August 2021

Market overview and positioning

Companies are delivering very pleasing quarterly results, thus meeting investors' high expectations. Despite the ongoing debate over the persistence of inflation, interest rates remain very low. This summer has been much sunnier for the financial markets than it has been meteorologically in much of Europe. Forecasts for the autumn are optimistic.

Strong markets, strong data

Equities have developed pleasingly since the start of the year. The economy is in good shape, and global leading indicators are pointing to an enduring cyclical upturn, even if momentum has now retreated from record-high levels. Corporate earnings can be expected to rise over the next few quarters too. We are therefore expecting equities to perform better than other risky asset classes over the remainder of the year.

Inflation up sharply

Inflation rates in the US have attracted plenty of attention over the last few weeks. In June, consumer prices recorded a 5.4 percent increase compared to June 2020. That was significantly more than expected. The prices of second-hand cars increased by 10.5 percent, for example. Just like other goods and services that are now once again available after the easing of coronavirus containment measures, these goods experienced hefty price increases. Although there are strong arguments to suggest that these price rises will prove only temporary, the financial markets will be watching US inflation data like a hawk over the coming months.

Inflated price level could persist

The number of concerned observers anticipating persistent increases in inflation is growing. The historically unprecedented fiscal and monetary measures being pursued by governments and central banks can be expected to fuel inflation going forward. The US labour market is in much better shape than many people expected. Higher prices are likely to persist longer than anticipated, partly due to problems in supply chains, but also because high household saving levels can easily trigger heavy demand.

"Corporate earnings strong, economic growth strong, inflation high: How should portfolios be adjusted?"

Alex Müller, Chief Investment Officer

Fed comments keep interest rates low

Despite current parameters, nominal interest rates have exhibited negative tendencies for several months now (see graph). This does not fit with a picture of a strong economy and rising inflation. One reason for this phenomenon is likely to be the current communication stance of the US central bank (Fed). In mid-June 2021, the Fed issued new forecasts for key interest rates, economic growth and inflation. Despite its generally positive economic outlook, it predicted only a temporary pickup in inflation. This has brought the trend of higher capital market interest rates to an end for now, as the majority of market participants have accepted the Fed's reasoning.

Wir begleiten Sie im Leben.

Market overview and positioning

Our inflation summary: normalisation

The recent sharp increases in inflation rates in Europe too will preoccupy the financial markets over the coming months. As we see it, nominal yields are too low given the current environment of growth and inflation. As an additional factor, the Fed can be expected to start tapering toward the end of 2021. We are not expecting an interest rate rise before the start of 2023. In our view, the spike in inflation caused by the base effect should prove only temporary in nature. In the long term, the markets are also expecting a low interest rate of only just over two percent. Our base scenario accordingly envisages a normalisation of the inflation rate later this year. We therefore remain cautious about the prospects for government bonds and high-quality corporate bonds.

Different opinions, same recommendation

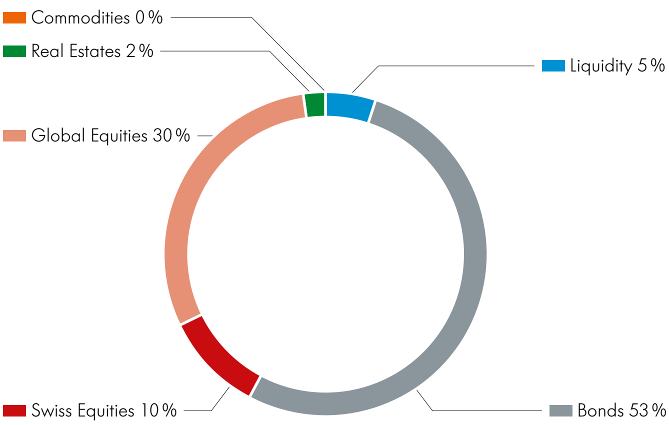
For the time being, both standpoints on the development of inflation lead to similar recommendations for action. An underweighting of government bonds is still advisable. We remain overweight in equities, where the challenge lies in selection. In Switzerland, the likes of EMS Chemie, Givaudan and Sika have provided perfect examples of how important price-setting power can be in the current environment. Investors should be overweighting equity markets such as Switzerland, where companies operating in defensive sectors have high-quality business models. A further overweighting of cyclical European markets will also enable them to benefit from the ongoing economic recovery. We would be more likely to view any setbacks due to political, economic, or inflationary scares as an opportunity to expand our equity positions rather than reduce them. Volatility will be generally high.

> **“A nice portfolio proposal – an unalloyed success”**
> Bilanz Private Banking Ratings 2021
>
> Find out how we can support you in the structuring of your portfolio https://www.zugerkb.ch/en/private-clients/investments-stock-market/investment-advisory

Delta not (yet) a spoiler

Thanks to containment measures and vaccine programmes, the coronavirus pandemic has gradually been brought under control since the spring. On the other hand, existing virus mutations and the fairly sluggish progress of vaccination in many countries can be expected to unsettle markets once again in the second half of the year. This would particularly be the case in the event of renewed restrictions being imposed on companies or individuals. But as long as the existing vaccines work against mutations too, the pathway out of the pandemic is now signposted. We are expecting to see further improvement on this front, and are optimistic about economic development. That said, it is still too early to call an end to the COVID-19 crisis.

Strategic Allocation (Source Balanced Mandate)



Tactical Allocation

	−−	−	=	+	++
Liquidity/Money Market				■	
Bonds		■			
Government Bonds	■				
Corporate Bonds		■			
High Yield Bonds & Emerging Markets				■	
Equities					■
Swiss Equities				■	
Global Equities ex Switzerland				■	
Emerging Markets Equities					■
Real Estates Switzerland			■		
Commodities				■	

Source: Zuger Kantonalbank

What does this mean for investors?

Upwards cycle not yet at an end

Equity markets have continued to develop positively since our last portfolio publication. In US dollar terms, the MSCI World Index has risen by just under 3 percent. Since the start of 2021, this key global index has risen by more than 14 percent. The Swiss equity market has gained just over 13 percent, while the US market has been the stellar performer, rising by more than 17 percent. The economy is in good shape. Quite apart from its current positive state, global leading indicators are pointing to a persistent cyclical economic upturn. Equities can therefore be expected to perform better than other risky asset classes over the remainder of the year. However, investors will be closely scrutinising corporate earnings development come the autumn.

Our portfolio positioning

We continue to recommend that investors overweight global equities from both developed economies and the emerging markets. Global economic development favours companies from Europe in particular, as we have already explained in previous publications. Furthermore, we increased our weighting of Swiss equities in the portfolios a month ago. Their defensive qualities are likely to be in greater demand as the second half of the year unfolds.

Equities remain attractive – particularly defensive stocks

Given this fundamentally strong background, we would still be more likely to view any equity market correction as a buying opportunity. Due to the pandemic situation outlined above, however, we would continue to urge caution with respect to the shares of companies that stand to gain most from the full reopening of the economy (e.g. airlines, hotels).

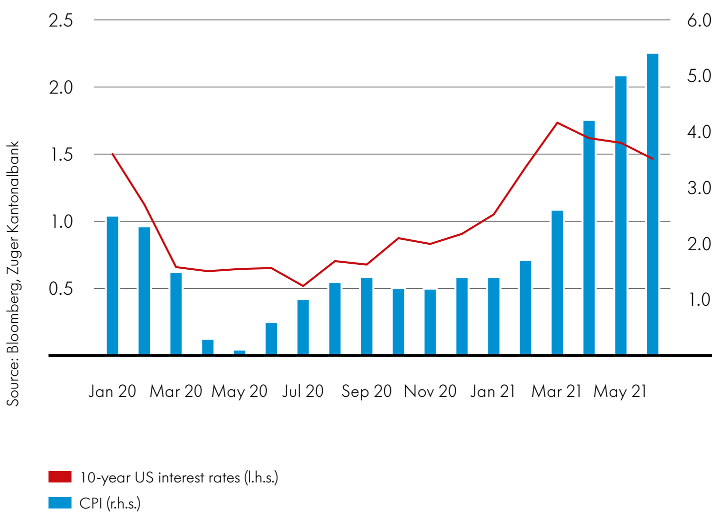
Selection for bond investors

High rates of inflation weigh on bond investors first and foremost. As things stand, we continue to view government bonds – and above all European bonds – as unattractive. Recent declines in interest rates confirm us in that view. For their part, corporate bonds have benefited from the increase in investor risk appetite in recent months, to the point where this asset class now looks very expensive. Only in the area of high-yield bonds do we still see some potential. On the one hand, current yields are higher here, while on the other this area of the fixed income market is favoured by the positive economic outlook and low overall interest rate environment.

Gold continues to glitter

Gold too is benefiting from the risk of higher inflation rates. As capital market rates have declined further recently, real interest rates remain deep in negative territory for now. This is likely to support the price of gold.

CPI vs. 10-year US interest rates



Investment Update

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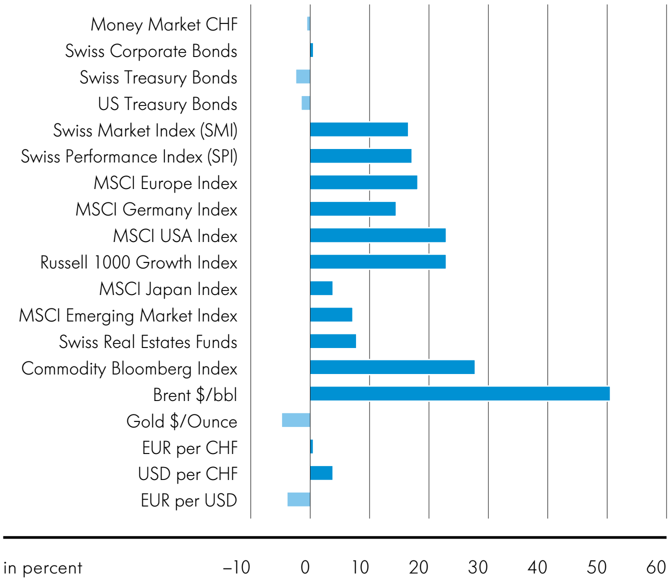
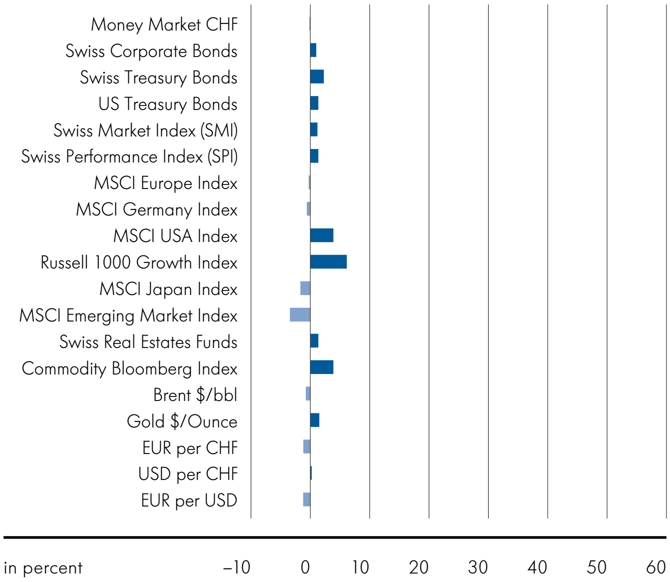
Market data (exchanges & markets)

Return Asset Class (in CHF) since year start (as of 23.07.2021)



Return Asset Class (in CHF) since year start (as of 23.07.2021 rolling)



Source: Bloomberg, Zuger Kantonalbank

Swiss Equities SMI (since year start till 23.07.2021)

Partners Group 50.2% / CHF 1529.5	**Richemont** 45% / CHF 116.1	**ABB** 40.1% / CHF 33.67	**Geberit** 36.7% / CHF 743.6	**Sika** 33.6% / CHF 320.2
Swatch Group 29% / CHF 307.8	**Lonza** 24.7% / CHF 705.6	**Givaudan** 22.5% / CHF 4489	**UBS** 20% / CHF 14.62	**Swisscom** 19.4% / CHF 544.8
Swiss Life 18.2% / CHF 465.3	**Roche** 15.7% / CHF 347.3	**Nestle** 13.8% / CHF 115.62	**Lafarge Holcim** 13.6% / CHF 53.3	**SGS** 12.9% / CHF 2927
Alcon 11.3% / CHF 65.42	**Swiss Re** 6.9% / CHF 83.26	**Novartis** 5% / CHF 84.57	**Zurich** 3.3% / CHF 366.7	**Credit Suisse** –17.9% / CHF 9.26

Leading Indicators of industrial production
Values > 50 indicate expansion, Values < 50 indicate contraction

	June 2020	July 2020	Aug 2020	Sep 2020	Oct 2020	Nov 2020	Dec 2020	Jan 2021	Feb 2021	Mar 2021	April 2021	May 2021	June 2021
Global	48	50.6	51.8	52.4	53.1	53.8	53.8	53.6	53.9	54.9	55.8	56	55.5
Switzerland	41.4	49.6	51	52.8	52.9	54.5	57.3	59.4	61.3	66.3	69.5	69.9	66.7
Eurozone	47.4	51.8	51.7	53.7	54.8	53.8	55.2	54.8	57.9	62.5	62.9	63.1	63.4
Germany	45.2	51	52.2	56.4	58.2	57.8	58.3	57.1	60.7	66.6	66.2	64.4	65.1
Great Britain	50.1	53.3	55.2	54.1	53.7	55.6	57.5	54.1	55.1	58.9	60.9	65.6	63.9
USA	52.2	53.7	55.6	55.7	58.8	57.7	60.5	58.7	60.8	64.7	60.7	61.2	60.6
Japan	40.1	45.2	47.2	47.7	48.7	49	50	49.8	51.4	52.7	53.6	53	52.4
Emerging Markets	49.6	51.4	52.5	52.8	53.4	53.9	52.8	52.1	51.5	51.3	52.2	52	51.3
China	51.2	52.8	53.1	53	53.6	54.9	53	51.5	50.9	50.6	51.9	52	51.3
Brasil	51.6	58.2	64.7	64.9	66.7	64	61.5	56.5	58.4	52.8	52.3	53.7	56.4

Source: Bloomberg, Zuger Kantonalbank

Do you have any questions or thoughts regarding the current portfolio?

Simply contact us by e-mail (alex.mueller@zugerkb.ch) or call us at +41 (0)41 709 11 11.

Zuger Kantonalbank