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# Market View

September 2021

## Executive Summary

- Recent macro data confirmed our assumption that global economic growth peaked in Q2 and has been on a slowing trend since May.
- Biden's approval rating has taken a severe hit in the wake of the Afghanistan withdrawal chaos. This will likely undermine his agenda, meaning less fiscal spending but also fewer tax hikes.
- We believe that – while they are less attractive compared to the start of the year – equities still offer a sufficiently attractive risk-return setup to continue to justify our slightly overweight position, with significant emphasis on high-quality stocks.
- Investor sentiment and forward guidance on monetary policy will be the key factors to watch in the coming weeks.
- Should current investor cautiousness transform into complacency and a "goldilocks" mindset, this would be our signal to think about reducing our risk allocation.

## Powell's "dovish tapering" lifts equity markets

Led by the US, equity markets in developed nations have shown strong performance over recent months, with very little volatility and relentless dip buying already at minor (<5%) pullbacks. Despite the stellar equity performance, the "wall of worry" in investors' minds is evident. Market action often reflects a tug of war between growth worries and perceived taper risk.

In this context, the Fed Chairman, Jerome Powell, gave his eagerly awaited Jackson Hole speech, which analysts interpreted as a signal for a "dovish tapering". So far, the speech has ignited new upward momentum in equity markets, led by the Big Tech sector.

## Market Development

### World

- Economic Surprise indices have now turned negative (Delta, the China slowdown, geopolitical uncertainty and fiscal delay in the US).
- The July US inflation prints may indicate the start of a moderation of inflationary pressure. We still need 3-6 months more of data to have a clearer picture.
- The private-sector crackdown in China may continue in some form or another until the 20th People's Congress in October 2022. Chinese tech companies are now trading at a steep discount to developed market peers.
- However, given the economic slowdown, China may soon start to ease monetary and fiscal policy, given recent comments by the People's Bank of China (PBoC).

### Europe

- With Merkel set to step down, the SPD is ahead in the polls for the first time in 15 years, increasing the probability of a left-leaning government that could change Germany's stance on fiscal spending and corporate taxes. Recent polls suggest that any two-way coalition might fall narrowly short of a majority. Forming a new government might therefore take a significant amount of time.

### Switzerland

- The KOF Economic Barometer fell more sharply than expected in August (from 130.9 to 113.5 points, the consensus estimate being 125). After reaching an all-time high of 143.7 points in May, this was its third decline in succession. However, the barometer is clearly still holding its own above its long-term average of 100 points and therefore continues to signal ongoing economic recovery.

## Moving closer to a "Goldilocks" market narrative

At the start of the summer, we expressed our view that the US Federal Reserve would be careful not to spook markets with an aggressive tapering stance in the face of the rampant delta variant. Powell's Jackson Hole speech in late August confirmed these expectations.

We believe that the speech delivered a good outcome for equity markets and real assets. It moved the overall market environment one step closer to what we see as "goldilocks" conditions.

- Powell emphasized that the process of tapering would carry no indication of the future rate hike path and made clear that once started, it would remain flexible and data dependent.

- While not giving a concrete date, the consensus of opinion expects an official announcement to be made in Sept/Oct and that tapering will begin in Nov/Dec of this year.
- As the Fed is very focused on labor market conditions, the coming employment reports will be important in determining the actual taper announcement.

Checkmarks for the "Goldilocks" environment:

- Rising corporate earnings, highlighted by continued strong earnings-per-share momentum in Q2, providing fundamental substance to elevated valuations.
- Peak growth is behind us, but global growth is still running above long-term trend.
- At the same time, inflationary pressure could be cooling off based on the recent decline in global PMI input and output prices (it remains too early to tell though).
- Unlike in 2015 and 2018, the latest drawdown in China has not been contagious with regard to global equities. Conversely, possible easing in China could still have a positive effect on global markets.
- Even when faced with the start of QE tapering by the Fed, monetary conditions will remain softer than at almost any other point since the global financial crisis until well into the second half of 2022.
- Finally, investor risk sentiment is muted despite strong equity performance.

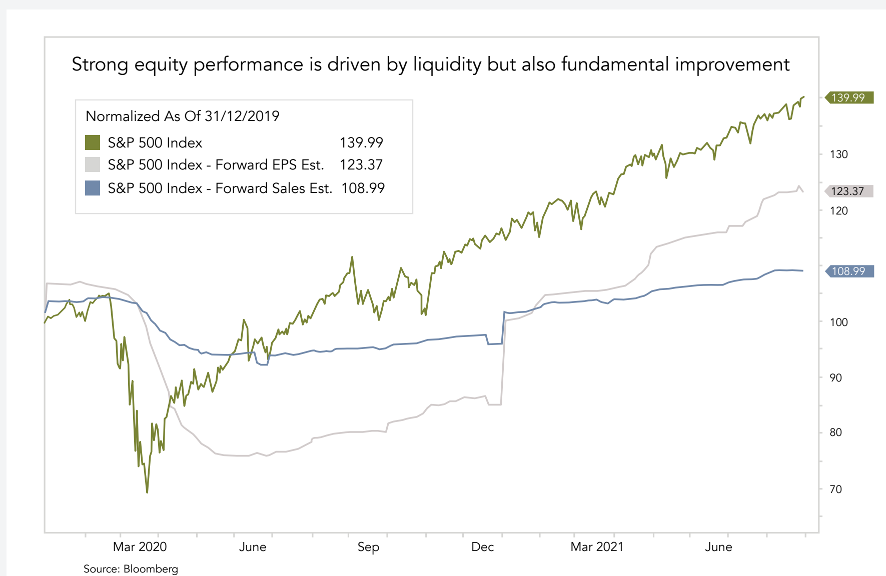
All this implies that conditions will still be attractive for risk assets. Once the market really starts to embrace the "goldilocks" narrative, we could imagine two scenarios going forward: Either a transition back to a reaccelerating cyclical recovery (decreasing delta, fiscal delivery, factor rotation and higher yields), or the materialization of a deeper global growth scare (rising credit spreads, overall risk-off). Either way, we expect volatility to return once this crossroads arrives.

## Positioning

- The notion that "there is no alternative" to stocks remains a key mantra for investors, despite the cautious risk sentiment. This implies that the path of least resistance remains upwards for now.
- Central banks will continue to be accommodative, real yields are negative, more fiscal stimulus can be expected and households have large excess savings as well as pent-up demand. Strong corporate earnings and the resumption of stock buybacks are further positive factors.
- We are trying not to underestimate how far this rally can run, but we can recognize a multitude of risks: a monetary policy mistake, unexpected inflation, a significant resurgence of COVID, a Chinese spillover, and rising geopolitical risk.
- We are maintaining our overall balanced allocation, with an emphasis on high-quality. We believe the ability to defend margins will become increasingly important as we move through the mid-cycle.
- China-sensitive trades, such as European luxury goods, may continue to struggle until China's PMIs start to rise again (probably due to stimulus measures).

## Chart

Since the end of 2019, the S&P 500 has risen 40% while estimated forward earnings-per-share have increased by 23% and estimated forward sales by 9%. This implies a price increase of 1.7x the expected earnings increase. In the 5 years prior, this factor was 1.5x. Since the end of 2019, the Fed's balance sheet doubled.




**Sources:** Bloomberg, Barclays, Morgan Stanley, Kepler Cheuvreux, Nordea, Goldman Sachs, The Market Ear, ZKB

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