UniCredit Wealth Management

Monthly Outlook

March 2021

Rising Prices

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Rising Prices

CIOs Letter

Rising Prices

The upward trend in stock markets appears to be continuing – although it is repeatedly interrupted by temporary setbacks. At the end of January, the effects of a veritable "short squeeze"* due to short selling in stocks such as Gamestop caused momentary volatility. And at the end of February, it was burgeoning inflation fears that caused bond yields to rise noticeably and interrupt soaring equities.

From an economic perspective, the rise in interest rates and yields is indeed significant, as it reflects the expectation that the economy will gradually recover from the pandemic shock and pick up speed again. When growth returns, this is accompanied by a rise in inflation, which pushes up nominal interest rates. Two things are important here: first, the development of yields relative to inflation and, second, the growth paths in Europe and the US. If yields rise in tandem with inflation (or inflation expectations), real yields remain unchanged. They are currently negative in both Europe and the US. However, if yields rise faster than inflation expectations, the real yield rises (or becomes less negative). Against the backdrop of the still difficult economic situation caused by the pandemic, such a development is unlikely to be welcomed by central banks, as it will make the financial environment more restrictive. This applies in particular to the European Central Bank (ECB), as the recovery of the European economy appears to be lagging behind that of the US. On the other side of the Atlantic, inflation expectations are therefore more pronounced and more persistent; on this side of the Atlantic, on the other hand, only a temporary overshoot is expected this year before inflation rates fall back to well below the ECB's target.

It is therefore to be expected that the development of interest rates in Europe, also as a result of the ECB's ongoing bond purchases, will move onto a fundamentally justified path beyond the short term. And this means that interest rates will remain low in the longer term and real yields will remain in negative territory.

European equities in particular should benefit from such a development. As vaccination rates rise, the economic impact of the pandemic should gradually diminish. At the same time, European companies have a stronger catch-up potential compared to their US counterparts. The consensus expects earnings growth of 35% for European equity indices in the current year, compared with just over 20% in the US. This trend should continue in subsequent years. At the

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same time, valuations, i.e. the price/earnings ratios, have not risen as much in Europe as in the US. The risk of a valuation setback is therefore lower in the Old Continent.

In any case, the risk of major price setbacks in Europe should be limited if the economic situation develops as expected. Individual valuations are certainly high, but a price decline against a gradually recovering economy and extraordinarily high earnings growth is rather unlikely. We are therefore sticking to our strategy of significantly overweighting equities compared with bonds.

However, the upward trend is not a one-way street. As the start of the year has shown, there are likely to be temporary setbacks again and again if, for example, inflation worries swell again, or the continuation of monetary policy is questioned, or a possible third coronavirus wave potentially puts the economy back into a stranglehold. However, the primary trend for equities is likely to remain upward. Higher volatility, however, makes professional investment advice even more important.

*A "short squeeze" occurs when the supply of shares that were sold short at an earlier point in time ("shorted" with a forward sell without owning the shares first), suddenly again sloughed. The short sellers then see themselves forced to buy the papers sooner than later (because they are becoming more expensive) in order to meet delivery obligations. The renewed increase in demand from short sellers causes the share price to rise.

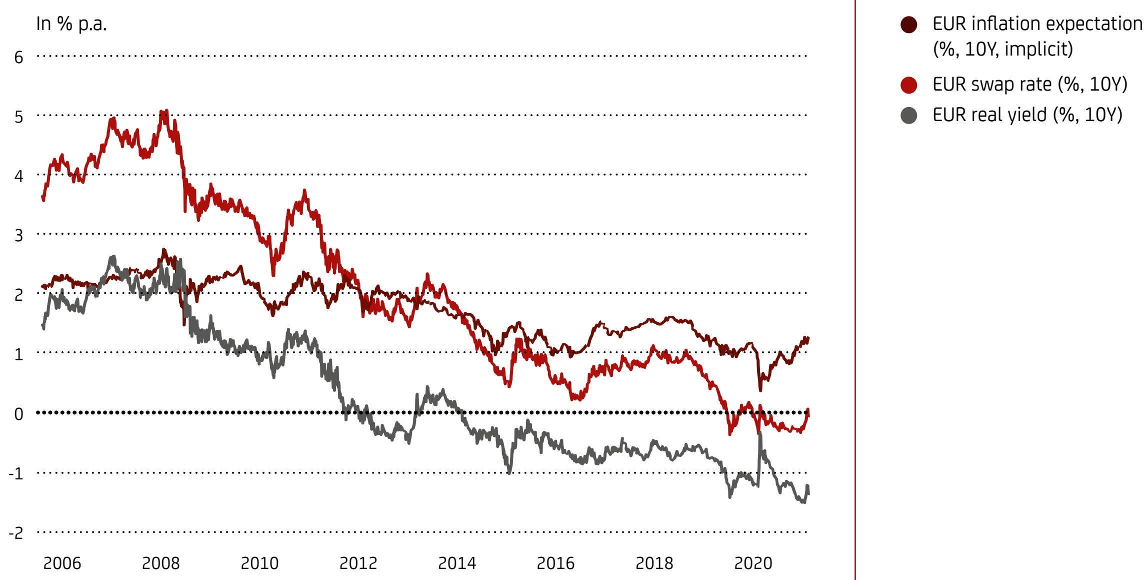
In Focus

What do rising inflation expectations mean for investors?

Since the beginning of the year, yields on longer-dated government bonds have been pointing upward across the board. At the end of February, for example, the 10-year Bund yield was -0.23%, more than 30 basis points (bps) above the level at the end of 2020 (-0.57%). The corresponding rise in yields on 10-year US government bonds was even more dramatic at more than 60 bps to the current level of 1.55%. It was driven on both sides of the Atlantic by a significant rise in inflation expectations. The following two charts illustrate the development and should help to place the events in their historical context.

For shorter maturities, however, the rise in yields was more subdued.

1. YIELDS AND INFLATION EXPECTATIONS (10Y) FOR THE EURO AREA

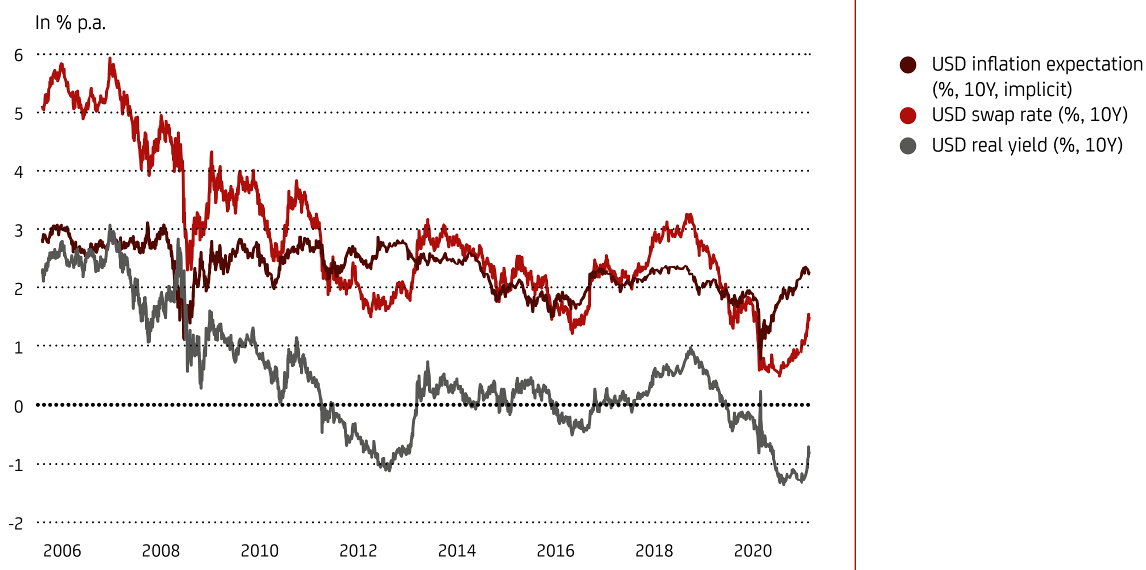


Source: Refinitiv Datastream, UniCredit Wealth Management

The first graph shows the 10-year swap rate as a measure of the average risk-free yield in the euro area. We prefer it to the government bond yield, as the latter is only available for individual countries and not, like the swap rate, EMU-wide. Inflation expectations over the next 10 years are derived from the prices of so-called inflation swap contracts. These are average annual rates (implicit expectations). The real yield is calculated as the difference. Since the inflation rate is higher than the swap rate, it is in negative territory. As of the end of February, it was -1.25%. This means that investors who invest with a time horizon of 10 years at the corresponding swap rate (0.03% p.a. as of the end of February) and inflation develops across the EMU over this period as expected at the current margin (1.28% p.a.), this results in a loss of purchasing power of 1.25% per year. The chart also shows that real yields have been negative since 2014 and have not really increased recently despite a significant rise in the swap rate.

In the US, real yields fell into similar regions in the wake of the pandemic (chart 2). However, both the underlying swap rate and inflation expectations are at a significantly higher level. Moreover, in the six years leading up to the pandemic, real yields traded above EMU levels and were mostly above the zero line. In recent months, however, the development has resembled that in the euro area. Nominal yields were pulled up by a noticeable rise in inflation expectations.

2. YIELDS AND INFLATION EXPECTATIONS (10Y) FOR THE US



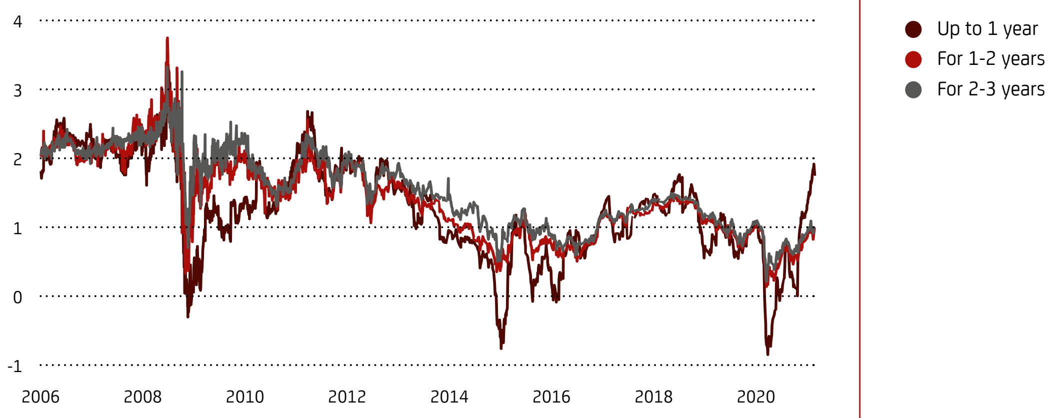
Source: Refinitiv Datastream, UniCredit Wealth Management

However, chart 3 shows a clear difference between the US and the euro area, which is crucial for assessing the situation. In the first two charts, we used the average expected inflation over a rolling 10-year period, which matched the time horizon of the swap rates. At the same time, the market expectations for inflation in the individual annual slices can also be derived from the underlying inflation swaps.

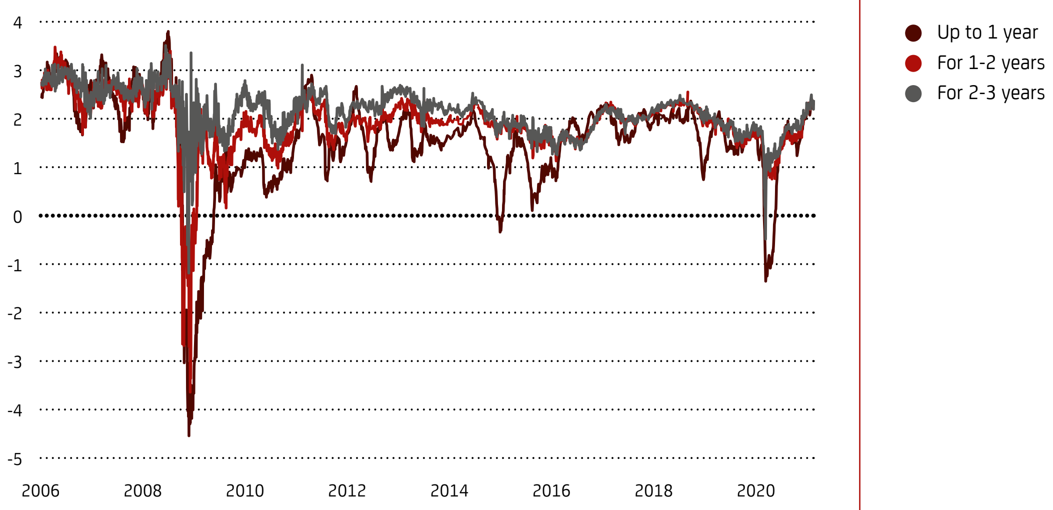
While a sharp rise in inflation is expected in Europe in the current seasonal slice (to around 2% p.a.), inflation activity should cool down again in the following years and return to around 1% p.a. The increase in the current year is therefore more likely to be of a one-off and driven by catch-up effects – which will quickly fade out again. In the US, by contrast, consumer price expectations are pointing noticeably upward in this and the following years. There, unlike in the euro zone, persistent inflation of over 2% is therefore to be expected.

3. IMPLICIT INFLATION EXPECTATIONS FOR 2021 AND SUBSEQUENT YEARS

EMU inflation expectations (implicit, in % p.a.)



US inflation expectations (implicit, in % p.a.)



Source: Refinitiv Datastream, UniCredit Wealth Management

What does this mean for investors? If inflation rates exceed investment returns, investors will have to cope with a loss of purchasing power. The risk of this is currently quite high in both the euro zone and the US. And even if inflation rates in our countries decline again in the coming years as expected, a corresponding loss of real value remains very likely, at least in the coming months. In addition, safe investments in fixed income securities still mean price losses in an environment of rising yields.

Conversely, negative real yields support the valuation of risky assets such as equities, especially as rising inflation expectations are due to expectations of a tangible economic recovery, not least as a result of a medical solution (mass vaccinations) to the pandemic. This means that any setbacks in equity valuation due to rising yields can be cushioned by rising corporate earnings expectations.

From an investor's perspective, equities thus remain significantly more attractive than fixed income securities, including cash, with zero or even negative interest rates.

Macro & Markets

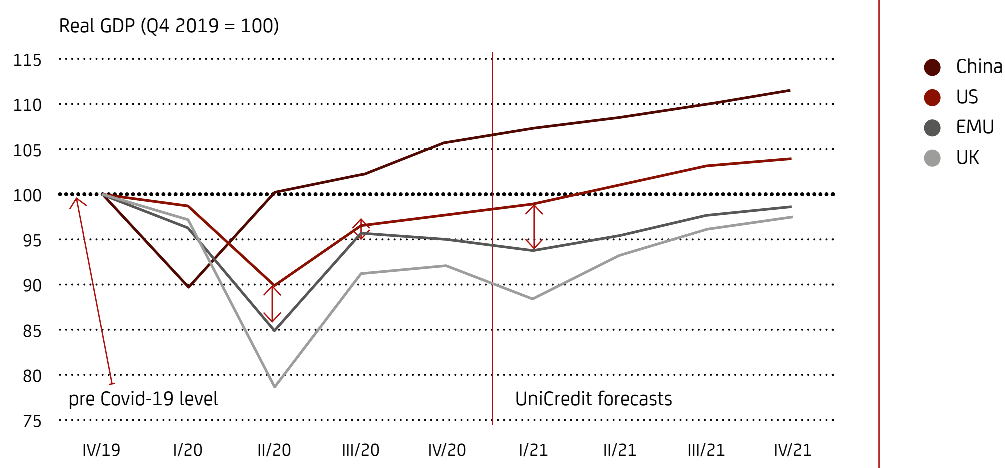
The widening transatlantic gap: US powers ahead

Fiscal policy makes the difference

Superior crisis management coupled with rapid and massive fiscal policy stimuli - these were the two key reasons that drove our forecast a year ago for Europe's economy to grow out of the Covid-19 crisis faster than the US. And this was indeed the case, initially. Last summer, EMU-wide economic output grew much faster than US GDP. The transatlantic gap that had opened up with the tighter lockdowns in Europe last spring almost closed again (see chart 3).

In Q3 2020, real gross domestic product (GDP) in the euro area grew by 12.7%, almost twice as fast as in the US (7.4%). However, the Q2 slump in the US was less severe than in the euro area. This was due to a noticeably milder US lockdown (at the expense of public health).

4. THE US IS ALREADY OVERTAKING EUROPE AGAIN



Source: Refinitiv Datastream, UniCredit Wealth Management

However, the hope that the euro area would then be able to overtake the US didn't (and will not) realise, on the contrary. The reasons are manifold.

- Firstly, Europe was ill-prepared for the second Covid-19 wave. Politicians across Europe had failed to use the summer months to develop coherent concepts. The lead in crisis management over the US was lost.

- Secondly, European governments acted far more hesitantly last autumn than at the beginning of the pandemic. As a result, government enforcement measures had to be tightened again and again, and lockdowns were protracted – to the detriment of the economy.

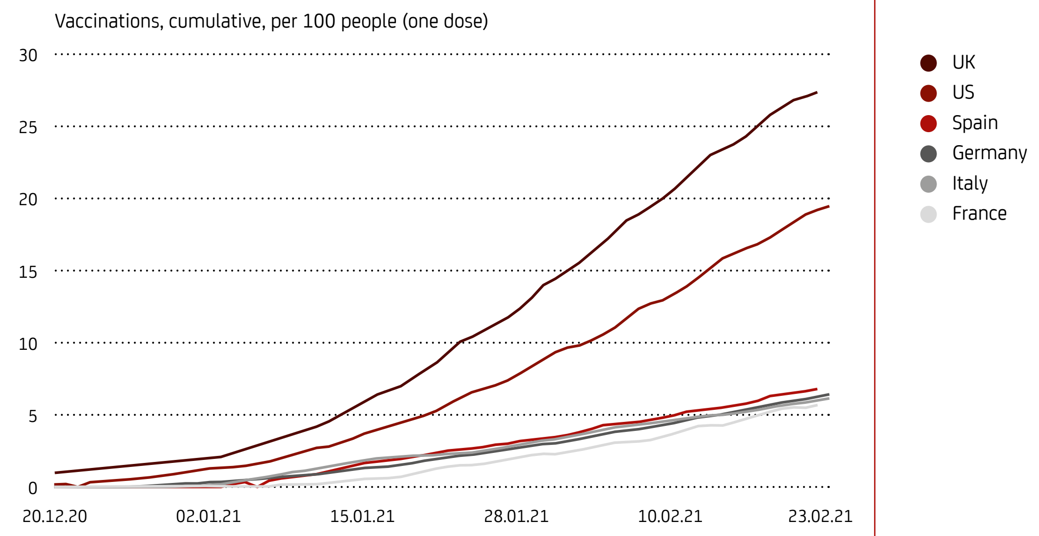
- Furthermore, there is a risk that the upcoming relaxations (as the number of new Covid-19 cases has since decreased noticeably) will soon have to be reversed against the background of the emerging third wave (highly infectious mutations). This would exacerbate the foreseeable surge of insolvencies in the service sector.

- In addition, the euro area has fallen far behind the US in terms of vaccinations. In relative terms, three times as many US people have now received their first vaccination dose as in the EMU (see chart 4).

This is especially true for Germany. Its lockdown light adopted in mid-October largely fizzled out. In mid-December, the measures had not only be extended, but tightened substantially.

In Israel, even 85 out of 100 people are vaccinated, which is 14 times more than in the euro area.

5. EMU IS LAGGING CLEARLY BEHIND



Source: www. ourworldindata.org, UniCredit Wealth Management

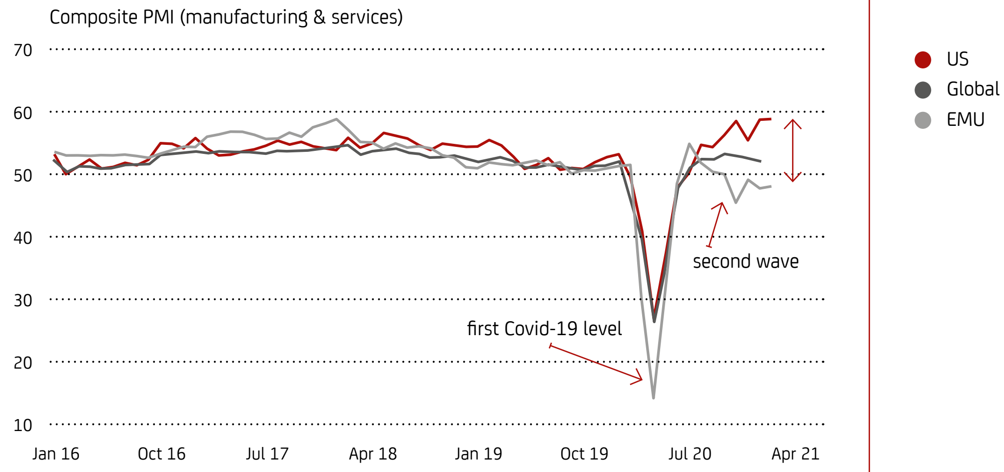
- Finally, the disbursement of financial aid has all too often fallen short of the full-bodied announcements ("bazooka"). Many enterprises and self-employed are still waiting for aid.

Therefore, it is hardly surprising that business sentiment in Europe has deteriorated again in recent months, while in the US, on the other hand, the indices continue to point north. With a good 10 points, the US lead in the highly regarded purchasing managers' barometers is almost record high. In late summer 2020, by contrast, Europe was still ahead (see chart 6). But it is not only businesses that are more confident in the US than those in the euro zone, but consumers as well.

In Germany, for example, payments of the November aid are only now really getting underway.

Compared to business people, however, consumers are still very cautious - on both sides of the Atlantic.

6. THE TRANSATLANTIC GAP IS WIDENING (I)



Source: Refinitiv Datastream, Markit, UniCredit Wealth Management

This is also reflected in hard economic data. While US GDP grew by an annualised 4% last quarter, it shrank by 2.5% in the euro area. And the gap seems to be widening further in the current quarter. In the US, for example, not only has production in the manufacturing sector risen significantly, but the housing sector is also proving to be quite robust. Moreover, initial jobless claims are declining even further. Retail sales are also heading up strongly – in real terms, they rose by more than 6% year-on-year this January (see chart 7). The stimulus checks are clearly having an effect. Approved at the end of December, they were already paid out from the beginning of this year.

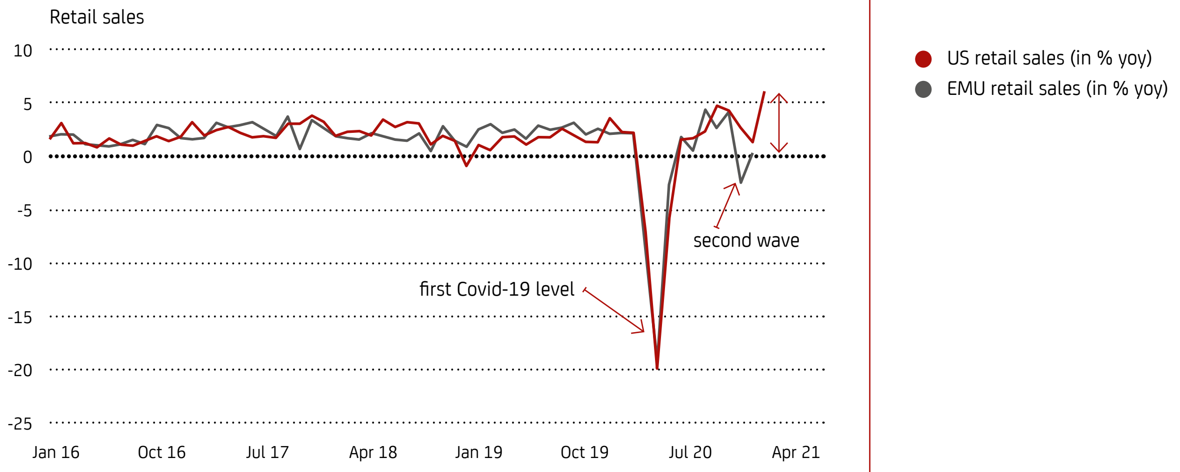
Over the past three months, manufacturing output has risen by 1% month-on-month.

In contrast to the US, retail sales in the euro area have fallen significantly since their interim high last autumn. Even if they were able to regain some ground recently, the meagre level (consumer confidence has even slumped again in the meantime in Germany) is a burden for the coming weeks. Unlike in the US, production in the manufacturing sector also declined again. The same applies to the construction sector.

It is therefore hardly surprising that, if one extrapolates the latest high-frequency data to GDP for the current quarter ("nowcast"), there are already signs of accelerating growth in the US to an annualised 5%-6%. The euro zone, on the other hand, is threatened with a further decline of 2.50%.

That would be significantly more than US growth forecast for the current quarter (4%). We therefore see considerable upside risks to near-term GDP growth.

7. THE TRANSATLANTIC GAP IS WIDENING (II)



Source: Refinitiv Datastream, UniCredit Wealth Management

US: Making do instead of spilling the beans

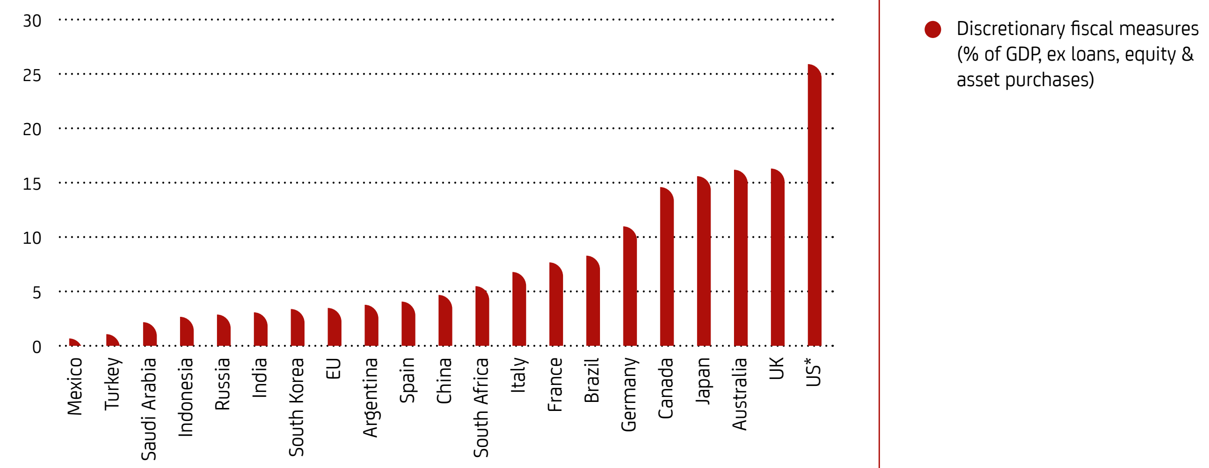
The real decisive factor behind the growing transatlantic gap, which is likely to continue in the coming quarters, is the great fiscal divide. Until last November, it was consensus view that US fiscal policy would become a brake on growth in 2021 – not because spending is being cut back, and taxes raised. All that is needed is for fiscal policy to remain expansionary but scaled back compared to last year. This, however, was precisely our expectation: under Donald Trump, there would at best be a modest new pandemic aid programme, and under Joe Biden even a far-reaching fiscal policy blockade. This may cost the US economy up to 2 percentage points of GDP growth this year, according to the consensus view up to just three months ago.

But we are far short of that. Shortly before the end of the year, Trump agreed to a second, USD944 billion Coronavirus aid package – the Response and Relief Act. What's more, as soon as he took office, Biden added another USD1.9 trillion (the American Rescue Plan). In the meantime, the Senate approved the program and it is only a matter of time when it finally passes the House as well. That alone would be just 9% of GDP – on top of the 4.5% approved in December.

In terms of discretionary Covid-19 fiscal measures (excluding government loans, equity stakes and guarantees), the US thus leave the euro states far behind (see chart 8). In terms of GDP, they have/will spend three times more than their European counterpart. Of course, EMU-wide fiscal policy also remains expansionary and many governments continue to add to it with every week of lockdown. In contrast to the US, however, we are currently doing no more than spilling the beans.

This plan calls for another round of stimulus checks to households of USD1,400 (in addition to the USD600 as part of the package passed in December), USD400 per week in extended unemployment benefits through September, USD350 billion in aid to state and local governments, an increase in the minimum wage to USD15 per hour, USD180 billion for Covid-19 vaccinations and testing, and USD155 billion for schools.

8. COVID-19 FISCAL MEASURES - US LEADS THE WAY



*US incl. the USD 1.9 trn projected Biden package
Source: International Monetary Fund (IMF), UniCredit Wealth Management

Our UniCredit Research colleagues recently calculated how far the US is likely to be ahead of the euro area this year. Taking only the two Covid-19 programmes of December and January into account and abstracting from additional spending in the context of Biden's "Green Deal", the additional US discretionary spending adds to USD2.8 trillion point. This is 6.6 times more than in the euro area (national plus EU programmes).

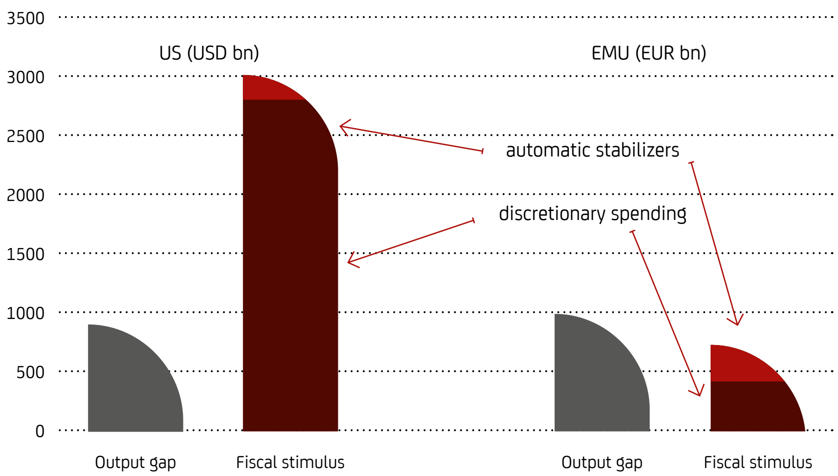
As part of his election platform, Biden proposed additional structural investments of USD7.5 trillion over the next 10 years.

Even more impressive, however, is the comparison of fiscal spending with the respective output gaps, i.e. the difference between aggregate supply and demand. Our colleagues estimate the US output gap at around USD900 billion. It is somewhat higher in the euro area because the crisis not only hit the economies harder (through tougher lockdowns), but the region already entered the crisis with a shortfall – which was not the case in the US.

For the details of the great fiscal divide, see our Group Chief Economist & Global Head of CIB Research, Erik F. Nielsen: "The mind-boggling difference in approach to the crisis", Chart of the Week as of Feb. 10, 2021.

9. USA VERSUS EMU: MAKING DO RATHER THAN SPILLING THE BEANS

2021: Planned fiscal expenditure and output gaps in comparison



Source: UniCredit Research

Closing the output gap as soon as possible is the foremost task of a counter-cyclical fiscal policy. The US is more than living up to this claim this year. In view of the great uncertainties about the progress of the pandemic and the economy, and also the level of fiscal multipliers in a crisis, it is certainly advisable to do too much rather than too little in terms of economic policy.

Against the backdrop of the massive fiscal stimulus, the economic conclusions are obvious. In 2021, there are clear prospects for a strong acceleration in US economic growth, significantly more jobs, and a noticeable rise in incomes. It is therefore quite possible that the US economy will grow by 5% or possibly 6% in real terms this year. This should be enough to close the output gap this spring.
By contrast, it will probably take another year (or even longer) for real GDP in the euro area to catch up with its pre-Covid-19 level. In Europe, too, fiscal policy should stimulate economic growth. However, it remains far behind that of the US. We expect EMU-wide growth of "only" 3.5%. This already includes noteworthy positive spill-over effects of stronger US growth.

For financial markets, the US fiscal boost means that the reflation story that has been played out for months is now even more underpinned. For global stock markets, this means further tallwinds. Beyond short-term setbacks, markets should continue trending north. Safe haven government bonds, however, are facing headwinds, since the fiscal boost tends to fuel US inflation rates. This discussion is already in full swing – and at times, even the menace of inflation is being painted on the wall again.

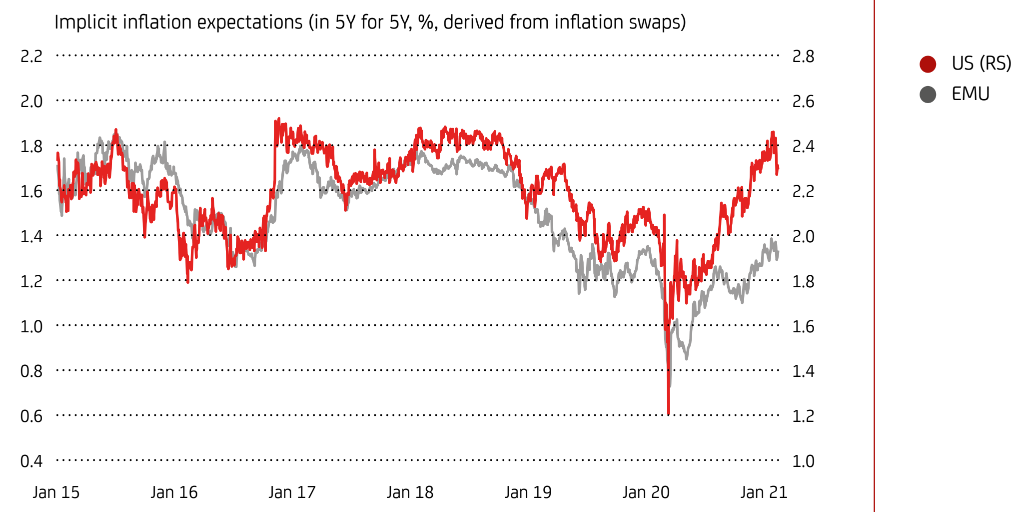
For details, please see the Sunday Wrap of our Group Chief Economist & Global Head of CIB Research, Erik F. Nielsen as of Feb. 14, 2021.

However, we think such concerns are exaggerated because the US Phillips curve is quite flat, and parts of the additional income will be saved. Therefore, while inflation rates are likely to rise, the increase beyond some short-term overshooting should remain manageable. US Federal Reserve (Fed) Chairman Powell has also emphasised this more recently. In the euro area, the risks of inflation are even more muted against the background of a more hesitant fiscal policy and weaker growth. The recent rise in EMU-wide inflation is primarily administrative in nature and exaggerated by the increase in the VAT rate (after being lowered temporarily) and higher CO_2 prices in Germany.

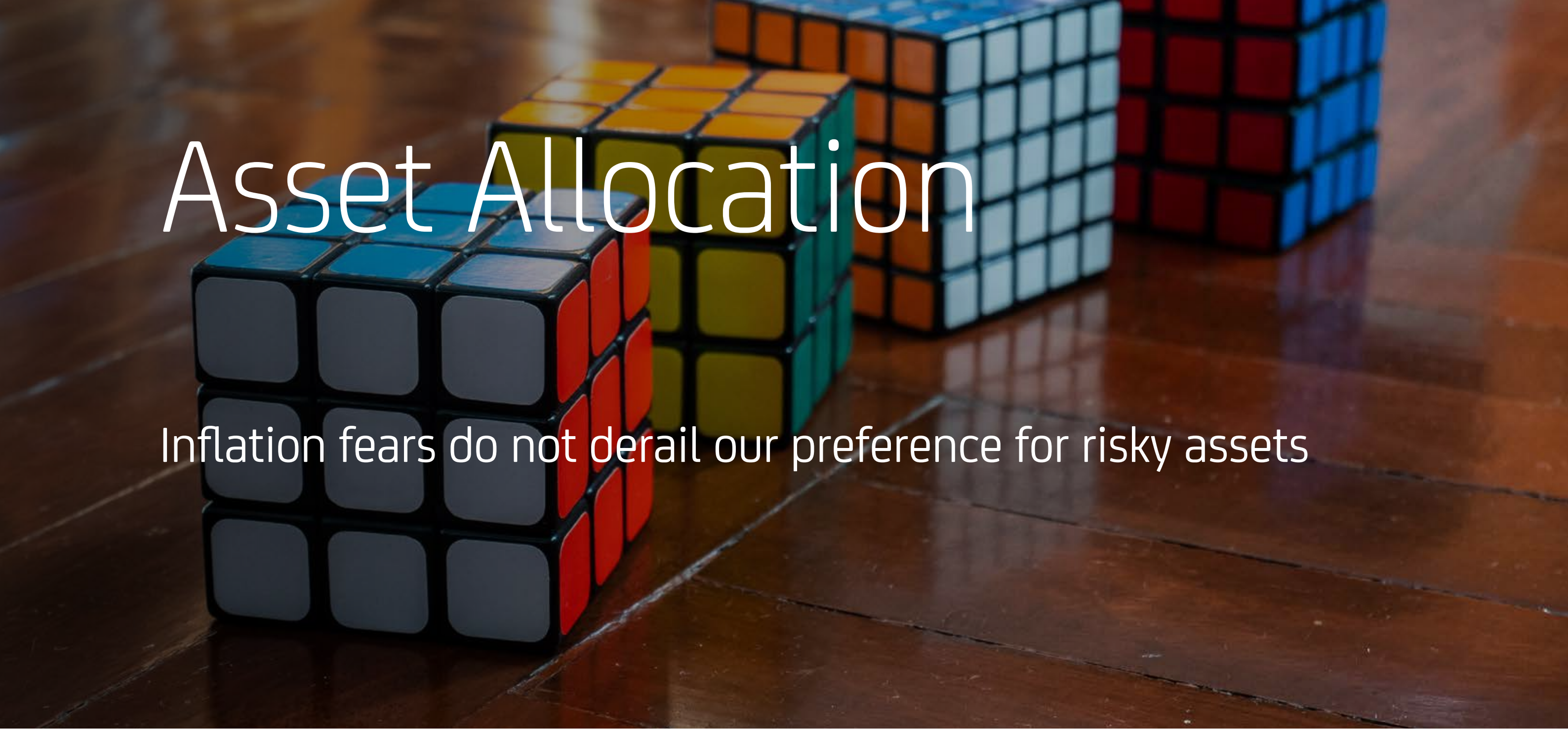
The Phillips curve depicts the relationship between unemployment and the inflation rate. When the unemployment rate falls, inflation normally rises - and vice versa.

But despite all the qualifications, inflation expectations in the US have risen massively in recent weeks (which was also spreading to the euro area, see chart 10) – and with them the nominal yields of government bonds. The flip side of the coin has been noticeable price losses. So, while government bonds in the developed world have recently lost considerable ground and will probably remain uninspiring for weeks and months to follow, they could well become more interesting over the medium- to longer-term horizon.

10. INFLATION EXPECTATIONS HEADING NORTH, ESPECIALLY IN THE US



Source: Refinitiv Datastream, UniCredit Wealth Management



Asset Allocation

Inflation fears do not derail our preference for risky assets

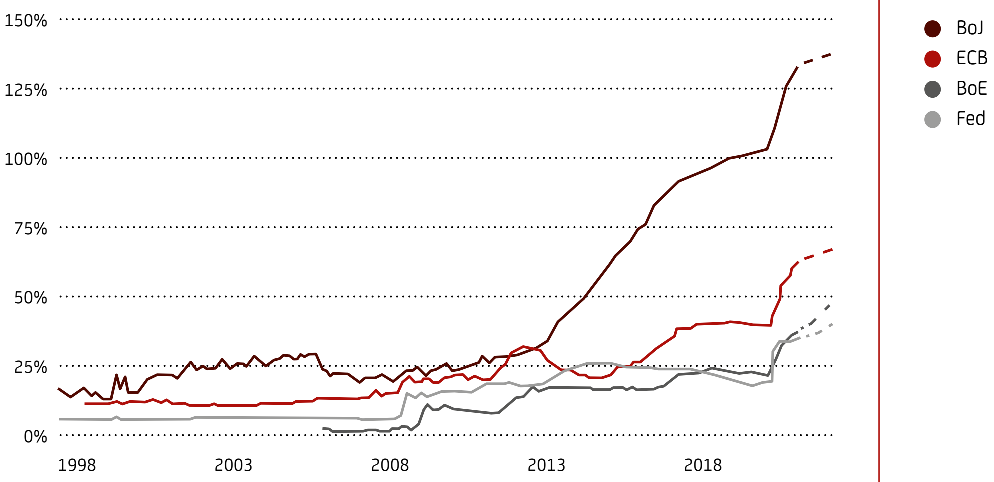
ASSET		INVESTMENT UNIVERSE	INVESTMENT VIEW: NEGATIVE	INVESTMENT VIEW: NEUTRAL	INVESTMENT VIEW: POSITIVE
MAIN ASSET CLASSES		Global Equities	○	○	●
MAIN ASSET CLASSES		Global Bonds	○	●	○
MAIN ASSET CLASSES		Cash	●	○	○
MAIN ASSET CLASSES		Alternatives	○	●	○
MAIN ASSET CLASSES IN DETAIL	EQUITIES	US	○	●	○
MAIN ASSET CLASSES IN DETAIL	EQUITIES	Europe	○	○	●
MAIN ASSET CLASSES IN DETAIL	EQUITIES	Pacific (DM[1])	○	●	○
MAIN ASSET CLASSES IN DETAIL	EQUITIES	EM[2]	○	○	●
MAIN ASSET CLASSES IN DETAIL	BONDS	EMU Governments	●	○	○
MAIN ASSET CLASSES IN DETAIL	BONDS	EUR IG Corporate Bonds	○	○	●
MAIN ASSET CLASSES IN DETAIL	BONDS	HY Corporate Bonds	●	○	○
MAIN ASSET CLASSES IN DETAIL	BONDS	EM Bonds	○	○	●
MAIN ASSET CLASSES IN DETAIL	COMMODITIES	Oil	○	●	○
MAIN ASSET CLASSES IN DETAIL	COMMODITIES	Gold	○	○	●

[1]DM = Developed Markets (Australia, Japan, Hong Kong, New Zealand, Singapore)
[2]EM = Emerging Markets

The overall macro picture remains supportive of risky assets, despite some short-term caution due to the resurgence of Covid-19 cases and delays in the vaccination campaigns in Europe, as well as fears of higher US inflation.

In fact, global monetary policies are extraordinary loose and will remain so for an extended period of time. The balance sheets expansion of the Fed, ECB and Bank of Japan equal 35%, 62%, and 133% of their GDP, respectively.

11. CENTRAL BANK BALANCE SHEETS, % GDP



Dotted lines represent 2021 forecasts
Source: Algebris Investments, BofAML, IMF Datamapper
Data as of 31.12.2020

However, higher 2021 US GDP growth, due to Biden's very expansive fiscal policy that amounts to well above the US output gap, poses risks of higher inflation in the US, igniting fears of a gradual Fed tapering starting from the second half of this year. We expect the increase in US CPI inflation in Q2 to be moderate, temporary and mostly driven by the base effect and energy prices. As such, the increase in inflation should not be able to derail the risk-on environment, although it will likely increase the volatility of financial markets. Investing in real assets such as equities, in particular by overweighting emerging markets equities, and maintaining the underweight positioning on core government bonds while reducing their duration, as well as increasing a selective positioning on inflation-linked bonds, may prove helpful to manage a temporary increase of inflation

Focus: More constructive on Italian assets

Italian assets have been supported by the launch of the ECB's pandemic emergency purchase programme, which was further increased by EUR500 billion and extended until March 2022, and by the launch of the Next Generation EU (NGEU), the plan for the recovery of Europe for a total amount of EUR750 billion. Italy is among the main beneficiaries of the latter, with overall resources of EUR210 billion to be allocated to digitalization and innovation, ecological transition and social inclusion. Meanwhile, the formation of a new government led by the former ECB governor, Mario Draghi, and supported by a large majority in the Parliament, is a significant event in favour of Italian assets.

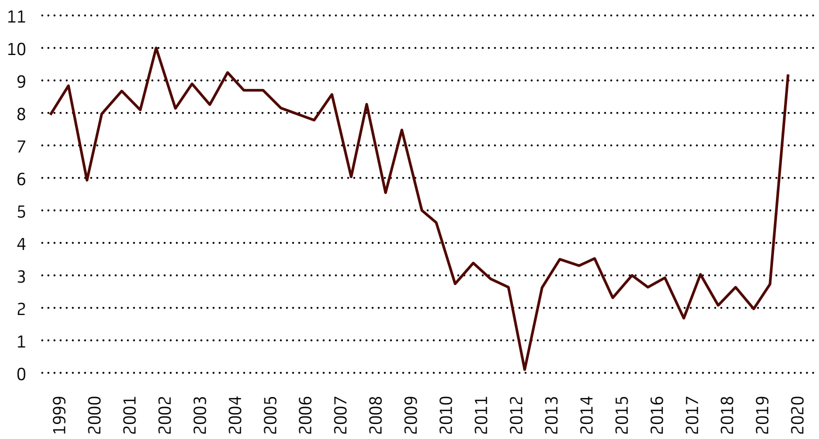
We expect a further reduction in the BTP-Bund spread which, in the Blue Sky scenario (duration of the government until the end of the legislature in 2023, acceleration of the vaccination campaigns and a faster return to normality, implementation of structural reforms, and maintenance of expansive fiscal and monetary policies in the Eurozone) may approach the current Spanish and Portuguese levels around 50-60 bps, while in the intermediate/base case scenario it could reach around 70-80 bps.

Banks will have clear benefits from a reduction in the spread, especially those that hold a higher share of BTPs in their portfolios. This, in turn, could favour their greater involvement in financing Italian companies.

But the positive results of Draghi's action could go much further:

1. In case of a speed-up in vaccination campaigns, it is fair to expect a strong recovery of the consumer sector in the stock market, due to pent-up demand and the likely reduction of the very high net savings of Italians (Italian families' net savings ratio increased from 2.8% at the end of 2019 to 9.2% of their gross disposable income at the end of June 2020, according to the estimates of the Bank of Italy, see below graph).

12. ITALIAN FAMILIES NET SAVING RATIO AS % ON GROSS DISPOSABLE INCOME

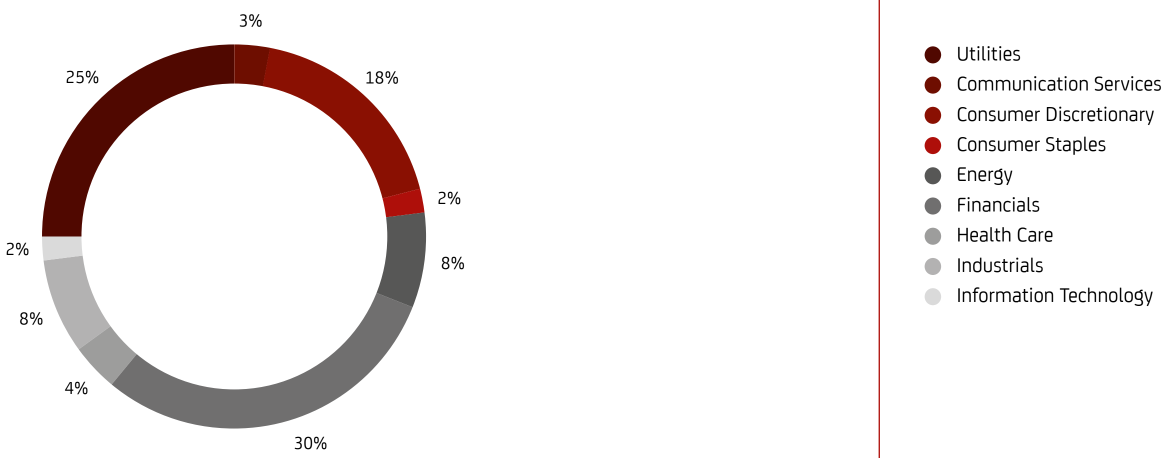


Source: Bank of Italy on ISTAT data

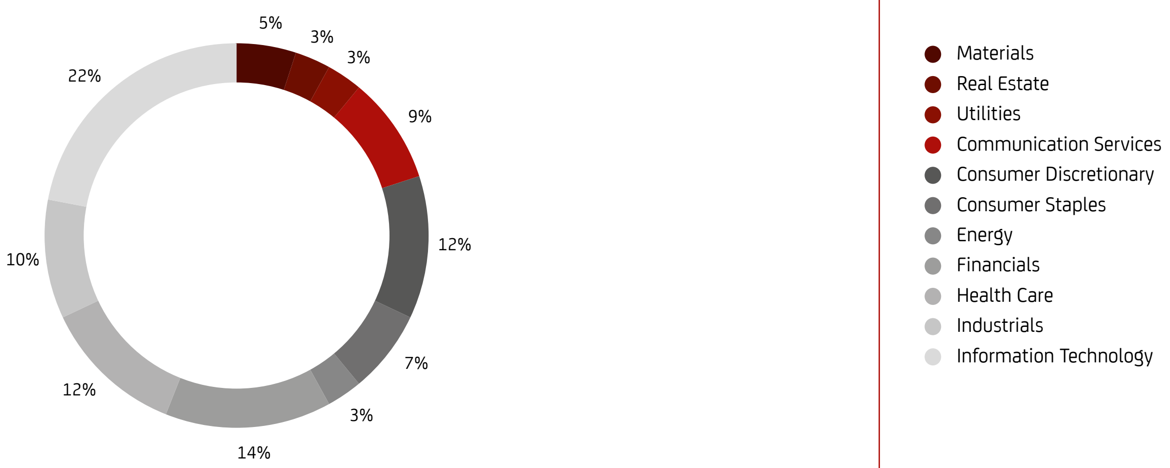
2. An important part of the funds allocated to Italy by Next Generation EU will favour the climate turnaround and renewable energies, benefiting companies that have oriented their growth strategy on renewable energies.

3. Investors also expect a reduction in the timeframe for the creation of a single network and a further recovery of the asset management sector. Construction would also benefit from increased investment in infrastructures.

13. HIGHER % WEIGHTING OF FINANCIALS, UTILITIES AND CONSUMER DISCRETIONARY SECTORS IN THE MSCI ITALY EQUITY INDEX VS MSCI WORLD EQUITY INDEX



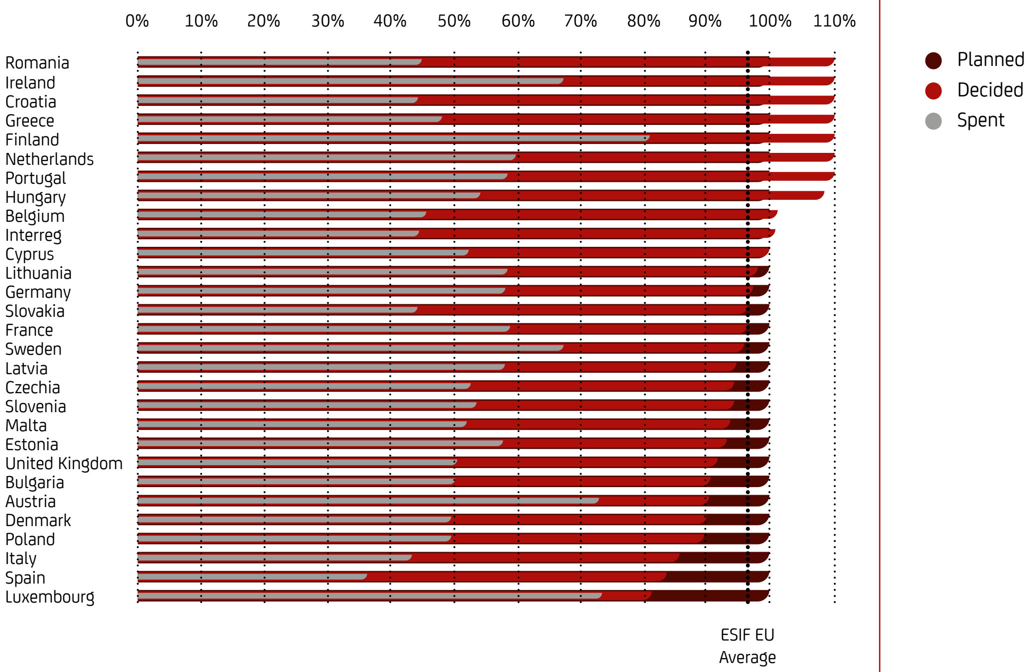
Source: MSCI Italy



Source: MSCI World

The Draghi government also offers better guarantees of greater use of EU structural and investment funds (ESIF). Italy is at the bottom of the list for spending capacity, equal to 43% in the period between 2014-2020.

14. ESIF 2014-2020: FINANCIAL IMPLEMENTATION (TOTAL COST) BY COUNTRY



Source: European Commission

If Draghi will succeed to at least start the key structural reforms of public administration, justice, taxation (favouring a gradual reduction of taxation for people and companies and an increase in women's job market participation rate), and to speed up digitalization, competitiveness and productivity, the Italian economy will be able to recover ground and reduce the gap with other European countries. Italy is, in fact, in 44th place in the IMD World Competitiveness ranking 2020 and in 41st place for digitalization.

Asset Allocation Stances

Overweight Global equities

The combination of massive fiscal / monetary action and hopes of a vaccine-driven global recovery starting from Q2 supports equity, despite high uncertainty due to the resurgence of Covid-19 cases, especially in Europe.

Overweight European equities

In the short term, European equities are penalized by Covid-19 resurgence, but monetary and fiscal policies are highly expansive. Attractive dividend yields, which are well above government and corporate bond yields.

Neutral US equities

Improving growth outlook due to Biden's expansionary fiscal policy, but less attractive valuation versus non-US areas.

Overweight Emerging Markets equities

The recovery, more evident in China, whose economy has returned above pre-crisis levels while there are hopes of falling US-China trade tensions thanks to the new Biden administration, may favour a catch-up versus developed markets. We prefer Asian countries. Countries and sectors selectivity among EMs is strongly recommended.

Neutral Pacific equities to neutral

Japan is supported by China's recovery, the high incidence of value/cyclical sectors, good management of the pandemic and by Prime Minister Suga's structural reforms.

Neutral Global bonds

Global bonds are supported by central banks expansive monetary actions but their valuations, especially of developed market government bonds, are not attractive.

Strong overweight Euro IG corporate bonds

European investment grade bonds are well supported by the ECB's purchases (through both the CSPP and PEPP) and carry trades. We prefer financial subordinated debt, given the increased capital buffer of European banks.

Underweight HY corporate bonds

Among the risk assets class we currently prefer equities, as the lack of market liquidity remains an issue for high yield corporate bonds.

Underweight European government bonds

The ECB's monetary policy is highly expansive, but valuations of core government bonds are currently not attractive. We prefer peripheral government bonds, such as Italian BTPs, which are supported by the ECB and the Recovery Fund.

Overweight EM bonds

The USD weakness and the search for yield given the lower for longer environment support selective buying opportunities, especially with regard to EM local currency bonds.

Underweight Money Markets

They are not attractive in our view, and should be used mostly as hedging for uncertainty.

Neutral Alternatives

We prefer the more liquid alternatives strategies.

Commodities

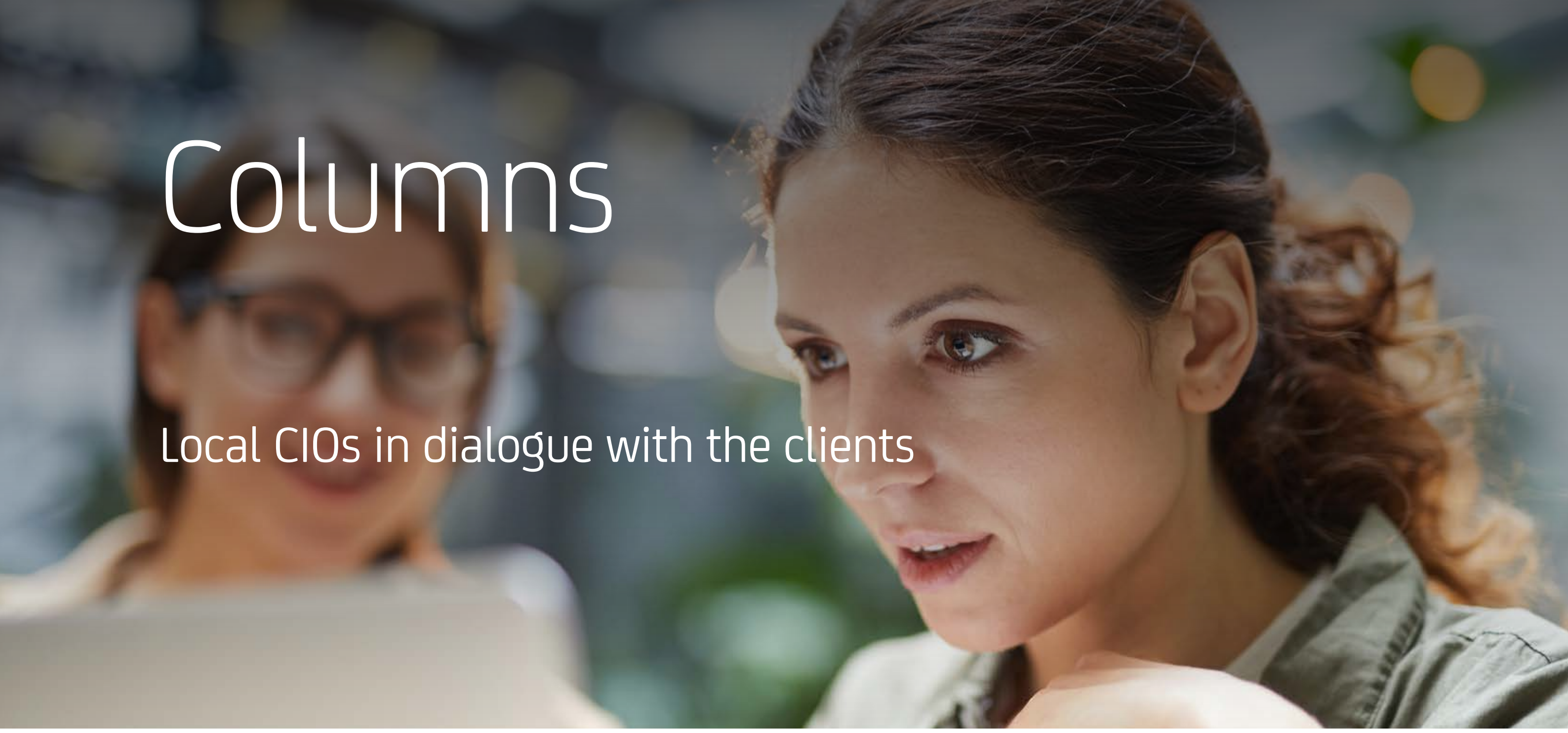
Positive Gold

The price of gold will likely remain sustained by the monetary reflation of central banks, as well as its role as a safe haven in a context of uncertainty linked to the pandemic.

Currencies

EUR/USD

In the short term there is a balance between rising US bond yields and the risk-on environment. However, in the longer term, the Fed's accommodative monetary policy and the US "twin deficits" will maintain a weaker the USD.



Columns

Local CIOs in dialogue with the clients

Answers from Italy

"What does the current yield curve steepening mean for our comfortable chairs?"

Many economic and macro indicators are currently displaying higher than normal volatility. The pandemic, with its waves and the consequent lockdowns and restrictions which are being deployed as countermeasures, is driving anomaly movements and base effects on data which usually show relatively stable behavior (at least when compared to financial instruments' price movements!). That is why it is so important to remind ourselves that not all macro data have the same information value. Basically, we can distinguish three main categories: leading, coincident, and lagging indicators.

Typically, labour market data are considered lagging indicators, since, for example, there is always a lag of time between the moment a company experiences an increase in orders and effectively increases its workforce to expand production. Coincident indicators are those referred to retail sales or industrial production since they represent current consumer behaviour or company order book. But the most important ones are the leading indicators. For example, the number of building permits requested today allow us to estimate how many building sites will start in the following months – implying the overall state of health of the real estate sector. Surveys on consumer or companies' confidence are among the most relevant forward-looking indicators and are also powerful market movers data since they provide input on the future evolution of the economic environment.

At the same time, some financial market prices are leading in terms of information about the future state of the economy. The shape of the interest rate curve contains several useful hints about the probable (or expected) evolution of the main macro aggregates. This

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is because the money market rates are controlled by the central bank. Whereas long-term interest rates, i.e. 10 years and over maturities, are more influenced by investors' expectations about future real growth and inflation rates (although the central bank can put in place effective maneuvers to guide their level).

As a result, a flattening yield curve, with long-term rates decreasing when short-term rates are stable, signal a worrying situation: a likely slowdown in economic activity in the following quarters.

On the contrary, a steepening yield curve, with long-term rates increasing when short-term rates are stable, signal a positive future evolution: an acceleration in economic activity. And this is precisely the situation we are in. Long-term interest rates of major developed economies are moving upward, anticipating progressive reopenings and a pick up in the sectors most negatively impacted by the pandemic, including services. These moves are resulting in a negative impact on equity markets, but we think this is likely to be temporary. If the main driver of today's curve steepening proves to be increasing real rates in the future, that will negatively impact government bonds (but improve perspectives for lower credit rating bonds), and will provide support for equity markets overall. However, if the main driver of today's curve steepening proves to be an increase in inflation in the future, that will again negatively impact government bonds (but inflation-linked bonds will benefit) and the equity industry sectors which have decent pricing power will likely strongly outperform.

In any case, the clear message that the steeper curve is sending us today is that sitting comfortably on cash is simply the worst investment strategy: either we will lose opportunities, or the inflation will erode our (falsely) comfortable chair!

Answers from Austria

"How did social trading result in a stock market sell-off?"

At the end of January, investors on Wall Street were confronted with an issue that has since grabbed the attention of the Securities and Exchange Commission, the judiciary, politicians and financial professionals. An attack by well-organised small investors, who joined forces on social media forums such as "Reddit", taught the established hedge funds a lesson. The battle was triggered by the positioning of hedge funds betting on further share price losses ("short selling"), such as that of the US video game retail chain "Gamestop". The price of Gamestop's share fell to a record low of USD2.57 in 2020 due to economic difficulties and rose to over USD400 within two weeks at the end of January, only to

Oliver Prinz

Co-CIO Bank Austria and Schoellerbank (Austria) fall back below USD100. But what ultimately triggered these sharp movements?

The group of small investors agreed to buy the stock to push it up. As the trading volume of the Gamestop share was significantly lower, it was easier to influence the price movement than would have been possible with large companies. As the share price subsequently moved upward, some hedge fund managers who were betting on falling prices were forced to limit losses by buying back Gamestop shares. This triggered further upward pressure on the share price, forcing more and more hedge funds to follow suit ("short covering"). This turmoil surrounding the battle between small investors and hedge funds consequently led to a short-term sell-off in the US stock market.

Recently, social trading has become increasingly popular and is attracting, in particular, young private investors. These investors exchange stock market information on social networks or on special platforms to make investment decisions. However, there are no legal regulations on which group of people may express investment recommendations on these platforms. A relevant education or professional experience in the investment field is not required. These developments usually have more to do with speculating than investing and often concern stocks with a low market capitalisation. Of course, profits can also be made with speculation. However, these are often dependent on external influences or coincidence and not on the business model and the success of the company.

In contrast, our focus in asset management is on a highly professional and transparent selection process, whereby strict quality criteria must be defined when selecting stocks. Important factors such as a company's long-term defensible competitive advantages, balance sheet strength or growth prospects play an important role in this process. We look past the short-term trends that last for a few hours or a few days and are made without fundamental evaluations or are only triggered by technical reactions to speculators.

Answers from Germany

"What are the economic consequences of a potential debt cancellation by the ECB?"

The debt ratios of many countries, i.e. debt in relation to GDP, have recently notably risen – on the one hand due to governments' additional spending or revenue shortfalls due to the pandemic, and on the other because GDP has shrunk. In order to, at least, somewhat slow down the increase, there are calls from some commentators for

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the ECB to cancel the government bonds it holds. Since we do not want to presume to assess the legal and political consequences, we will focus on the economic aspects. Let's be clear from the outset: the relief effect for the countries would be far less significant than it might appear at first glance. The consequences for the ECB, however, would be serious.

Government bond purchases by the ECB represent an extension of its balance sheet. This means that the bonds held by the central bank on the asset side are matched by the money spent on their purchase as a liability on the liabilities side of the balance sheet. The interest income from this leads to a profit for the central bank. This, however, is distributed to the Treasury. It is important to note here that the government bonds are not legally held by the ECB, but by the respective national central bank, which is also responsible for the profits and losses from them. This means that from the government's point of view, the bonds acquired by the ECB (minus any costs) are effectively "interest-free". So any debt cancellation at the ECB does not change the sovereign's interest burden. And if the central bank replaces maturing bonds with new ones, this would remain the case in the future.

But debt relief would have serious implications for the central bank, as in this case the bonds would be off the balance sheet, but the money supply that the ECB used to buy the bonds would not be. Again, this may not matter at first. But the situation changes at the latest when the economic environment changes and the central bank wants to reduce the money supply, for example, because the economy is growing strongly and inflation is overshooting the target. With the bonds on its balance sheet, however, the ECB has an extremely effective tool at its disposal. If the central bank does not reinvest maturing bonds, for example, it withdraws liquidity from the economy to the same extent. And if it has to act particularly quickly, it could also sell the bonds.

To conclude, debt cancellation by the ECB currently offers little additional relief for government finances. And if the relief provided by bond purchases is needed in the future, the central bank will simply have to roll over maturing bonds into new ones. Debt cancellation, however, would strip off the central bank of an extremely effective tool for removing excess liquidity from the system in the future - should this ever become necessary.

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