Weekly - July 5, 2021

PERFORMANCES 2021	
EQUITIES	
MSCI World	+13.2%
S&P 500	+15.9%
Nasdaq	+13.6%
Stoxx 600	+14.5%
SPI	+15.2%
Nikkei	+4.2%
China	-2.4%
Emerging	+5.0%
BONDS	
CHF Corp	0.0%
US Govt	-2.4%
US Corp	-1.1%
US HY	+3.8%
EUR Gvt	-2.4%
EUR Corp	0.0%
EUR HY	+2.7%
CURRENCIES	
USD index	+2.5%
EURUSD	-2.8%
EURCHF	+1.2%
USDCHF	+4.2%
USDJPY	+7.3%
EM FX	-1.2%
COMMODITIES	
Gold	-5.6%
Silver	-0.7%
Brent	+7.3%
Copper	+23.9%
CRB index	+28.1%

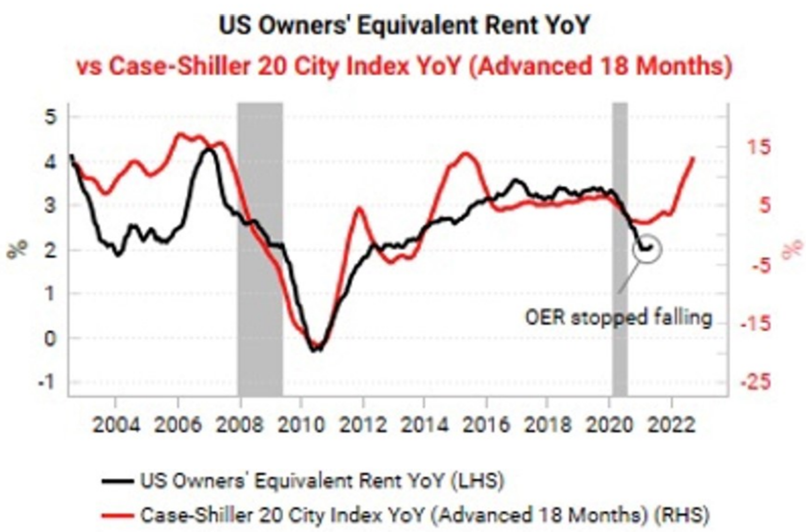
A thorn in the flesh

The wealth effect engineered by the Fed, thanks to its ultra-accommodative monetary policy, is observable not only in equity markets, but also in housing prices. Housing benefitted in two respects from the central bank generosity: through the long-lasting collapse of US nominal interest rates from the aftermath of the 2008/9 crisis and, from last year, through the purchase of Mortgage-Backed Securities.

For now, the significant rise of residential property prices is not worrying, as we are not on the verge of a bubble. Indeed, household mortgage financing is healthy and the short-supply situation, essentially due to pandemics, will gradually normalize with the re-opening of the economy. However, the surge in real estate prices is not insignificant. Housing price inflation is somewhat linked to consumer price inflation, as it raises the buying power of house owners. But, additionally, property prices indirectly impact, with a lag, consumer prices.
Soaring home prices complicate monetary policy

Side effects of housing price inflation

By construction, US inflation indices do not incorporate housing prices per se. This is incidentally also the same in most OECD countries. The rationale is that housing units are considered as a capital / investment and not a consumption item. To consider the housing costs of households, most countries include different types of rent calculations. In the US, this metric is called Owners' Equivalent Rent. Though imperfectly, OER tends to reflect developments in housing prices, with a lag of about 6 quarters. Presently, the Case-Shiller index prefigures a rebound of OER. See graph below. According to estimates from Fannie Mae, the eventual OER rebound should add more than 1.0% to CPI and core PCE from the 2021-end up to 2022-end at least...



Covid has severely impacted millions of renters, namely those who have skipped rent payments or whose jobs have not come back. In this respect a moratorium has been imposed to protect people at risk of losing their homes. A (very) last delay has been granted by the Biden Administration to July-end.

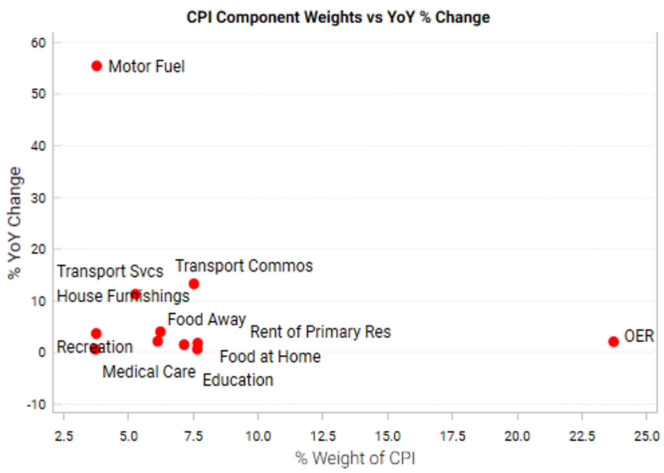
Everything leads us to believe that the rents will rebound from next August

From Q3/4, OER will take over from other strong contributors to US CPI, like used cars

The Fed has been throwing fuel on the fire

Soaring house prices is becoming problematic in many respects. As mentioned above, it will eventually put significant upward pressure on CPI from Q3/4.

Housing weight in US headline and core CPI is significant



Source: Bloomberg, Macrobond, Variant Perception

Rising prices fuels a deterioration of housing affordability, which reinforces the societal tensions, between generations (lucky boomers) and haves between and not haves.

More, this rise in inequalities is opposite to the rebalancing and redistributive policy pursued by the Biden Administration.

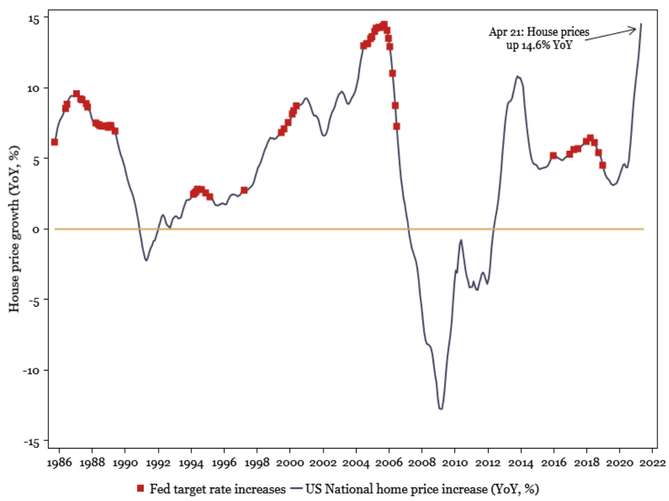
The unstoppable rise of property prices means that, ultimately, risks of a boom-and-bust housing cycle are on the rise.

For more than a year, the Fed strongly supported the mortgage market. All in all, the total MBS that the Fed has been buying since April 2020 amounts close to... $2trn! Needless to say that these two processes respectively pushed mortgage rates and their spread to Treasury to an all-time low.

Fed should revisit its purchases of MBS

The quicker the better

Historically Fed intervened earlier



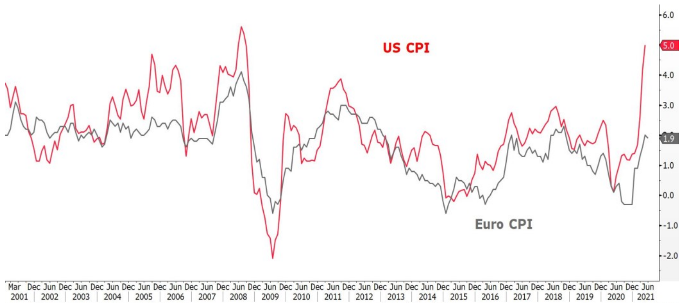
Source : Longview Economics, Macrobond

- *A tapering of Fed's MBS purchase is overdue*
- *It would confirm the Fed's preemptive and cautious approach to bubble risks*
- *There is little time left to act efficiently and in serenity before Jackson Hole meeting (August), which crisps all investors*

Fixed income. Another successful month for the ECB

The Euro-area inflation outlook continues to be rather calm. Headline and core inflation came at 1.9% and 0.9% in June. The slide was mainly due to declining services inflation and the Pentecost holiday. The energy component is expected to come off from its peak, while core inflation is set to take off from here though and goods inflation is already taking off due to higher input costs. The German VAT cut reversal of last year will come into data in July. So, overall, the small decrease in June headline inflation is not so relevant. For now, most of the evidence points to this being largely temporary, but inflation outlook upside risks have not been this substantial in years and should keep the ECB on the edge of its seat.

Headline inflation



Source: Bloomberg

As of now, the ECB primary objective is to maintain price stability. And more precisely, it aims at maintaining inflation rate below, but close to, 2.0% over the medium term. So, the ECB has for the 2nd month in a row reached its goal. We can only expect than the ECB enjoys this moment just before a special meeting, this week, where it will discuss running unconventional monetary policies despite higher-than-2% inflation. It will be the latest meeting of a series to rethink the ECB strategy. It should provide clarity on asset purchases and inflation target. A first group (German, Dutch, Belgian and Austrian central banks) is prepared for a clear decision on ending the €1.85trn emergency program PEEP scheduled in March 2022. By contrast, another group (southern central banks) wishes to maintain flexibility on PEPP.

By adjusting the current wording in place since 2003 of "close to but below 2.0%", the ECB should merely recognize that it may overshoot inflation target in coming years after persistently undershooting. It is not going to be easy.

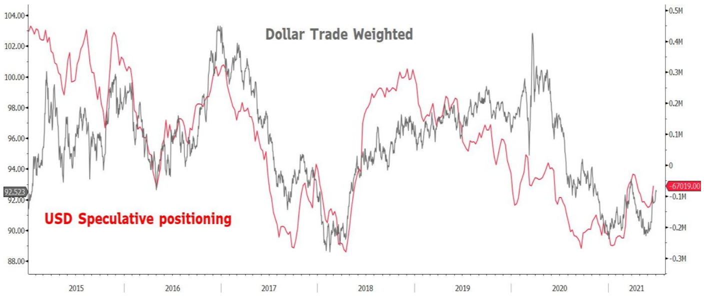
1. First, reflecting the special nature of the strategy review, the hawks are unlikely to be outvoted in this round of discussions. This gives them some clout – but also makes them wary about squandering goodwill amongst other members more open to semi-permanent use of unconventional policies. Those favoring less accommodative ECB policies know that they have more power to influence the strategy review than they would for a normal monetary policy decision.
2. Second, German inflation has been picking up faster-than-expected. The Bundesbank has raised its German inflation and growth forecasts, both close to 4.0% by year-end. Euro core and headline inflation will be significantly lower. German inflation should abate next year but still above euro area levels. Many other governors want further large asset purchases to support euro area inflation.
3. Third, the issue looks likely to become hotly debated ahead of the September German election. The CDU/CSU group - expected to form the biggest faction in the next Bundestag - has set a program of solid finances for Germany and Europe. Laschet, the coalition leader, is determined to ensure that Europe does not become over-reliant on cheap ECB funding.

In June, according to PMI, European companies continued to expect a rapid rise in the service sector output prices. However, the link from the PMIs to inflation has been weak and the uncertainty is elevated. Headline inflation moved lower on a weaker energy contribution in June, but goods and services inflation are set to trend higher. This will push inflation back above 2% for the rest of the year.

- *European inflation inched lower in June and is likely to fall again in July before heading above target during autumn, adding pressure on the ECB to taper the PEPP*
- *In the meantime, European inflation expectations remain too depressed vs US ones*

Currencies. King dollar

The dollar has enjoyed a strong start to July and a healthy June job release should keep it supported against the low yielding currencies at least. Though the unemployment rate was higher than expected, progress in jobs gains will be welcomed by the Fed and are likely to keep US money market rates biased towards a 2022 rate hike. The sluggish USD performance on last Friday probably owed to profit-taking ahead of the Independence Day holiday.



Source: Bloomberg

The USD on trade weighted is pushing above the big 92.5 level and is trying to take out the range highs as well as the downward trend line. We have not closed here since early April. The US front-end yields are driving the currency. The challenge for the FX market will be that with no rate on the cards for over 12 months, expectations regarding the Fed's guidance will cause the currency to fluctuate.

- *The net speculative positioning in the USD is no longer extreme*
- *Still some room to adjust upward*

Actions. Three bad news

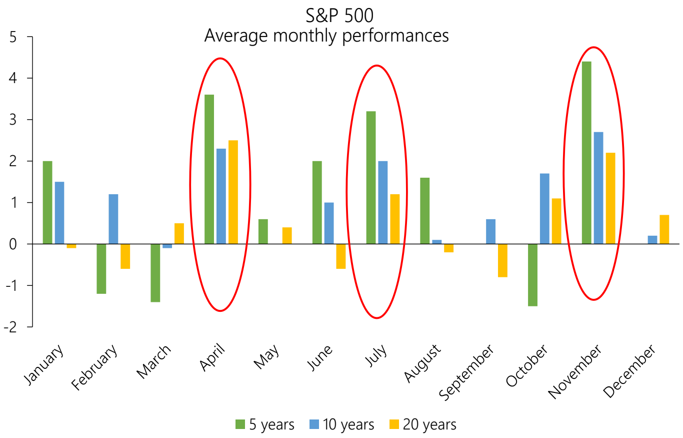
We have 3 cumulative bad news : the Delta variant, a new giant cyberattack and the confirmation that the Chinese will integrate Taiwan.

The Delta variant. Despite a vaccination rate with at least one dose above 50% in Europe and the United States, the infection curves are picking up faster than expected, even in Israel. The good news is the confirmation by Pfizer, Moderna and Johnson & Johnson of a same rate of effectiveness for the Delta variant as for the previous variants. The situation is fragile and some countries, such as Portugal and Israel, are putting health constraints back in place. The slackening due to EuroFoot or the student festivities in Spain should never have been allowed.

A giant new cyberattack. Americans believe this is the biggest cyberattack ever. The attack targeted the American company Kaseya (IT management, server management) which has 40,000 customers worldwide of which 1,000 could potentially have to pay a ransom. A large supermarket chain in Sweden had to close because its checkouts were paralyzed. According to the FBI and the CISA (Cybersecurity and Infrastructure Security Agency), this ransomware attack could come from Russia and would be the same group of hackers that tripped, SolarWinds (IT management software), JBS (meat giant) and Colonial Pipeline (pipeline manager) in the United States. At the Biden-Putin summit in Geneva on June 16, Joe Biden warned that the US would respond if it turned out that Russia was, directly or indirectly, behind these hacker groups.

Complete China-Taiwan reunification. In his speech to mark the 100th anniversary of the Communist Party, President Xi Jinping called reunification with Taiwan an unswerving historic mission and common aspiration of the Chinese people. Some US military have said, a Chinese invasion will take place before 5 years. It is obviously no longer "if", but "when" the Chinese decide to take Taiwan. In any case, in the next 5 years, the US will not allow a Chinese invasion of Taiwan to occur, an island 160 km from China where 70% of the world production of semiconductors is located.

Despite little participation in the recent rally and an entry into the Overbought zone, the S&P 500 could continue to rise in July with the release of strong results, whereas July is a statistically favorable month. Like April and November, July is a month with positive average performance.



Source: Heravest, Bloomberg

Still too early to tell, but the second part of July could be a good time for profit taking, before entering a statistically more chaotic period in August and September. We will recall the Fed meeting on July 27-28 and the summit of central bankers/finance ministers in Jackson Hole in August 26-28.

The scenario remains favorable for equities: the global vaccination is accelerating, especially in Asia, the main central banks are very accommodating, inflationary fears have waned, fiscal plans are strong in the US and Europe, and profits will rise further for several quarters. But we find that there is still a lot of sympathy for the “Fantastic 4”, Apple, Amazon, Alphabet and Facebook, which will face tougher regulation, with a real risk of business splitting, and less complacent taxation.

In the US, the Transportation Security Administration reported a higher number of travelers at airports for the weekend of July 4 than the same period in 2019, but investors remain in the Growth/Technology segment with fears of a health situation that could worsen quickly with the Delta variant. However, since mid-June, the Value/ Cyclical segment no longer underperformed thanks to the prospects of a giant US infrastructure spending plan.

The green theme confirms its return. Brokers/analysts recommend buying all segments of the theme. The investments will be massive if countries want to achieve the objectives of the Paris Agreements. The COP26 will be in Glasgow in 5 months. Solar panel manufacturers (First Solar, SunPower) have profited from retaliatory measures taken by the US government on Chinese solar panels produced in Xinjiang, the region where the Uyghur "forced labor camps" are located; this has allowed to talk again of the Swiss solar panel manufacturer Meyer Burger, which after having almost gone bankrupt, is now focusing exclusively on photovoltaic panels.

- *Growth and Value/Cyclical should perform in line*
- *July still positive, before 2 next uncertain months?*

Contact for Switzerland

Rue François-Bonivard 12 ◆ 1201 Genève
t +41 22 906 81 81 ◆ f +41 22 906 81 82

Rue Pré-Fleuri 5 ◆ 1950 Sion
t +41 27 329 00 30 ◆ f +41 27 329 00 32

Schauplatzgasse 9 ◆ 3011 Berne
t +41 58 404 29 41

Seidengasse 13 ◆ 8001 Zurich
t +41 43 322 15 80

Chemin du Midi 8 ◆ 1260 Nyon
t +41 22 906 81 50 ◆ f +41 22 906 81 51

Rue du Centre Sportif 22 ◆ 1936 Verbier
t +41 27 329 06 83

info@pleion.ch ◆ www.pleion.ch/en/

Contact for Monaco

11 avenue de la Costa ◆ 98000 Monaco
t +377 92 00 25 00

contact@pleion.mc ◆ www.pleion.mc/en/

Contact for Mauritius

Suite 301 ◆ Grand Baie Business Quarter (GBBQ)
Chemin Vingt Pieds ◆ Grand Bay 30529
Republic of Mauritius
t + 230 263 46 46 ◆ f +230 263 47 47

info@pleion.mu ◆ www.pleion.mu