BELVOIR
CAPITAL AG

June 2021

Strategy Update

Foreword by Steffen Bauke, CEO

Dear Investors,

Since the beginning of this year, and even more so since April, investors have been preoccupied with the question of inflation. Never before in my 20-year career as an asset manager and investment advisor have I been asked so often how we see **inflation** and how we position ourselves. We have written research on that subject, compared many analyses and expressed our views to our investors. We don't have a crystal ball here either, but experience teaches us: ***"Things are never as bad as they seem."*** Although we have seen a recent surge in commodity, raw material, producer, and supplier prices, we do not believe that we are entering, or have already entered, a period of "hyperinflation." Currently, we see a base effect after the "corona jam" of the last 18 months. In the long run, inflation will indeed be higher than before the pandemic, since the deflationary effects of globalization will largely disappear due to the "retraction of production". But the oversupply of goods and services and global competition will keep inflation in check. Also, interest rates will not or cannot return to the levels seen in the 1980s, as countries simply cannot afford to service their debts. As a consequence, this means: ***"Japanization",*** i.e. creeping, hidden inflation without compensation via interest rates. Therefore, investors have to take risks and thus go into **equities** and **other higher-yielding investments** if they want to escape the creeping inflation in the long run.

Zurich, 30.06.2021

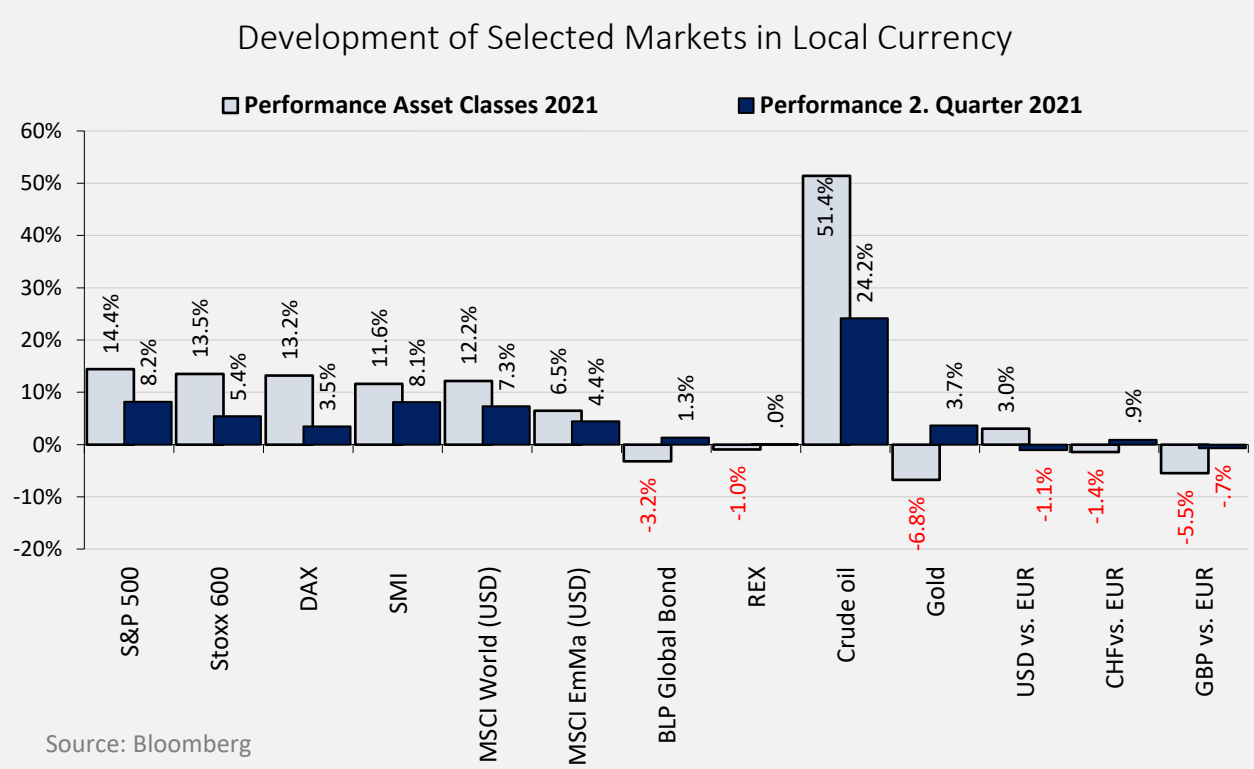
BELVOIR CAPITAL AG

Strategy Update 2nd Quarter 2021

June 30, 2021

Review

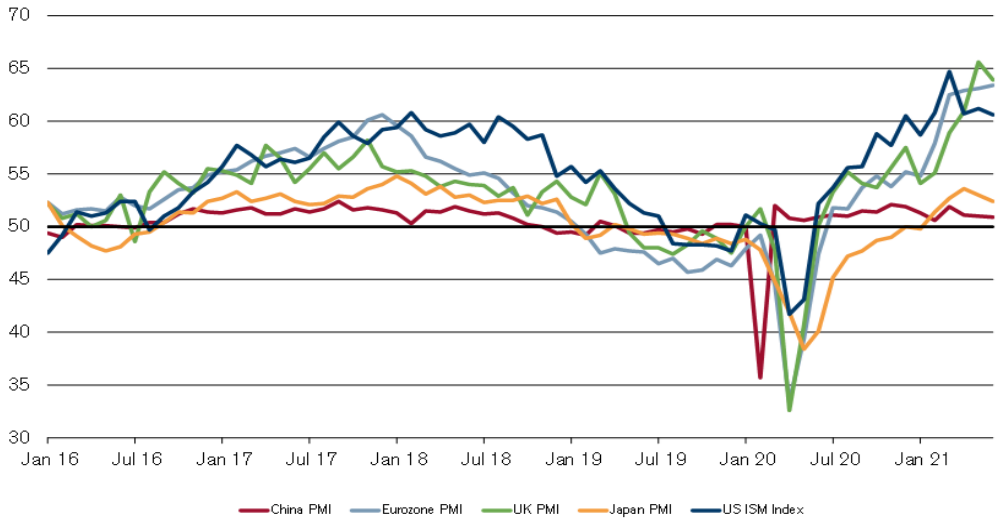
Almost all stock indices realized new highs in June; that applies to the S&P 500, the Nasdaq, the DAX and the SMI. It was the best 1st semester in 20 years. While the European markets clearly lagged the technology-heavy US markets last year, the situation was different this year. European stocks were able to start from a lower base as well as valuation and could show strong earnings momentum. Among others, the Swiss market was convincing in the 2nd quarter; the SMI took the 12,000-point mark in June. China was among the laggards, due to deleveraging and a restrictive fiscal policy and a deliberate credit shortage. Also from a sectorial approach, performance differences were considerable. The winner in the first half of the year was clearly the energy sector, followed by financials, while non-cyclical consumption and utilities were the laggards. Where did the almost boundless optimism come from? The surprisingly bright economic outlook, positive



signals in vaccinations compared to the previous quarter in Europe, and continued support from policymakers in combination with central banks (dual stimulus of monetary and fiscal policy) were the drivers of the market. Gold could not maintain the interim gains of almost 12% and gained 3.7% in USD terms in the second quarter.

Economy – Normalization after Extraordinary Growth

The global economy should grow by around 6.3% in 2021 and decline again to 4.4% in 2022. The current high growth rates will fall significantly in 3-6 quarters at the latest. In the US, economic momentum is expected to peak in the current quarter, in the Eurozone in all probability in the 3rd quarter. Parts of Asia and Latin America are currently rather weak regions, partly because vaccination rates there are still very modest. The PMIs have reached their highs, but most analysts do not believe that the growth cycle will come to an abrupt end.



Purchase Manager Indices (Source: Bloomberg)

Federal Reserve (FED) – Adjusted Rhetoric with a View to Less Expansionary Monetary Policy

The FED's balance sheet should amount to around USD 9,000 billion by the end of 2022. Currently, about USD 120 billion of government bonds and securitized bonds are still being purchased per month, which purchases are likely to be slowly reduced in 6 months (tapering). At the beginning

of 2020, the FED's balance sheet still amounted to USD 4,100 billion. This situation cannot go on forever. The FED is trying to get the markets in the mood for a less expansionary monetary policy. However, the differences of opinion in the Open Market Committee are great. The mere fact that a likely tapering puts the cat among the pigeons, shows how great the dependence on monetary policy measures has become. 13 out of 18 FOMC members expect the first-rate hikes as early as the second half of 2023; they also expect a clear communication regarding the timing of tapering in the second half of 2021. FED Chairman Powell stressed that he wants to see a broad recovery in the labor market before tapering is on the table. We expect the ECB to stick to its generous stance longer than the FED.

Inflation – No Concern, but Higher Level than in the Past

Producer prices in China, the US and Germany are all currently growing by more than 4% year-on-year. A jump in consumer inflation of 5% in May in the US is mainly due to higher energy prices, prices for used cars, airfares and hotel prices. These base effects have no lasting effect. And yet, this is spurring fears that central banks may start to scale back the generous supply sooner than expected. The key to the inflation trend will be the labor market data, especially that from the US. In order that inflation rises permanently, lower incomes in particular will have to increase. However, with unemployment still at 8.3%, this pressure is still low. In addition, the bargaining power of unions in the US is significantly lower than in the 1970s and 1980s, when high inflation prevailed. Most of the factors driving prices are likely to prove temporary; nevertheless, inflation is likely to be above the levels of recent years.

Bonds – Real Interest Rates Remain Negative

With 1.45% the yield for ten-year US Treasuries is around 30 basis points below the high for the year in March. The yield of 10-year Bunds being at -0.24% hardly changed in the 2nd quarter. However, due to steady growth and inflation expectations, there will be a slight upward trend in interest rates. Even if this occurs, they will still be in negative territory when adjusted for inflation. Credit Spreads are at multi-year lows. Bondholders are not being adequately compensated for the credit risk they have incurred. This circumstance and the expectation of slightly higher interest rates induce us to abstain from investing in bonds as much as possible.

10-year government bond yields US, Germany and Switzerland (Source: ZKB/Swisscanto)

Stock Markets – Positive Drivers Remain, Slightly Higher Alertness

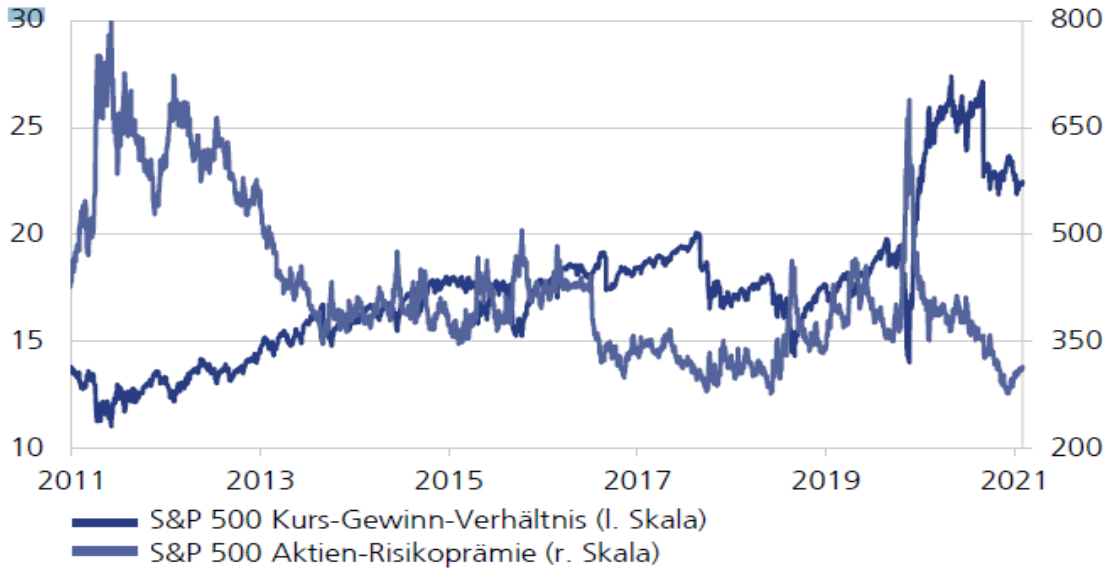
The drivers for the stock markets are still in place – including the normalization of the economy, fiscal and monetary policy support, and strong earnings growth. It is impressive by how much earnings growth has exceeded analysts' expectations so far. UBS expects profits to rise by 31% in 2021. As is well known, the stock market trades the future. At present, many positives factures already seem to be priced in and the risks seem rather unconsidered. Shareholders should be increasingly prepared for sources of liquidity drying up, or at least not flowing as abundantly. In 2013, the central bank's announcement that it would reduce bond purchases caused volatility to rise sharply within days. Significant shifts from equities to bonds are not to be expected. The past has shown that equities offer much better inflation protection than nominal investments. Despite the merging change in the FED's rhetoric, we still see the most potential in equities. The risks equities will increase when the rise in inflation were to prove persistent and monetary policy were to react decisively to it. However, we have not yet reached that point. Even if the markets have reached high valuations in some cases, it must be noted that there has been no euphoria on the stock markets.

Interesting to observe were the extreme dispersion of performance between sectors and sub-sectors. Until Q3 2020, the IT sector, Greentech, the Healthcare sector, together with all Online-based business models as corona winners, gained massively in value. Since fall 2020 up to and including April 2021, especially in connection with rising interest rates in the US, the «Corona High Flyers» have been massively punished with markdowns of 50% and more («the overhyped ones).

During that period, «Old-Economy» stocks and cyclical sectors in particular were able to gain value. On an index basis, the strong sector rotations were hardly reflected, which is why they are mentioned here. Since April, when 10-year US Treasury bonds stopped their rise in interest rates, these sectors which suffered before are now back in demand. Therefore, the positioning within equities needs to be observed closely and adjusted if necessary.

Fear and Greed Index (Source: CNN)

The MSCI is currently trading at a P/E ratio of 19.7 based on consensus earnings estimates for the next 12 months. S&P 500 stocks trade at a P/E of 20.5 with reference to 2022 earnings. The historical average is 15. For the STOXX 600, the P/E is 15.9, with the historical average at 14. Even though equity risk premiums have fallen while P/E ratios increased, equities are still the more attractive asset class relative to bonds.



Higher P/E Ratios vs. Lower Equity Risk Premiums (Source: LGT, Bloomberg)

Gold – Protection against Crises and Inflation

We continue to hold gold as meaningful complement to other asset classes and an insurance against crises. One of the most important drivers for the gold price is the level of real interest rates respectively their development. In view of global debt levels, it is hardly conceivable that central banks will tolerate a significant increase in real yields in the long term. The main driver of the correction since the beginning of June has been the strong USD and reports from the FED that it might curb inflation sooner.

Conclusion

We maintain our preference for equities over bonds and complement them with alternative investments that have little or no correlation to equities and interest rates. Among other things, we build on quality, market leadership and future themes. A possible consolidation on the markets – we do not expect major corrections – does not change the long-term attractiveness of equities and other tangible assets compared to bonds. In our view, real capital preservation can primarily be achieved through equities. History teaches us that at some point volatility will rise again, and perhaps as early as the second semester of this year. Volatility has fallen to its lowest level since the pandemic and geopolitical issues are almost completely ignored by the stock markets at present. In the upcoming months, we will therefore take some profits or build in some hedges. In terms of bonds, we remain heavily underweighted; gold remains a supplement with a function as a hedge against inflation and crises. Diversification into good hedge funds (where allowed) will further help to reduce downside risks and slightly smooth the portfolio development. We thank you for your trust and are at your disposal for further information.

Your Belvoir Team

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