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BILBoard March/April 2021: Positioning for recovery



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Reopening and recovery is the predominant narrative in markets, with investors looking past the here and now to position themselves for a bright post-pandemic future.

Already, things are looking better than expected – the OECD recently upgraded its global growth forecast for 2021 to 5.6% (up 1.4% from previous estimates), while earnings revision trends are positive in all regions.

Better growth prospects have also led to higher bond yields – especially in the US. While higher yields are causing (and could continue to cause) volatility for equities, we do not think it will derail them; firstly because they are rising from extraordinarily low levels, and secondly because their increase is a reflection of an improved economic outlook. In a nutshell: we think yields are rising for good reason.

MONETARY POLICY IS EXPECTED TO REMAIN ACCOMMODATIVE FOR NOW

The reopening and recovery theme has also caused an uptick in inflation expectations. Inflation usually becomes a problem when central banks decide to fight it by hiking rates to cool an overheating economy. In the US, the Fed seems confident that any increase in inflation will be transitory (breakeven rates also show that the market expects an inflationary burst rather than sustained price increases). At its March FOMC, the Fed reaffirmed its commitment to using its tools to achieve its full employment mandate "for as long as it takes". Clearly the central bank is focused on fostering sustainable growth, beyond the post-lockdown sugar-rush and, as such, the Fed's dot plot doesn't indicate any rate hikes until 2024, even if some Fed board members are considering 2023. The committee also said it would maintain the current pace of its asset purchases (\$120bn per month). We view inflation risk as limited for now in the eurozone, as well as in China, where falling pork prices have reduced inflationary pressures.

A continuation of supportive monetary policy, combined with fiscal stimulus and the vaccine rollout, underpins our overweight on risk assets like equities.

EQUITIES

Certain regions, like the US and China, are ahead in terms of the reopening and recovery narrative. In our equity allocation, we give preference to those regions, simply because that is where growth potential is higher and where we see the most opportunities.

In the US, the effects of Joe Biden's new \$1.9 trillion stimulus package are already filtering into the macro data. In March, IHS Markit noted a strong increase in demand, buoying growth of orders for both goods and services to multiyear highs. Indeed, US households (on aggregate) now have higher savings and less debt than before the pandemic and, consequently, there is a lot of dry powder piled up waiting to be spent. **Consumer Discretionary** is therefore one of our preferred sectors.

Sector-wise, we also like **Materials** (a sector with strong earnings revisions, supported by higher commodity prices) and **Industrials** (a key beneficiary of the reopening theme and government stimulus). Finally, we like **Utilities**. Initially, this defensive play may seem like a bit of a black sheep among the three aforementioned cyclical sectors, but we hold on to it as, within it, we are actively cherry-picking the companies that are poised to benefit from the energy transition (including \$400bn earmarked by Biden for spending on clean energy and innovation).

Because the US is ahead in terms of reopening (which is reflected in higher rates and inflation expectations), we have implemented a Value tilt inside of our US equity exposure. Value stocks typically do well when the economy is in an expansionary phase and when corporate profits and interest rates are on an upward trajectory. As of now, Value stocks have clearly cheaper valuations than Growth stocks.

The upward push on interest rates and steepening yield curves would normally represent a positive signal for European equities, due to the higher concentration of Value stocks in the region. Despite a modest increase to our exposure lately, we think it is premature to go overweight. The ambiguity around the reopening timeline in Europe, with some countries still in lockdown, means there is more uncertainty with regard to corporates' ability to meet earnings expectations. UK equities are now more attractive, given the speed of the vaccination drive.

FIXED INCOME

Overall, we are negative on fixed income, especially Sovereigns due to a global uptick in rates. In the US, the curve continues to steepen and the overall tone of the Fed leaves bonds with longer maturities at the market's mercy for increasingly higher rates. This month, we closed all remaining TIPs positions, meaning we no longer have any US Treasuries in our portfolios. The small underweight we hold in govies is concentrated in Europe, where the ECB is front-loading its Pandemic Emergency Purchase Program (PEPP) to cap rising rates. The ECB is also trying (and succeeding) to contain intra-European spreads, making us neutral on core vs. periphery.

We are overweight on investment grade corporate bonds as we believe they should continue to benefit from supportive monetary policy and an improving macro landscape, potentially even overshooting in terms of spread tightening.

We have a small overweight on the high-yield bond segment. Spreads are now at pre-Covid levels, flows are supportive as investors hunt for yield and expected defaults are falling back towards historical averages. Higher oil prices are providing relief for the US energy sector, which represents quite a substantial part of the US high-yield market.

Within our Emerging Market debt allocation, we prefer hard currency corporates, which better withstood the recent sell-off. Corporates are more resilient against a rise in real yields.

CONCLUSION

All in all, we look to be headed into *a period of rebounding growth and ample liquidity, fuelled by an unprecedented symbiosis of fiscal and monetary policy and broad economic re-engagement* as vaccines are rolled out. As such, we favour riskier assets, focusing on companies that are set to benefit from the themes of reopening and recovery, primarily in more cyclical sectors.

23/03/2021		DEFENSIVE		LOW		MEDIUM		HIGH	
		Stance	Change	Stance	Change	Stance	Change	Stance	Change
Global Allocation	Equities	●	➡	●	⬆️	●	⬆️	●	⬆️
	Bonds	●	➡	●	⬆️	●	⬆️	●	⬆️
Equities	USA	●	➡	●	⬆️	●	⬆️	●	⬆️
	Europe	●	➡	●	⬆️	●	⬆️	●	⬆️
	Japan	●	➡	●	⬆️	●	⬆️	●	⬆️
	China	●	➡	●	⬆️	●	⬆️	●	⬆️
	Emerging Markets Ex-China	●	➡	●	⬆️	●	⬆️	●	⬆️
Bonds	Government Bonds - Developed	●	⬆️	●	⬆️	●	⬆️	●	⬆️
	Emerging Market Debt	●	⬆️	●	⬆️	●	⬆️	●	⬆️
	Corporate - Investment Grade	●	➡	●	➡	●	➡	●	➡
	Corporate - High Yield	●	⬆️	●	⬆️	●	⬆️	●	⬆️
	Total Return	●	➡	●	➡	●	➡	●	➡
Commodities	Oil	●	➡	●	➡	●	➡	●	➡
	Gold	●	➡	●	➡	●	➡	●	➡

Stance: Indicates whether we are positive, neutral or reluctant on the asset class . Change:
Indicates the change in our exposure since the previous month's asset allocation committee

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