US yields still leave the risks tilted towards some further yen weakness.

Amid eased tail risk, the euro will benefit from the euro's recovery and by higher capital inflows

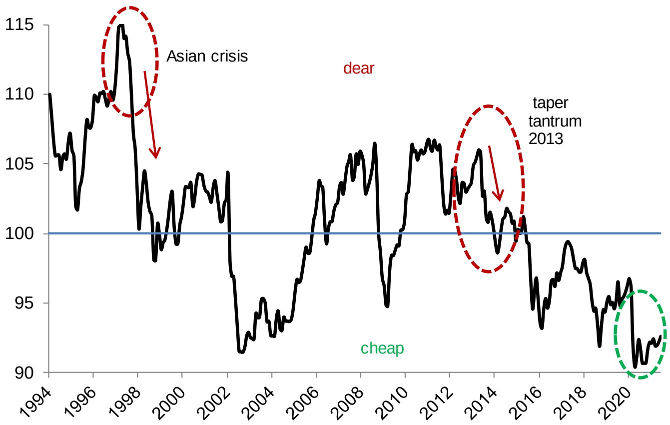
Conversely, mounting confidence in the economic rebound may trigger the next leg higher for the cheap single currency. The trade-weighted euro has been little changed in trade-weighted terms since last summer despite significantly reduced tail risks: A hard Brexit is off the table and a pro-European Italian government addresses structural challenges. Progress on the Recovery Fund is not only ensuring continued fiscal support in most battered parts of the EU; the issuance of commonly backed safe bonds will also strengthen the euro's international role. The euro area's C/A surplus of about 3% of GDP this year implies persistent capital inflows seconded by solid net FDI and improving net equity flows. Consequently, while we lowered our EUR/USD outlook on more hawkish Fed signals, we still see some upside back towards the lower 1.20s by year-end. We also expect EUR/CHF to trend higher amid rising Bund yields and, with less conviction, a moderately higher EUR/GBP amid a diminishing vaccination lead.

Graph 3: HEADWINDS TO USD FROM GLOBAL RECOVERY




*USD TWI model 2000-2019 based on MSCI World %yoy and global man. PMI;

Graph 4: EM REAL EFFECTIVE EXCHANGE RATES




avg. of 15 major EM trade-weighted exchange rates adj. for inflation, long-term avg. = 100

We are not too worried about a taper tantrum hitting EM FX, as valuations and external balances look more robust than in 2013.

Concerns about the impact of a Fed tapering have brought EM currencies into the spotlight. In 2013, the taper tantrum and sharper rise in US yields had triggered an EM FX slide, with vulnerable countries particularly hit. Notwithstanding, we keep a moderately constructive view. First, the Fed will be keen to avoid communication mishaps as in 2013, keeping any rebound in yields smoother. Second, fundamentals for EMs are generally more solid. Admittedly, fiscal debt has risen noticeably, but sustainability concerns are partially offset by the decline in prevailing yields. And unlike in 2013, when C/A deficits made several EMs vulnerable to capital withdrawals, external balances are generally not a source of concern. Finally, real effective EM FX look rather cheap today (Graph 4). We particularly like CEE currencies, which will benefit from the European rebound, the need to tighten monetary policies and a beta to a higher EUR/USD.

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# Equities

- In the last 3 months equities rallied as the ongoing policy support added to a surging earnings momentum. As yields stayed low, the EMU index came out aligned to the S&P500 while the Nasdaq outperformed.
- Stocks can survive an orderly rise in bond yields as the equity yield still offers a good premium versus real bond yields.
- The ongoing earnings rebound will offset a modest pullback in PEs, producing positive total returns in the range of 3-5% over 12 months. We go overweight Europe and EM at the expense of US.
- That said, both the policy support and economic confidence are close to peak. Positioning remains high, along with investors' confidence in Value and Cyclical sectors.
- For this reason, our suggested sector allocation is getting more prudent. We decrease our OW in the Value style (banks, div. financials, and energy), and we brought to OW Food, Household, and Software where we see rebounding earnings revisions, positive quant signals and bottoming relative PEs. We think this phase of the cycle merits a greater diversification and higher weight to more secure sectors.

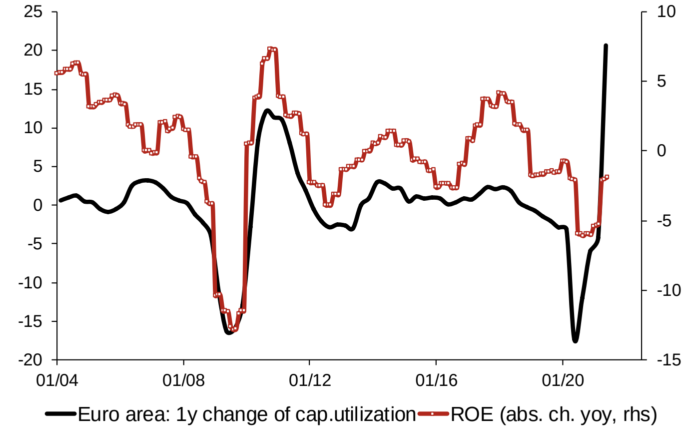
Lingering low yields favoured equities but put rotation into Value on hold

In the last 3 months equities rallied further. Policy support lingered and earnings rose appreciably while yields haven not killed the party yet. The EMU index came out aligned to the US one (a total return of nearly +10% for both) against expectations of a euro area's (EA) superior performance. The Nasdaq outperformed (+12%) as US 10-year yields declined, favouring Growth against Value. Overall, 12-month forward earnings estimates increased by 10% and only +2% for the less cyclical Swiss index (SMI). Year-to-date, 12-month earnings revisions outrun equity indices' total returns by 4% to 8% (in the EA and the US, respectively) rendering slightly lower PEs.

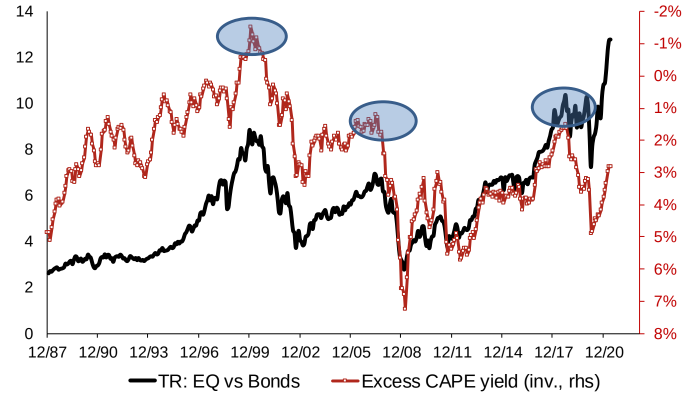
## Equity yield still offers a good premium versus real bond yield

Notwithstanding high market multiples, the current US CAPE yield gap indicates still decent equity yields as compared to the real 10-year bond yield. CAPE (cyclically-adjusted PE) takes an average of 10-year deflated earnings at denominator. The inverse ratio (1/CAPE) is the CAPE yield from which the real bond yield is subtracted

Graph 1: EURO AREA CAPACITY UTILIZATION AND ROE




Graph 2: US EQUITY TOTAL RET. VS BONDS AND EXCESS CAPE YIELD *




* real earnings yield minus real rate, using 10 yr avg for CPI and earnings

to get the excess CAPE yield (ECY). Currently, the ECY is higher (more attractive) than those experienced prior to market crises in 2000, 2008 and 2018. Our long-term models and targeted risk premium (based on historical average during periods of similar inflation to the current one) show the same result and come up with a positive total return of 3-5% for the next 12 months. Accordingly, we think equity still offers

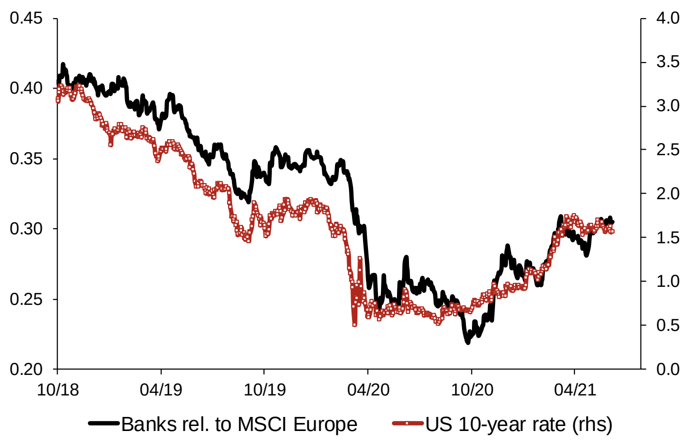
Excess equity yield (ECY) still far from the pre-crisis levels in 2000, 2008, and 2018

value versus bonds. Does it mean that there are no risks? Of course, not. To begin with, the economic recovery is well advanced and, while GDP has still scope to increase above potential, confidence indicators might be next to peak. Second, the Fed is slowly changing stance and most probably both the fiscal and the monetary stimulus have already seen their maximum expansion. Furthermore, rising inflation and real yields (which we forecast) will most probably reduce PEs. In sum, we are getting more cautious on equity but still keeping an overweight. Indeed, volatility is decreasing, and earnings growth remains upbeat. With increasing capacity utilization, firms can achieve higher margins notwithstanding higher input costs. We see an earnings growth for the EMU index of nearly 50% this year and 13% the next, +40% and 10% in the US.

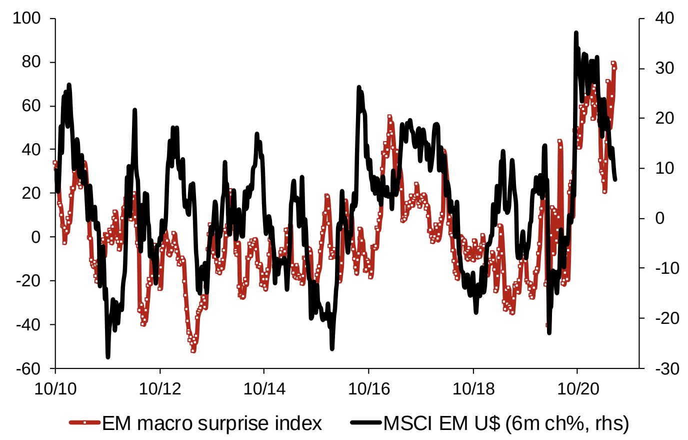
## Equity allocation getting more defensive

We have recently turned more cautious due to the cited almost peaking confidence indicators, increasing inflation and probable lower PEs in addtion to high investor positioning. We still think that the EA has chances to outperform the US, as higher yields will benefit financials, economic growth is rebounding fastly, and valuations

Graph 3: EU BANKS REL. TO MSCI EUROPE AND US 10-YEAR YIELDS




Graph 4: EMERGING MARKETS AND MACRO SURPRISES




We OW EU vs US, Value, Staples and Software.
EM equities: we expect a total return of 5.7% in euro over the next 12 months

stay lower. We stay OW also in Japan, UK and marginally in the EM. Inside Europe, we are suggesting an increasingly defensive sector allocation. We decreased our OW in the Value style (banks, div. financials and energy), and we brought to OW, in particular Food, Household, and Software. Here, we observe rebounding earnings revisions, positive quant models and bottoming relative PEs. We think this mature phase of the cycle merits a higher diversification and higher weight in more secure sectors.

### EM: to benefit from supportive global backdrop

After having reached a cyclical low, earnings revisions stabilized and the current EM performance is lagging significantly its earnings' one. EMs show relatively attractive market multiples, even adjusted for the expected growth in the next 3 years. In the short term, the EM market would also benefit from favourable financial conditions, higher macro surprises and improving investors' sentiment. A mildly weaker US dollar and higher commodity prices in the mid-term will add to the positives. Within the EM universe, we favour Korea, India, Poland and Taiwan.

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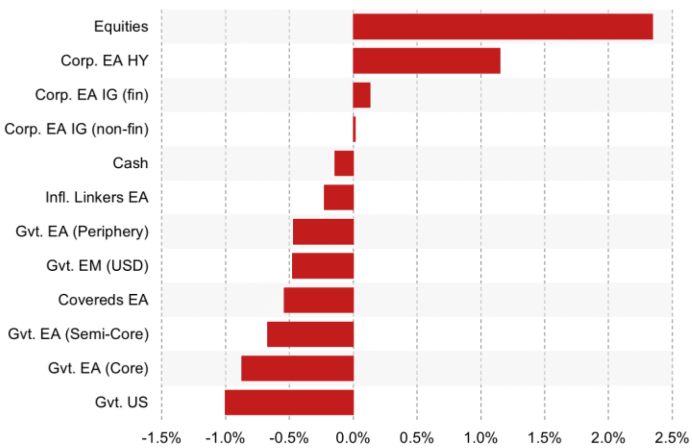
# Asset Allocation

- **Backed by an ongoing Covid-19 vaccination success, the 2021 recovery is getting more dynamic in Europe compared to the US. Europe is expected to face a bright summer, given reopening services, a strong pent-up demand, excess savings and extended policy support.**
- **Issues arising from supply bottlenecks are constrained to the manufacturing sector. They are not expected to jeopardize the cyclical rebound, as pent-up demand will shift from consumer goods to services.**
- **Core yields will rise moderately given the lingering worries about overheating and rising tapering concerns in the US.**
- **The strong macro momentum, the still dovish central banks, the vaccination progress, and Europe reopening still support risk assets. Furthermore, with real yields still being low, expected bond returns cannot keep up with those seen for equities.**
- **On balance, we confirm our TAA recommendation, still favouring (but slightly reducing) EA credit and equities over government bonds. We prefer a short stance on duration but increase the cash portion of the portfolio. USD exposure should be hedged.**

Primarily driven by a strong equity performance as well as a rise in core yields, our model portfolio roughly generated another +35bps of outperformance in the second quarter of 2021 so far. The overweight in equities and the underweights in EA core government bonds as well as in US Treasuries continued to pay off particularly well.

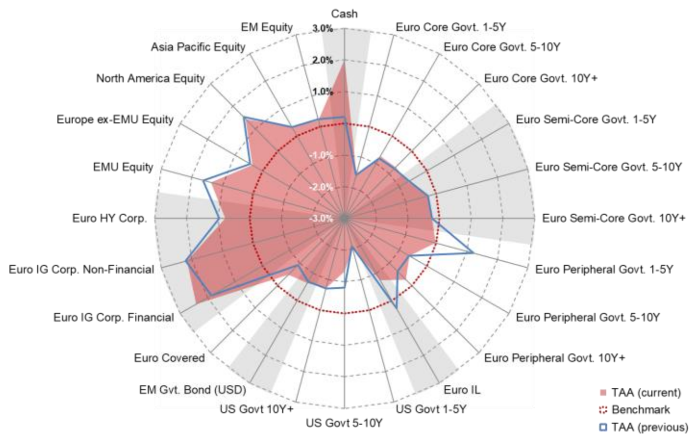
The Covid-19 pandemic will continue to have a significant impact on the financial markets. Over the summer, however, the improved economic framework conditions should first and foremost make themselves felt. The reopening of services, made possible by the progress of vaccination and the sharp decline in the number of infections, should pave the way for the pent-up demand to unfold its full potential. Risks arising from concerns about overheating and tapering in the US mainly affect the fixed income markets.

Graph 1: AGGREGATED TOTAL RETURN FORECASTS




Hedged into EUR

Graph 2: BALANCED MtM MODEL PORTFOLIO (ACTIVE POSITIONS)




In pp; Semi-Core = Spain; Periphery = Italy

Equities and EA HY still most attractive from a total return perspective

On balance, the risk-assets-supportive environment remains intact, at least in the short term. We thus basically confirm our overweight positions for equities and EA Credit which we still deem most attractive from a total return point of view. Favouring a short duration, we also recommend expanding our OW position in Cash. Resuming capital flows to Europe into the recovery will support the EUR an add to the various headwinds the USD is facing. We thus recommend hedging USD exposure.

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# Forecasts

GROWTH

| | 2019 | 2020 | 2021 forecast | 2021 Δ vs. cons. | 2022 forecast | 2022 Δ vs. cons. |
|---|---|---|---|---|---|---|
| US | 2.2 | - 3.5 | *7.5* | 0.9 | *4.7* | 0.5 |
| *Euro area* | 1.3 | - 6.7 | *4.6* | 0.4 | *4.5* | 0.2 |
| Germany | 0.6 | - 5.1 | *3.6* | 0.3 | *4.4* | 0.3 |
| France | 1.8 | - 8.0 | *5.6* | 0.1 | *4.2* | 0.3 |
| Italy | 0.3 | - 8.9 | *4.6* | 0.4 | *4.2* | 0.0 |
| *Non-EMU* | 1.6 | - 7.6 | *5.7* | 0.5 | *4.6* | - 0.1 |
| UK | 1.4 | - 9.9 | *6.8* | 0.8 | *5.3* | - 0.1 |
| Switzerland | 1.1 | - 2.7 | *3.3* | 0.0 | *2.9* | 0.0 |
| Japan | 0.0 | - 4.7 | *2.2* | - 0.6 | *3.1* | 0.5 |
| *Asia ex Japan* | 5.3 | - 0.8 | *7.4* | - 0.6 | *5.5* | - 0.2 |
| China | 6.4 | 2.3 | *8.4* | - 0.3 | *5.4* | - 0.2 |
| CEE | 2.2 | - 1.8 | *5.0* | 1.1 | *3.7* | 0.1 |
| Latin America | - 1.7 | - 8.6 | *3.3* | - 0.8 | *2.8* | 0.0 |
| **World** | **2.6** | **- 3.5** | ***5.9*** | **0.0** | ***4.5*** | **0.1** |

INFLATION

| | 2019 | 2020 | 2021 forecast | 2021 Δ vs. cons. | 2022 forecast | 2022 Δ vs. cons. |
|---|---|---|---|---|---|---|
| US | 1.8 | 1.2 | *3.5* | 0.7 | *2.4* | 0.1 |
| *Euro area* | 1.2 | 0.3 | *1.9* | 0.2 | *1.4* | 0.1 |
| Germany | 1.4 | 0.4 | *2.5* | 0.3 | *1.6* | - 0.0 |
| France | 1.3 | 0.5 | *1.5* | 0.2 | *1.1* | 0.0 |
| Italy | 0.6 | - 0.1 | *1.1* | - 0.1 | *1.2* | 0.2 |
| *Non-EMU* | 1.5 | 0.6 | *1.6* | 0.2 | *1.7* | - 0.1 |
| UK | 1.8 | 0.9 | *1.9* | 0.3 | *2.1* | - 0.1 |
| Switzerland | 0.4 | - 0.7 | *0.3* | 0.0 | *0.5* | 0.0 |
| Japan | 0.5 | - 0.0 | *0.1* | 0.1 | *0.5* | 0.0 |
| *Asia ex Japan* | 2.7 | 2.8 | *2.4* | 0.0 | *2.6* | - 0.1 |
| China | 2.9 | 2.5 | *1.6* | 0.1 | *2.1* | - 0.1 |
| CEE | 6.6 | 5.5 | *7.6* | 0.6 | *5.9* | 0.4 |
| Latin America | 3.6 | 3.2 | *3.1* | - 0.4 | *3.5* | 0.6 |
| **World** | **2.5** | **2.1** | ***2.9*** | **0.2** | ***2.6*** | **0.0** |

Regional and world aggregates revised to 2015 IMF PPP weights; Latin America Inflation excluding Argentina and Venezuela

FINANCIAL MARKETS

| **3-month LIBOR** | **Current** | **3M** | **6M** | **12M** |
|---|---|---|---|---|
| *USD* | 0.15 | 0.15 | 0.20 | 0.20 |
| *EUR* | -0.54 | -0.55 | -0.55 | -0.55 |
| *JPY* | -0.08 | -0.10 | -0.10 | -0.10 |
| *GBP* | 0.08 | 0.10 | 0.10 | 0.10 |
| *CHF* | -0.75 | -0.75 | -0.75 | -0.75 |
| **10Y Government Bonds** | **Current** | **3M** | **6M** | **12M** |
| *US* | 1.50 | 1.70 | 1.95 | 2.15 |
| *Euro-Area* | -0.17 | -0.10 | 0.05 | 0.20 |
| *France* | 0.17 | 0.25 | 0.50 | 0.60 |
| *Italy* | 0.82 | 0.85 | 1.05 | 1.25 |
| *Japan* | 0.05 | 0.10 | 0.15 | 0.20 |
| *UK* | 0.77 | 0.90 | 1.10 | 1.25 |
| *Switzerland* | -0.20 | -0.10 | 0.05 | 0.20 |
| **Spreads** | **Current** | **3M** | **6M** | **12M** |
| *GIIPS* | 80 | 75 | 85 | 90 |
| *BofAML Covered Bonds* | 33 | 30 | 35 | 35 |
| *BofAML EM Gvt. Bonds (in USD)* | 271 | 264 | 260 | 260 |

| **Corporate Bond Spreads** | **Current** | **3M** | **6M** | **12M** |
|---|---|---|---|---|
| *BofAML Non-Financial* | 83 | 80 | 75 | 75 |
| *BofAML Financial* | 84 | 80 | 75 | 75 |
| **Forex** | **Current** | **3M** | **6M** | **12M** |
| *EUR/USD* | 1.19 | 1.21 | 1.22 | 1.23 |
| *USD/JPY* | 111 | 111 | 109 | 107 |
| *EUR/JPY* | 132 | 134 | 133 | 132 |
| *GBP/USD* | 1.39 | 1.40 | 1.40 | 1.40 |
| *EUR/GBP* | 0.86 | 0.87 | 0.87 | 0.88 |
| *EUR/CHF* | 1.10 | 1.11 | 1.13 | 1.15 |
| **Equities** | **Current** | **3M** | **6M** | **12M** |
| *S&P500* | 4,263 | 4,315 | 4,330 | 4,365 |
| *MSCI EMU* | 147.1 | 151.5 | 152.0 | 151.0 |
| *TOPIX* | 1,953 | 1,995 | 2,005 | 2,015 |
| *FTSE* | 7,107 | 7,290 | 7,300 | 7,290 |
| *SMI* | 11,964 | 12,185 | 12,290 | 12,205 |

As of 25.06.21 (3-day-average)

FORECAST-INTERVAL* – 3-MONTHS HORIZON

| | | | | |
|---|---|---|---|---|
| Government Bonds (10Y) | US | 1.39 | 1.70 | 2.01 |
| | Germany | -0.15 | -0.10 | -0.05 |
| | UK | 0.70 | 0.90 | 1.10 |
| | Switzerland | -0.13 | -0.10 | -0.06 |
| Spreads | 10Y-GIIPS Spread | 55 | 75 | 95 |
| | BofAML Covered Bonds | 23 | 30 | 37 |
| | BofAML IG Non Financial | 54 | 80 | 106 |
| | BofAML IG Financial | 46 | 80 | 114 |
| | BofAML EM (in USD) | 197 | 264 | 331 |
| Forex | EUR/USD | 1.18 | 1.21 | 1.24 |
| | USD/JPY | 108 | 111 | 114 |
| | EUR/GBP | 0.84 | 0.87 | 0.89 |
| | EUR/CHF | 1.09 | 1.11 | 1.13 |
| Equities | S&P500 | 3,975 | 4,315 | 4,655 |
| | MSCI EMU | 137.7 | 151.5 | 165.3 |
| | TOPIX | 1,842 | 1,995 | 2,148 |
| | FTSE 100 | 6,727 | 7,290 | 7,853 |
| | SMI | 11,391 | 12,185 | 12,979 |

FORECAST-INTERVAL* – 12-MONTHS HORIZON

| | | | | |
|---|---|---|---|---|
| Government Bonds (10Y) | US | 1.63 | 2.15 | 2.67 |
| | Germany | 0.10 | 0.20 | 0.30 |
| | UK | 0.87 | 1.25 | 1.63 |
| | Switzerland | 0.10 | 0.20 | 0.30 |
| Spreads | 10Y-GIIPS Spread | 53 | 90 | 127 |
| | BofAML Covered Bonds | 23 | 35 | 47 |
| | BofAML IG Non Financial | 34 | 75 | 116 |
| | BofAML IG Financial | 24 | 75 | 126 |
| | BofAML EM (in USD) | 157 | 260 | 363 |
| Forex | EUR/USD | 1.17 | 1.23 | 1.29 |
| | USD/JPY | 100 | 107 | 114 |
| | EUR/GBP | 0.82 | 0.88 | 0.94 |
| | EUR/CHF | 1.11 | 1.15 | 1.19 |
| Equities | S&P500 | 3,813 | 4,365 | 4,917 |
| | MSCI EMU | 128.5 | 151.0 | 173.5 |
| | TOPIX | 1,740 | 2,015 | 2,290 |
| | FTSE 100 | 6,352 | 7,290 | 8,228 |
| | SMI | 10,866 | 12,205 | 13,544 |

*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5 year history of percentage changes, equally weighted in the case of the 12-month forecast and exponentially weighted in the case of the three month forecast. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

# Imprint


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