UniCredit
Wealth Management

Monthly Outlook
April 2021

# Every cloud has a silver lining

# Table of contents

# Every cloud has a silver lining

# CIOs Letter

## Every cloud has a silver lining

Despite the current tense pandemic situation in Europe, which may lead to further lockdown measures, hope is spreading for a notable economic recovery. The latest sentiment indicators in Europe, the PMI indices, reflect an almost euphoric picture, especially for the manufacturing sector. Recently published March data climbed to a level that already significantly exceeds the peak from the last cycle (which was reached at the turn of the year 2017 to 2018). And while the services sector is still lagging behind the manufacturing sector, this is quite understandable given the much harsher impact of lockdown measures. Indeed, stock markets are celebrating this optimistic outlook. The EURO STOXX 50 index, for example, rose by over 10% in the first quarter. In this environment, European stocks have risen much more strongly than US stocks, which have only posted slightly more than half the gain. By contrast, Emerging Market equities, which had recovered strongly in the past year, gained just under 2%.

This outperformance of European equities is particularly remarkable against the backdrop of a slower economic recovery relative to the US or Asia, for example. Nevertheless, it was not unexpected and can be explained by several factors. First, the catch-up potential of European equities was significantly greater in a global comparison, as the market had not recovered as strongly as other equity markets in the second half of 2020. In addition, inflation expectations have risen noticeably in the US, in particular as a result of massive stimulus programmes, causing yields on long-dated US government bonds to rise sharply. This rise in yields is currently weighing down on US stock markets, whose soaring prices in the past year were supported in part by a sharp rise in valuations (price/earnings ratio, P/E ratio) – which were driven in part by the historically low level of interest rates. The sharp rise in yields is now reducing the relative attractiveness of US equities (some of which are already overpriced) compared with interest-bearing securities. In addition, the rise in yields is likely to continue for some time, and with it the burden on very highly valued equities.

However, when considering this situation against the overall picture, the underlying economic recovery, which fundamentally supports stock markets, should not be ignored. In our view, this is a good argument for continuing to favour equities over fixed income securities.


Manuela D'Onofrio

**Head of Group Investment Strategy and CIO Group Wealth Management**

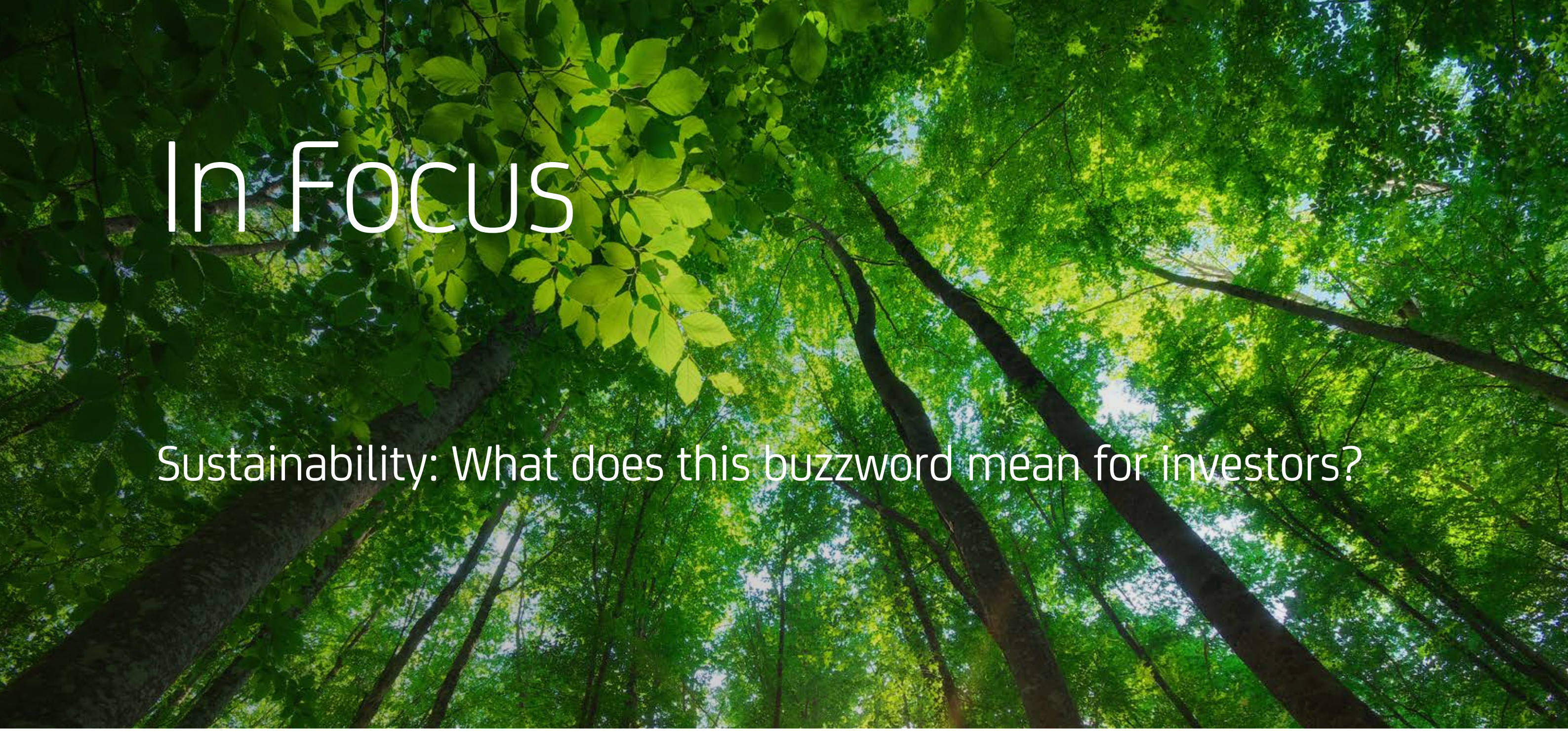
Philip Gisdakis

**Co-CIO of Group Wealth Management and CIO UniCredit Bank AG**
(HypoVereinsbank) (Germany)

The increasing rate of vaccinations in Europe is also encouraging. In particular, we are observing the rate of vaccinations per week in relation to the size of the population. In Europe, the rate is just over 2%, which, although less than half the rate in the UK and the US, is rising noticeably. By comparison, in the first quarter, only about 1% of the population was vaccinated per week on average – driven largely by the bottleneck in the availability of vaccines. In fact, this is highlighted by the case that certain European countries, which also work with Chinese and Russian vaccines, have already vaccinated around 5% of their population. With the expansion of production capacities in Europe, the vaccination success should also accelerate significantly in the coming months – and the declining incidence figures in the UK and US give justified hope for a normalization of the situation in Europe.

The economic recovery will likely be felt across the board. However, in the medium term, we believe companies that are particularly well placed to adapt to sustainable future trends will perform well, as they should be supported by European investment programmes. As a result of these programmes, sustainable ESG strategies, which have showed strong performance last year, will remain in focus for investors in the future.

Overall, we believe optimism for the outlook is warranted. However, until herd immunity is achieved through vaccination, we should all remain vigilant – as while the economic risks may be diminishing, the health risks have not yet been eliminated.

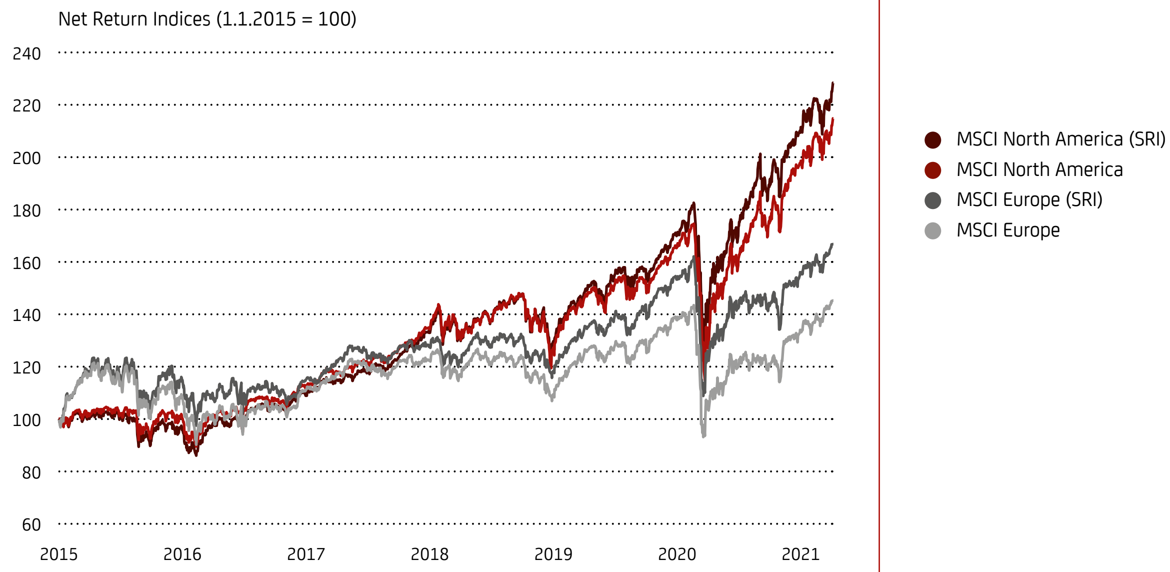


# In Focus

## Sustainability: What does this buzzword mean for investors?

Sustainable business and sustainable investing – two topics that seem to be a part of every conversation today. And it doesn't come as a surprise, given that tackling climate change, for example, was already at the top of many people's agendas prior to the pandemic. In fact, the past year has reinforced the importance of sustainability. On the one hand, the pandemic – a kind of natural disaster in slow motion – showed us the enormous impact that environmental changes can have on our lives. On the other hand, sustainable investment strategies have been particularly successful during this time. We would like to shed some light on this topic and take a closer look at the significance for investors.

1. MSCI EUROPE INDICES (STANDARD AND SRI)

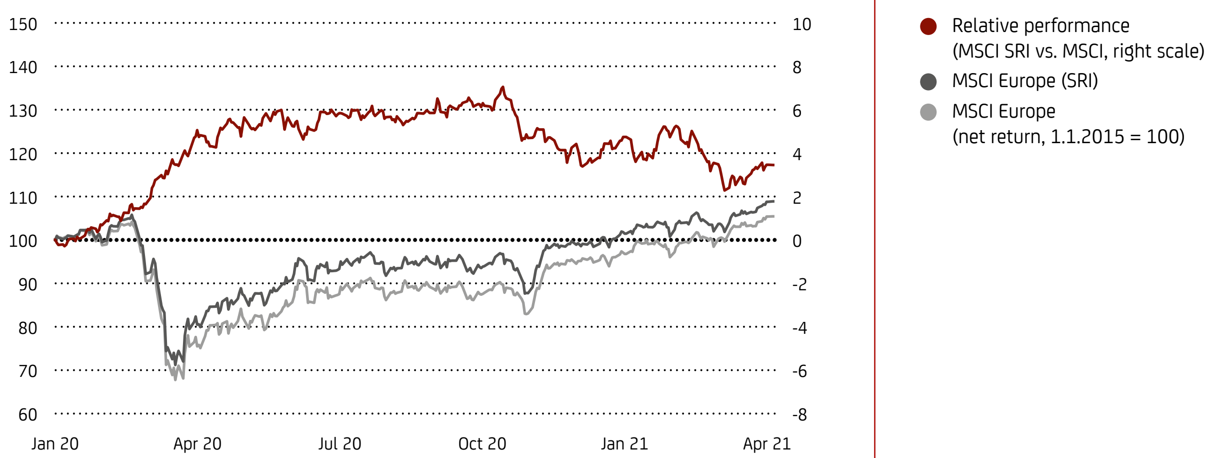



Source: Refinitiv Datastream, UniCredit Wealth Management

Chart 1 shows the price development of the European and North American stock markets in the standard and sustainable versions for comparison. It is clear that the sustainable versions have cumulatively outperformed the respective standard comparison indices in recent years. And in Europe, the difference was even more pronounced than in North America. For this comparison, we used the so-called SRI (Socially Responsible Investment) indices from MSCI.

Chart 2, which shows the development of the two index variants for Europe, together with the corresponding difference since the start of last year, highlights that the outperformance of sustainable strategies was also evident during the pandemic. Further, during the first phase of the crisis, when markets significantly sold off, the sustainable variant held up better and did not lose as much value. This outperformance continued to gain ground during the recovery, reaching a peak of around 7%. In the fall, this overperformance gradually disappeared as the standard indices caught up.

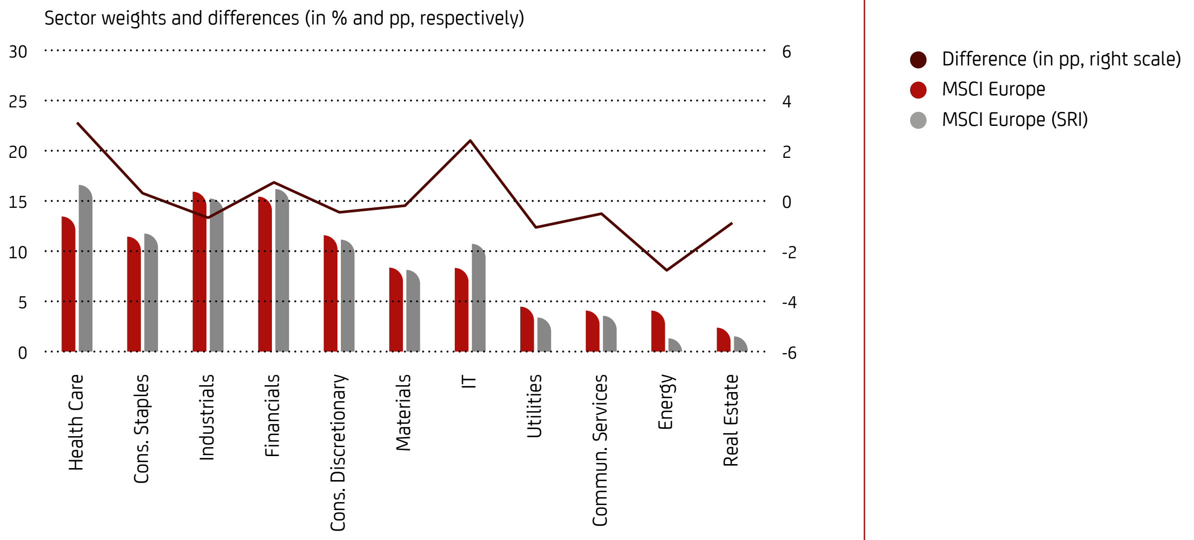
2. MSCI EUROPE INDICES (STANDARD AND SRI)




Source: Refinitiv Datastream, UniCredit Wealth Management

This development is easily explained by the sector distribution of the respective indices. In chart 3, we compare the respective sector weights and the difference between standard and SRI indices. This shows that the SRI indices have a comparatively high weighting in the healthcare and technology sectors and a low weighting in the energy sector. However, companies from the healthcare and technology sectors were the winners during the crisis, while oil companies in particular lost out. This resulted in strong outperformance during the peak of the crisis. Since the fall, however, oil stocks in particular have been in demand again, which led to a temporary reversal of the outperformance. The “bend” in relative performance in chart 2 in the fall is directly related to a rally in the oil price.

### 3. MSCI EUROPE SECTOR WEIGHTS (STANDARD AND SRI)




Source: Refinitiv Datastream, UniCredit Wealth Management

However, such a catch-up rally after a phase of sharp price declines is not surprising, and in our view does not indicate a structural problem in sustainable strategies. On the contrary, many countries want to get their economies back on track with investments following the pandemic, and as a result are focusing on promoting so-called future issues. Companies with a particular emphasis on sustainable development are likely to benefit strongly from this.

This development is reinforced by recent legal initiatives that encourage financial service providers to focus on sustainable investment. For investors, these initiatives bring more transparency and clarity about what strategies financial services companies are pursuing in sustainable asset management – and what impact the companies will have on the environment. Ultimately, this will allow for more targeted and sustainable investing in the future.

# Macro & Markets

## Rising US yields challenge central banks

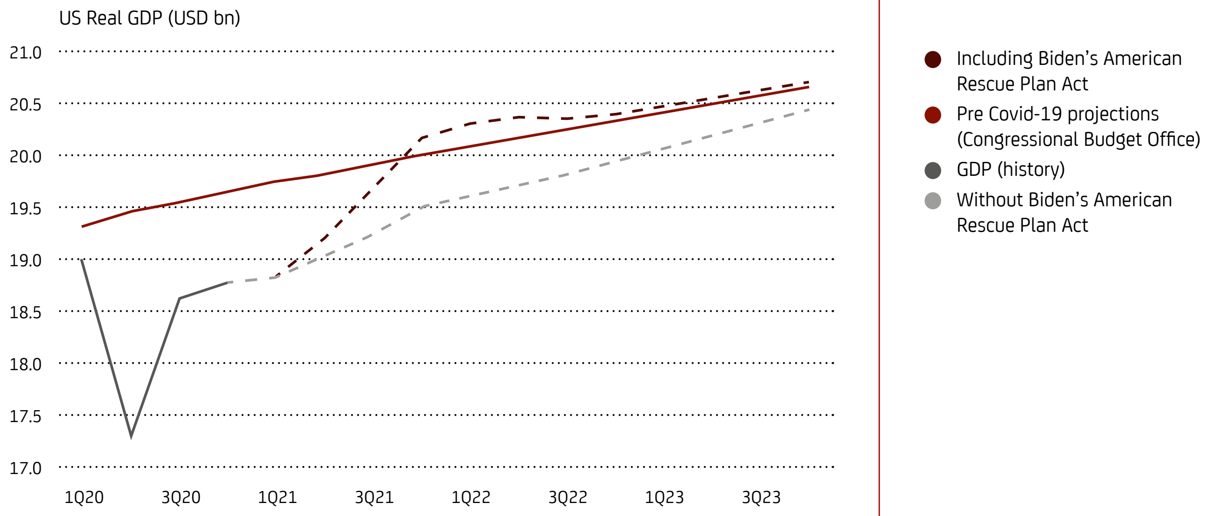
### A substantial rise in US yields

The reassessment of the US economic outlook was the primary factor that shaped financial markets in recent weeks - and it is likely to do so for some time to come. The upward revisions of GDP forecasts provided further tailwind for equities, while bonds had to pay tribute to burgeoning inflation fears. Treasury yields have risen substantially since the beginning of this year.

The reassessment was triggered by the turnaround in US fiscal policy. Concerns about the fiscal cliff were quickly replaced by euphoria around the fiscal boost when President Joe Biden not only doubled the Trump package of late December, but also, contrary to expectations, got his American Rescue Plan through Congress swiftly and without any significant cuts. At a combined total of almost USD3 trillion or 13.5% of GDP, the fiscal stimulus this year is enormous and exceeds the output gap by over three times. According to a simulation by the renowned Brookings Institute, this would not only ensure that the US economy exceeds its static pre-Covid-19 level as early as this spring, but it would also exceed the GDP level that would have been reached without the pandemic at the end of this year (see chart 4).

For details of the projections, please see here

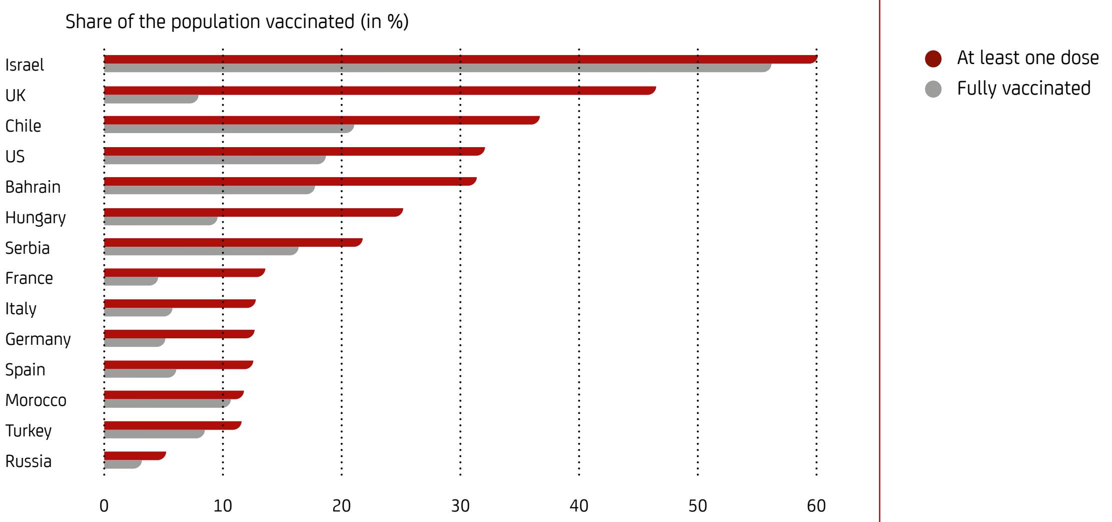
### 4. THE BIDEN PACKAGE – A BOOST FOR US GROWTH




Source: www.brookings.edu, UniCredit Wealth Management

In addition, the US is showing a swift pace of vaccination deployment (see chart 5). This means that the country – unlike continental Europe – could largely be spared the third Covid-19 wave. Lockdown measures should, therefore, be further scaled back and the upward trend in economically relevant mobility indicators thus consolidated.

### 5. VACCINATION RATES – US FAR AHEAD OF CONTINENTAL EUROPE



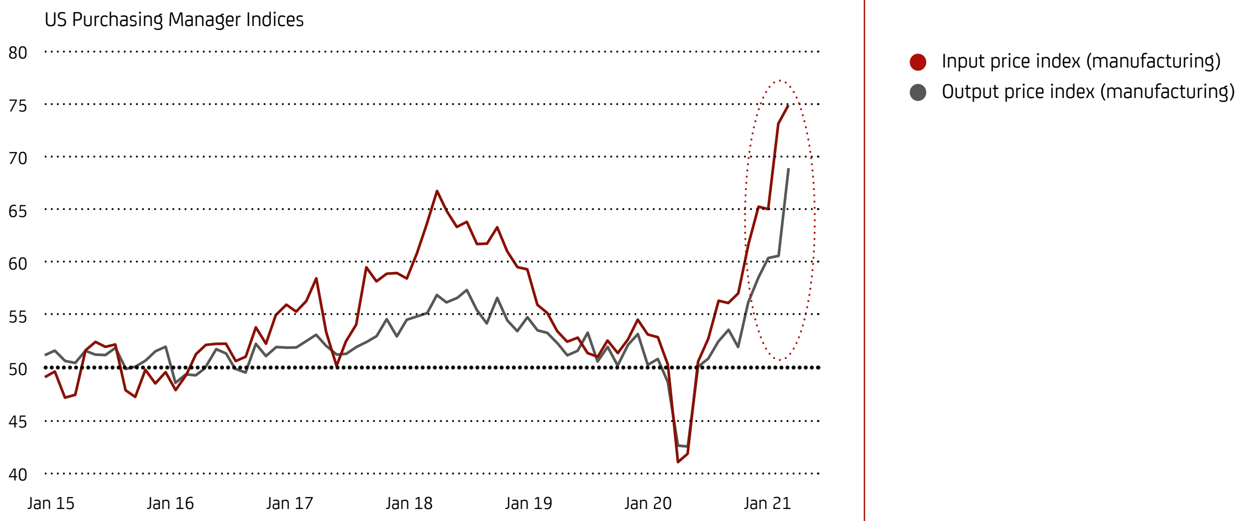

Source: ourworldindata.org/covid-vaccinations, UniCredit Wealth Management

Therefore, it comes as no surprise that US growth projections for this year have been pulled up massively. Only recently, the International Monetary Fund as well as the Organisation for Economic Cooperation and Development almost doubled its 2021 US growth forecasts from December to 6.5% – a figure that has now become broad consensus. The recent weak retail trade, industrial production and housing numbers are also unable to dampen the optimistic outlook. In fact, they are solely due to the icy winter weather and should soon pick up again. March sentiment figures and the latest labour market report illustrate this.

At the same time, the OECD has raised 2021 global growth by 1.5 pp to 5.6%. In contrast to that, the forecast for the euro area remained almost unchanged (+0.3% to 3.9%). However, this seems to not reflect the evolving third Covid-19 wave yet. For details see here.

The flip side of a rapidly closing output gap is building inflationary pressure. At the consumer level, there is still little sign of this beyond higher energy prices – the price of Brent crude oil has risen noticeably in recent months because of increasing growth optimism. At upstream levels, however, prices are already rising strongly, at least according to purchasing managers surveys (see chart 6).

6. US: PRICE PRESSURE AT UPSTREAM LEVELS



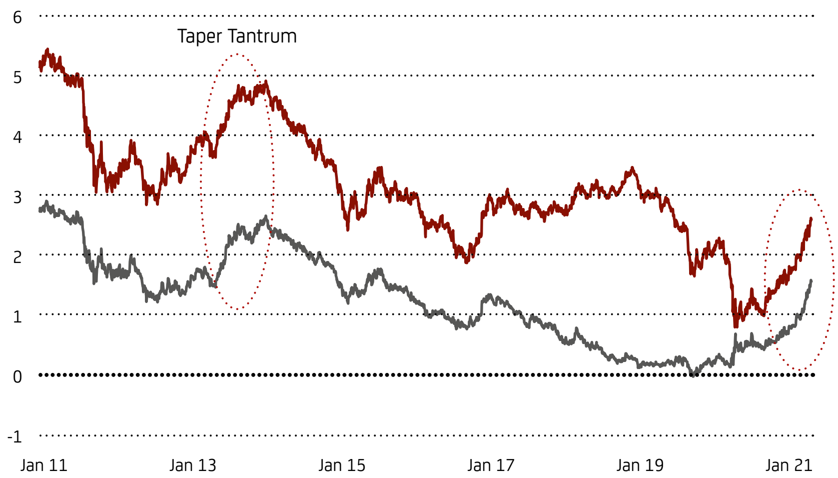

Source: Markit, Refinitiv Datastream, UniCredit Wealth Management

Growing inflation expectations in combination with rising real yields (upward revisions of economic growth) resulted in nominal US government bond yields rising sharply. In the 10-year maturity segment, yields have almost doubled since the end of last year to a good 1.7%.

This is strongly reminiscent of the so-called taper tantrum, when Federal Reserve (Fed) Chairman Ben Bernanke announced in May 2013 that they wanted to gradually reduce the policy of quantitative easing, i.e. the pace of bond purchases (tapering). In a kind of collective panic (tantrum), investors sold off US government bonds en masse. Yields and swap rates, respectively, shot up. At the same time, the yield curve steepened (see chart 7).

In the end, the taper tantrum turned out to be unjustified. Bond markets were able to recover shortly after the tapering programme had started.

7. TAPER TANTRUM RELOADED?




Source: Refinitiv Datastream, UniCredit Wealth Management

This time, there was not even a need for a Fed announcement. The (foreseeable) huge fiscal stimulus in combination with strong economic figures at the turn of the year – as well as the initial vaccination successes – were enough to fuel inflation fears and send government bonds into a tailspin.

Even the change in the Fed's strategy last autumn could not prevent this, when the Fed replaced its annual 2% goal by an average of 2% over several years indicating that it will tolerate a temporary inflation overshoot, versus an undershoot previously.

## Fed not even considering tapering

Although Fed members are eyeing the yield dynamic carefully, they consider investors' fears of both inflation and tapering to be exaggerated – and are essentially trying to allay them. They are still "not talking about talking about tapering", according to the press statement following the latest Open Market Committee meeting. Rising inflation rates are only of a temporary nature. It is worth noting that Committee members have noticeably raised their 2021 inflation forecast along with their growth projection. However, the core deflator of personal consumption expenditures, their preferred inflation measure, is expected to fall back to the 2% target as early as next year (2021: +2.2%). It is therefore not surprising that the majority (11 out of 18 members) are still not considering an interest rate hike by the end of the forecast period 2023. Thus, they are much more dovish than investors, who are pricing in the first move about a year earlier.

The Fed now also expects GDP to grow by 6.5% in 2021. It was "only" 4.2% back in December.

After all, the Fed's message was able to calm bond markets for the time being, with 10-year Treasury yields falling by around 10 basis points (bps) since mid-March – but whether this will stay the case remains to be seen. We have our doubts, and investors are likely to test the Fed's resolve again and again. Above all, however, inflation (expectations) and yields are likely to continue to rise (moderately) as growth accelerates.

But even that will probably not be enough to set the Fed's alarm bells ringing since the rise in yields is little more than a return to normality after the pandemic lows – which the US economy can cope with quite well. This is even true beyond 2021, as further fiscal stimulus can be expected in the coming years given that the discussion on Biden's USD 2.3 trillion infrastructure and green deal programme has already begun. Rising yields may thus push up financial conditions and stress indices – they have not done so far (see chart 8) – but it will be a long time before the US financial environment becomes truly restrictive.

Financial Conditions or Financial Stress indices aggregate a variety of indicators of money, bond and equity markets as well as the banking system into a single number. They are also considered to be accurate leading indicators of the economy.

8. US FINANCIAL ENVIRONMENT STILL VERY SUPPORTIVE


US Financial Conditions Indicator (OFR*)

*Office of Financial Research
Source: www.financialresearch.gov, UniCredit Wealth Management

## ECB to fight against the import of higher US yields

For the ECB, (further) rising US bond yields are a greater challenge than for the Fed. The message Frankfurt is giving is that it will counter any unwelcome import of higher yields and steeper curves. The problem in the euro area is that a deteriorating financial environment meets a still fragile economy. The former has spilled over from the US, but the latter is home-grown.

While the US is opening its fiscal floodgates ever wider, continental Europe is falling back into old habits. Instead of lifting the stimulus beyond the output gap, EMU countries are scaling back their efforts compared to the previous year. It is the reflexive warnings of a debt trap, the reference to the (suspended) debt brake or even concerns about bubbles building up in the financial and real estate markets that are causing the euro area to dither again on fiscal policy. The critics' arguments are not convincing, as our Group Chief Economist, Erik F. Nielsen, pointed out in his Sunday Wrap from 21 March. Valuations may be partly strained, but they are still far from bubble or even crisis levels – especially since the equity boom is not leveraged as it was before the financial market crisis. And fiscal expenditures are ultimately self-financing if they will be spent on investments, particularly if the interest service is currently close to zero.

Even if automatic stabilisers and government guarantees are added to direct spending, the fiscal stimulus of 6% of GDP this year falls well short of the output gap (8.5%). It does not close even if one considers new initiatives/supplementary budgets such as in Italy (EUR31 billion) or Germany (EUR60 billion).

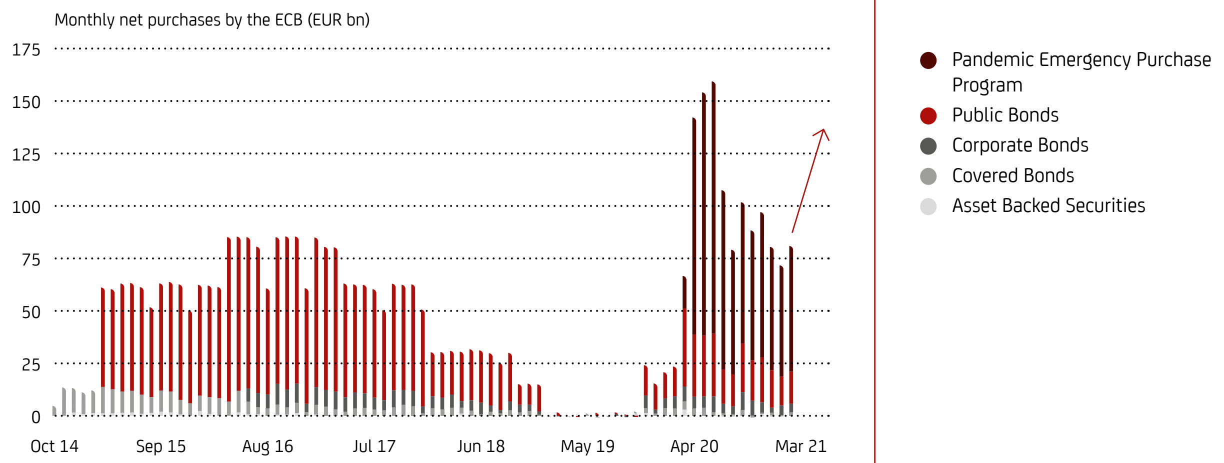
Continental Europe is further aggravated by insufficient crisis management. This refers not only to the extremely slow vaccination drive (see chart 5), but also to the back and forth of lockdown measures. Easing into the beginning of the third wave does not seem to have shown strategy and foresight. New measures will then have to be all the tougher and last longer. Therefore, it is hardly surprising that the expected spring recovery has to be postponed into the summer and 2021 GDP forecasts must be lowered again. How does this differ from the US!

Slower growth than expected so far, coupled with inadequate fiscal policy – once again, it seems that the ECB is primarily being called upon to manage the crisis. And it reacted! After the last Council meeting in mid-March, the European Central Bank's (ECB) Christine Lagarde announced that the central bank would massively increase securities purchases within the framework of the pandemic emergency purchase programme (PEPP). The already approved framework, which is still just EUR1 trillion approved until March 2022, allows for this. If necessary, it can also be stepped up. However, the ECB must ask itself why it has halved the monthly purchase volume over the last 12 months (see chart 9).

According to the latest Politbarometer survey, more than half of the population in Germany is dissatisfied with the crisis management.

In mid-March, the Council of Economic Experts lowered its 2021 growth forecast for Germany from 3.7% to 3.1% in view of the third Covid-19 wave, downside risks are clearly outweighing upside risks.

9. ECB TO SIGNIFICANTLY INCREASE BOND PURCHASES




Source: Refinitiv Datastream, UniCredit Wealth Management

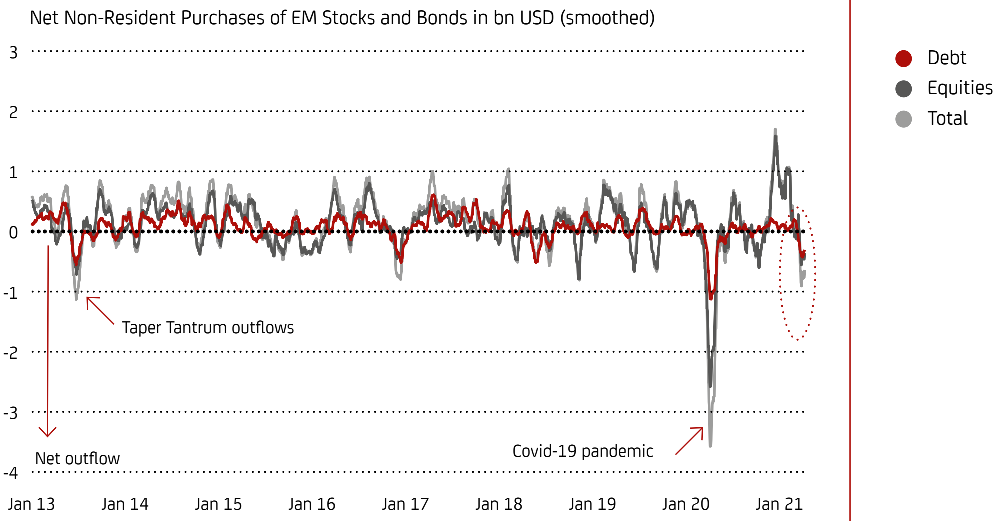
One can debate whether the new quantitative target (more PEPP) is a proxy for the price target applied so far (yield curve control to prevent a tightening of the financial environment), or whether this should be seen as a holistic and multi-layered approach of the Governing Council – and as a matter of fact, the measure is well targeted. It dampens the imported deterioration of the financial environment. However, it is also a fact that economic crisis management is once again focused on the ECB and Europe is now losing out on growth opportunities by its insufficient use of fiscal policy.

For details, please see the Sunday Wrap by our Group Chief Economist Erik F. Nielsen, as of 21.03.2021.

## Even bigger challenges for Emerging Markets' central banks

The strains on Emerging Markets' central banks posed by the rise in US yields are even greater than those on the ECB. Investors have withdrawn a similar net amount of capital from those countries in recent weeks as they did during the taper tantrum period (see chart 10).

## 10. CAPITAL IS FLEEING EMERGING MARKETS AGAIN




Source: Institute of International Finance (IIF), UniCredit Wealth Management

The countries most affected are those with high external financing requirements (huge current account deficits), i.e. the so-called Fragile Five: Brazil, Turkey, South Africa, India and Indonesia. Their central banks are faced with the dilemma of having to support their ailing economies on the one hand and raise interest rates to counteract capital outflows on the other. Turkey and Brazil seem to have the biggest problems currently. We can only hope that the current turmoil there will not spread to other Emerging Markets countries.

On the other hand, countries with close trade relations to the US or commodity exporters should benefit from the boost to US and global growth.

# Asset Allocation

## Higher global growth supports our preference for equities

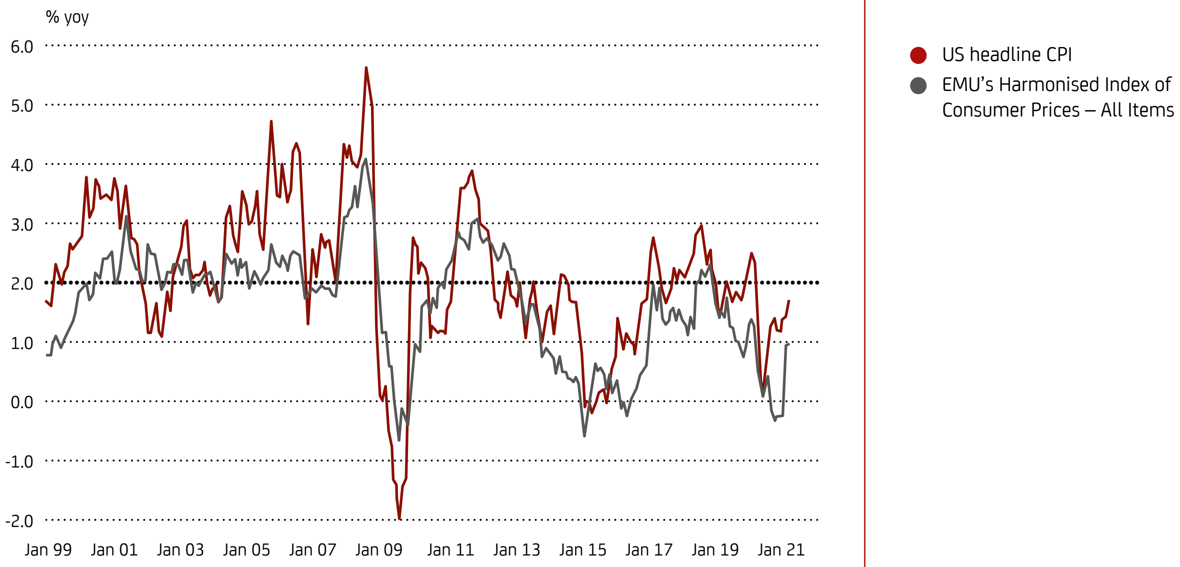
| | | | INVESTMENT VIEW | | |
|---|---|---|---|---|---|
| ASSET | | INVESTMENT UNIVERSE | NEGATIVE | NEUTRAL | POSITIVE |
| MAIN ASSET CLASSES | | Global Equities | ○ | ○ | ● |
| | | Global Bonds | ○ | ● | ○ |
| | | Cash | ● | ○ | ○ |
| | | Alternatives | ○ | ● | ○ |
| MAIN ASSET CLASSES IN DETAIL |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

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

The macro picture is centered on Biden's huge fiscal stimulus which, in combination with the speeding up of vaccination campaigns in the US, is boosting both 2021 US GDP growth and global GDP growth. At the same time, it is also igniting fears of higher inflation in the US. We expect the increase in US inflation to be moderate, energy prices driven and mostly due to the comparison with the very low levels in the corresponding period of the previous year (base effect).

Moreover, we believe that our current asset allocation is coherent in a scenario of mildly higher inflation. In fact, investing in assets such as equities, and in detail overweighting a growth and commodity play such as Emerging Markets (EM) equities and a cyclical / value play such as European equities, maintaining the underweight positioning on core government bonds while reducing their duration, and increasing our selective positioning on inflation-linked bonds, may prove helpful to deal with the issue of rising inflation.

11. EMU AND US INFLATION




Source: Refinitiv Datastream, Eurostat, ECB, UniCredit Wealth Management

Therefore, the March 23 UniCredit Group Investment Committee has broadly maintained the global portfolio asset allocation. The only minor move was the upgrading of non EMU governments bonds to neutral from underweight, which was a tactical action given the level already reached by long-term US Treasury yields, and a qualitative assessment on Euro investment grade bonds to positive from very positive, as they remain supported by the ECB's purchases – but their tighter spread buffer makes them more vulnerable to rising rates.

We remain constructive on EM assets given, on the equity side, their higher GDP growth and, on the bond side, their superior bond yields, which allows the implementation of carry trades. However, they are losing momentum in consideration of a moderate slowing of China's GDP growth due to the beginning of a credit tightening cycle, rising US Treasury yields and the recent strengthening of the USD.

In consideration of the last two factors, we are implementing a more defensive and prudent approach to EM bonds, by reducing their duration and assuming an opportunistic focus on hard currency bonds. We are also becoming increasingly selective on countries with imbalances in terms of high quote of their public debt financed in USD, and with a low level of FX reserves, and /or countries with high political risk. We also expect the beginning of a hiking cycle in EMs: the central banks of Brazil and Russia have already acted pre-emptively, hiking their official rates in March, with further rate hikes expected.

Going forward, we estimate that bond portfolio returns, net of fees, will merely cover inflation, with real returns at zero or negative levels. Therefore, we suggest shifting from bonds into equities. Our clients will need to lengthen their investment time horizon and accept an increase in volatility. In any case, the current low nominal yield environment is at serious risk to becoming a lose-lose situation for our clients – who may also see their bond returns erode in a scenario of rising yields.

Equities instead appear supported not only by the low rates scenario, but also by governments' commitment to use fiscal policy to boost GDP growth, as they benefit from the multiplier effect. It is also worth considering that after the recent approval of the American Rescue Plan, an additional USD2.25 trillion fiscal stimulus, centered on infrastructures and clean energy, has been proposed in the US, though the package will be multiannual and partly financed by an increase in the corporate tax rate. And in Europe, the Next Generation EU programme should be viewed as the starting point of the next EU common fiscal policy.

## UniCredit GWM Asset Allocation Stances Summary

### Overweight Global equities
The combination of massive fiscal and monetary actions and hopes of a vaccine-driven global recovery supports equities, despite the high uncertainty around the resurgence of Covid-19, especially in Europe.

### Overweight European equities
In the short term, the asset class is penalised by the resurgence in Covid-19, but monetary and fiscal policies are highly expansive. Higher weighting of value and cyclical sectors versus the US equity market and attractive dividend yields, which are well above government and corporate bond yields.

### Neutral US equities
Improving growth outlook due to Biden's very expansionary fiscal policy and better health conditions, but less attractive valuations versus non-US areas.

### Overweight Emerging Markets equities
The recovery, which is more evident in China, and better health conditions, may favour a catch-up versus developed markets (DMs). We prefer Asian countries. Country and sector selectivity among EMs is strongly recommended.

### Neutral Pacific equities
Japan is supported by China's recovery, the high incidence of value/cyclical sectors and good management of the pandemic.

### Neutral Global bonds
Global bonds are supported by central banks' expansive monetary actions but their valuations, especially of DM government bonds, are not attractive.

### Overweight from strong overweight on Euro investment grade corporate bonds
Still supported by the ECB' purchases, but their tighter spread buffer makes them more vulnerable to rising rates. We prefer financial subordinated debt, given the increased capital buffer of European banks.

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

### Underweight EMU 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. We prefer

short duration and are selectively increasing the positioning on inflation-linked bonds. This may prove helpful to deal with the base scenario of a temporary and moderate increase in inflation.

### Neutral from underweight on non-EMU government bonds

A tactical move given the level already reached by US Treasury yields.

### Overweight Emerging Markets bonds

The search for yield supports selective buying opportunities, but we are now more defensive and selective given rising long-term US yields and a strengthening USD.

### Underweight Money Markets

We do not believe they are attractive, and should be used primarily as hedging for uncertainty.

### Neutral Alternatives

They offer portfolios diversification opportunities.

## Commodities

### Positive Gold

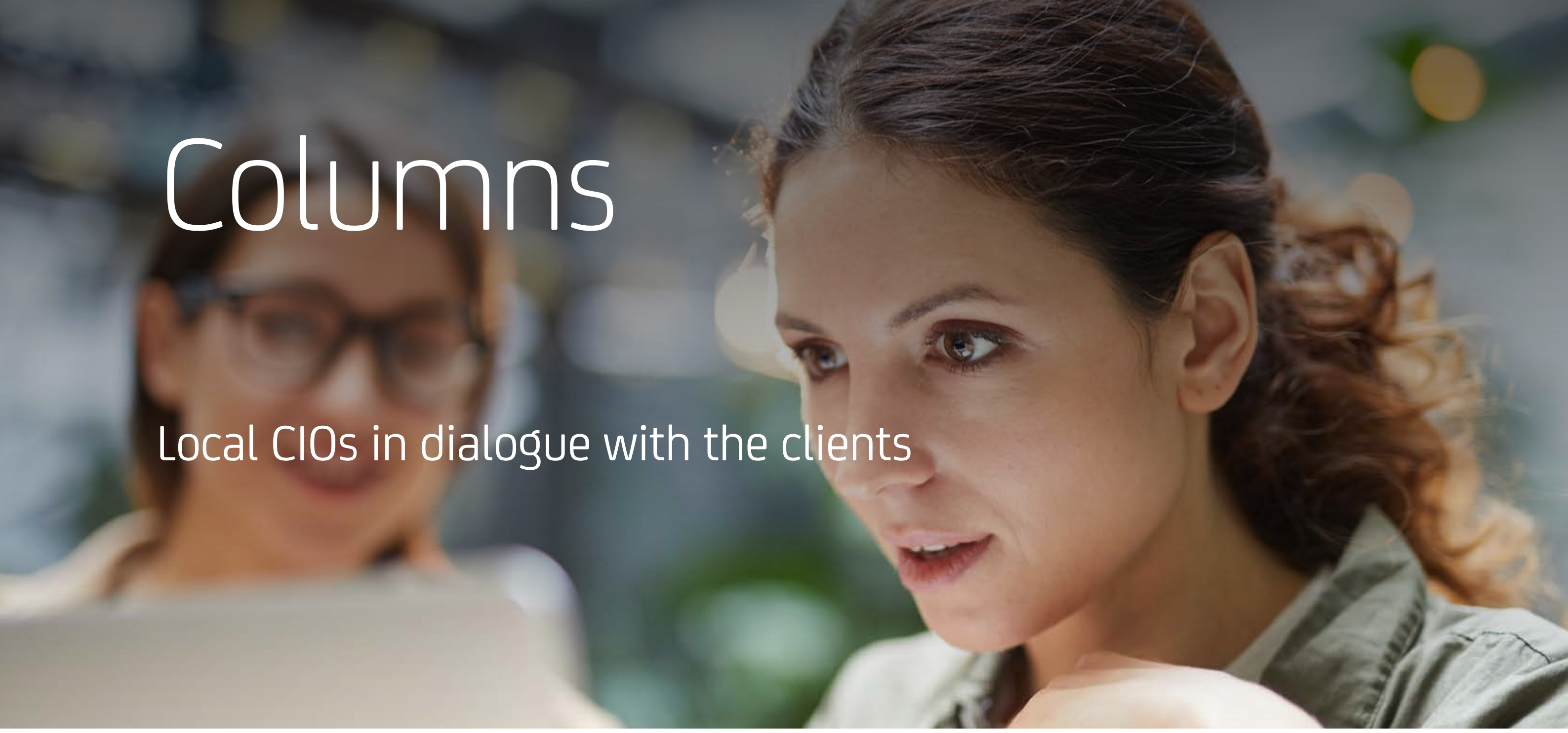
The price of gold will remain sustained by the monetary reflation of central banks and its role as a safe haven in an uncertain environment.

## Currencies

### EUR/USD

In the short term, the USD is supported by rising US bond yields and a faster US recovery thanks to successful vaccination campaigns. However, in the longer term, the Fed's accommodative monetary policy and the US "twin deficits" should maintain a weak USD.

A situation of "twin deficits" or "double deficit" occurs when a country has both a current account deficit and a fiscal deficit at the same time.



# Columns

## Local CIOs in dialogue with the clients

### Answers from Italy

**Is the increase in government debt a threat to financial markets?**

We are living through a historic economic period. The majority of developed countries have deployed impressive stimulus measures, comparable only to those seen in the aftermath of World War II. In the US, for example, the budget deficit in 2020 was over 15% of GDP, while the new administration, in addition to the last USD1.9 trillion package, has already proposed an infrastructure investment plan. Meanwhile in Europe, for the first time in several years, we have been moving into fiscal expansion territory and are starting to think about common debt instruments. Such extraordinary measures are deemed necessary to heal the economic wounds of the pandemic. And as a consequence, the potential inflationary effects of those measures have now become the hot topic.

At the same time, there is another relevant topic coming up for debate. Today's deficit is tomorrow's debt. And the debt to GDP ratio has been considerably increasing in developed countries. Historically, an excessive level of this ratio has been associated with the risk of unsustainable debt and financial market turmoil. Thus, some investors are asking themselves if today's cure could be tomorrow's disease. We think these worries are currently overdone – but nevertheless, sound reasoning is warranted to avoid past mistakes.

First, it is not always true that a high level of public debt implies unsustainability risks in absolute terms. Japan is an example of a highly developed and sophisticated economy, which has notable challenges in terms of real potential long-term growth amid deflationary forces, and for which debt sustainability has never been put

### Our experts:


**Alessandro Caviglia**

**CIO**
**Cordusio Sim** (Italy)

into discussion. This is a consequence of the fact that Japan has full printing money power. At the same time, monetary and fiscal policies have been working together to maintain control over debt servicing costs. While the same holds true for the US, this does not fully apply to the Eurozone, although we are seeing initial steps towards common instruments for debt financing. Second, the rise in debt in 2020 and in the coming years is being financed by central banks. Therefore, higher and higher percentages of debt are domestically held and controlled. Foreign investors, who in the past have been decisive for strong sell flows and yield increases, have a marginal role today – and this helps in maintaining control over flows and debt servicing costs.

In conclusion, the only relevant factor to evaluate sustainability for the additional debt that is being created today is the way we will spend this money. For developed countries, to finance mainly consumption in a globalized world where most of the goods are produced abroad, means increasing domestic public debt and favouring foreign wealth creation (or the "bad" debt). Investments directed towards strengthening infrastructures, sustaining digitalisation, protecting environmental health, and reducing social and economic inequality, will seed increases in the long-term potential of real growth. In our opinion, the fruits of these investments will more than compensate the costs of the "good" debt.

## Answers from Austria

### What does the current environment suggest for stock picking?

In the first quarter of this year, global equity markets performed very well, reaching new all-time highs to the delight of investors. Many segments in the bond market, on the other hand, posted losses and continue to offer no attractive real returns to protect the wealth of our clients against the loss of purchasing power. It therefore comes as no surprise as to why the majority of questions from clients refer to the equities asset class, where we continue to have a positive view.

How do we interpret the current environment, and what approach do we take to stock selection? In our view, current valuations across the major equity indices have indeed become very expensive. Growth stocks from the technology sector were considered winners of the pandemic and were bought at any price. In recent months, the previous laggards have caught up and given these indices an additional valuation boost.

In the meantime, we believe being particularly selective in stock picking is crucial in order to make our portfolios

Oliver Prinz

**Co-CIO Bank Austria and Schoellerbank** (Austria)

less sensitive to a potential correction. Therefore, and more than ever, our focus is on selecting inexpensive quality stocks with long-term growth prospects. In particular, during this phase, individual stock selection has the advantage of including fairly valued stocks in the portfolio, some of which are even in the technology sector.

Measured by the NASDAQ Composite Index, the technology sector is valued at an above-average level with a price-earnings ratio of around 70. Based on earnings expectations for the next 12 months, however, this value is only around 32 and thus only slightly above the long-term average. This means that market participants expect strong earnings growth in US tech stocks over the next 12 months and have already bought the stocks today in the hope that they will "grow into" the valuation. Valuations today are in many cases even higher than those of the dotcom bubble in the early 2000s, but the environment today is different. Interest rates are hovering around zero worldwide, while at the same time, governments and central banks are supporting the economy with trillions of dollars.

Therefore, we prefer shares in solid companies that offer a balanced risk / reward ratio.

We favour a balanced and diversified investment portfolio and recommend considering quality companies from as many sectors as possible. This year, while it is still young, is a prime example of the success of a diversified portfolio. It would have been wrong to focus only on the sectors that did well in 2020, because it is in fact the bottom performers of the previous year, energy and financials, that are outperforming so far in 2021.

## Answers from Germany

**On March 10, new rules around sustainable investing came into force in Europe. What do they mean for investors and what's next?**

The rules will initially provide investors with transparency about whether financial service providers are incorporating sustainable goals into their investment management strategies and how these goals are to be managed or achieved. Investment solutions, e.g. asset management or funds, are divided into three categories. The first category includes all solutions that do not pursue a dedicated sustainability strategy. According to the corresponding article in the regulation, such investment products are sometimes also referred to as Article 6 products. The second category includes those solutions in which the portfolio managers take sustainable criteria into account when

Philip Gisdakis

**Co-CIO of Group Wealth Management and CIO UniCredit Bank AG**
(HypoVereinsbank) (Germany)

managing the assets under management. These are also referred to as Article 8 products. These are distinguished from so-called Article 9 products (third category), in which the underlying investments each pursue a dedicated environmental objective, and this must also be named. Such strategies are sometimes also referred to as impact investing. In addition to these disclosure obligations, asset managers must now also include so-called sustainability risks in their investment decisions, regardless of whether the respective strategy pursues sustainable goals or not.
What does this mean? The term sustainability risk requires some explanation. The issue of sustainability can be spread out in two directions. First of all, it is about minimising the negative effects that society and companies have on the environment and thus to operate sustainably. There is also the definition of what is meant by sustainable development, according to the Brundtland Commission of the UN (named after the former Norwegian Prime Minister Gro Harlem Brundtland): "Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."
However, the sustainability risks mentioned earlier are not about these risks, but rather refer to the opposite direction. Environmental changes and new laws and regulations designed to minimise environmental damage can also have a negative impact on the economic prospects of individual companies. These economic risks are referred to as sustainability risks and must now be taken into account in investment management.

While these changes bring about more progress to sustainable investment management, the journey is not yet complete. The next steps will bring better and clearer reports on the sustainability impact of investment portfolios, e.g. with a presentation of the carbon footprint of the invested companies or the negative environmental impact these companies have. Investors will therefore be even more precisely informed about their investments, and as a result will be able to make appropriate decisions.

# Disclaimer

This publication of UniCredit S.p.A., Cordusio SIM S.p.A., UniCredit Bank Austria AG, Schoellerbank AG and UniCredit Bank AG (hereinafter jointly referred to as the "UniCredit Group") is addressed to an indistinct public of investors and is provided free of charge for information only. It does not constitute a personalized recommendation or consultancy activity by the UniCredit Group or, even less, offer to the public of any kind nor an invitation to buy or sell securities. UniCredit S.p.A., Cordusio SIM S.p.A., UniCredit Bank Austria AG, Schoellerbank AG, UniCredit Bank AG and the other companies of the UniCredit Group may have a specific interest in relation to the issuers, financial instruments or transactions that may be published, or have banking relations with the issuers themselves. Any estimates and/or assessments contained in this publication represent the independent opinion of the UniCredit Group and, like all the information contained therein, are given in good faith on the basis of the data available at the date of publication, taken from reliable sources, but having a purely indicative value and subject to change at any time after publication, on the completeness, correctness and truthfulness of which the UniCredit Group makes no guarantees and assumes no responsibility. Interested parties must therefore carry out their own investment assessments in a completely autonomous and independent manner, relying exclusively on their own considerations of the market conditions and the information available overall, also in line with their risk profile and economic situation.

It should also be noted that:

1. Information relating to the past performance of a financial instrument, index or investment service is not indicative of future results.

2. If the investment is denominated in a currency other than the investor's currency, the value of the investment can fluctuate strongly according to changes in exchange rates and have an undesirable effect on the profitability of the investment.

3. Investments that offer high returns can undergo significant price fluctuations following any downgrading of creditworthiness. In the event of bankruptcy of the issuer, the investor may lose the entire capital.

4. High volatility investments can be subject to sudden and significant decreases in value, being able to generate significant losses at the time of sale up to the entire capital invested.

5. In the presence of extraordinary events, it may be difficult for the investor to sell or liquidate certain investments or obtain reliable information on their value.

6. If the information refers to a specific tax treatment, it should be noted that the tax treatment depends on the individual situation of the customer and may be subject to change in the future.

7. If the information refers to future results, it should be noted that they do not constitute a reliable indicator of these results.

The UniCredit Group cannot in any way be held responsible for facts and/or damages that may arise to anyone from the use of this document, including, but not limited to, damages due to losses, lost earnings or unrealized savings. The contents of the publication – including data, news, information, images, graphics, drawings, brands and domain names – are owned respectively by UniCredit S.p.A., Cordusio SIM S.p.A., UniCredit Bank Austria AG, Schoellerbank AG and UniCredit Bank AG unless otherwise indicated, covered by copyright and by the industrial property law. No license or right of use is granted and therefore it is not allowed to reproduce its contents, in whole or in part, on any medium, copy them, publish them and use them for commercial purposes without prior written authorization from respectively UniCredit S.p.A., Cordusio SIM S.p.A., UniCredit Bank Austria AG, Schoellerbank AG and UniCredit Bank AG save the possibility of making copies for personal use only.