Q2 2021

GENERALI INVESTMENTS

Investment View

Some like it hot

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Some like it hot

- **Get ready for the summer boom. Slow vaccination in Europe is a headwind, but a strong cyclical upswing and inflation spikes will still dominate markets into summer.**
- **The inflation spike will be transitory. Or so it is assumed. In truth, inflation uncertainty has increased. A new fiscal age has arrived, and central banks want to run the economy hot and exit the under-inflation regime.**
- **The new policy paradigm is an attack against secular stagnation forces. This implies upward pressure on bond yields eventually, but for now central banks want to keep them low. We think they have both the teeth and the tools to keep the rise in yields orderly and expect risky assets to show resilience (Value better than Growth).**
- **We keep an overweight in Equities and Credit, and an underweight in Govies. Yield curves are skewed towards further steepening (forwards too flat). We cut our EM equity overweight on China tapering, rising yields and slow vaccination.**

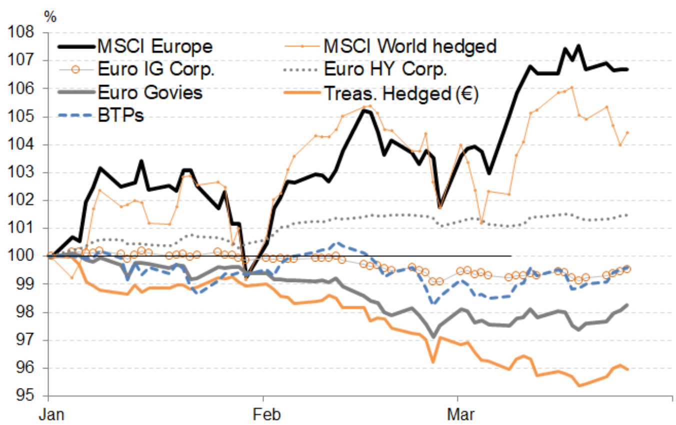
Financial rotation is proceeding fast, in anticipation of a powerful economic upswing

On the ground it does not feel like it just yet, as Europe battles with a third wave of infections, but markets are fast proceeding to the Covid crisis exit door. Too fast? We do not think so and see room for further rotation. The turn of the year already had already seen a very strong performance of cyclical assets, as investors positioned for a strong economic recovery. The rotation amplified in 21Q1, with safe-haven assets taking a hit, most specifically US Treasuries. As Graph 1 shows, year-to-date total returns paint a nice scissors effect, with the (2020 laggard) European equity markets performing strongly (up almost 7%), while Treasuries have delivered negative performance of -4%. The outperformance of European equities, despite the slow vaccination in Europe (relative to the UK and US), underlines the strength of cyclical assets. Covid winners such as Growth stocks (most particularly tech stocks) have started to lag, more so since long-term US real yields started to creep higher in mid-February.

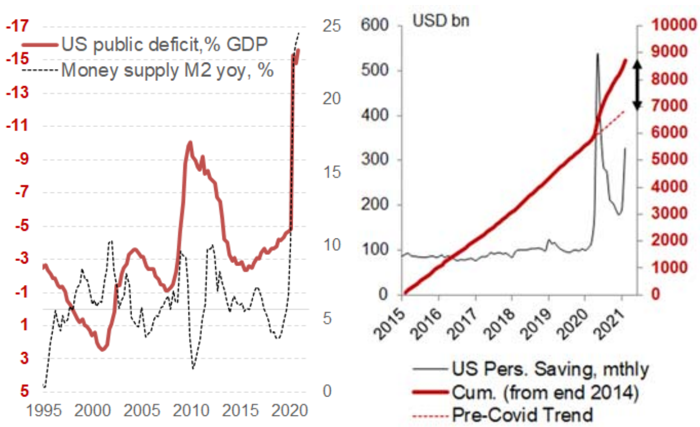
Preparing for a summer boom

Powerful recovery, notwithstanding the third wave. Investors have already positioned for it, yet we see little value in trying to fade the upcoming economic upswing, which we expect to be particularly strong in the US, on three counts: 1/ Vaccination has delivered strong success in countries where the rollout has been fast. The surge

Graph 1: YEAR-TO-DATE TOTAL RETURN



Graph 2: POLICY STILL EXPANSIVE; HUGE CONSUMER WAR CHEST



in the UK Services PMI in March is testimony to the benefit of progressive reopening. 2/ Policy support remains very strong (Graph 2a), and financial conditions easy, even after the pick-up in long yields. The $1.9tn ARP will contribute to a boom in US growth over spring and beyond. 3/ The consumer has built a war chest through the crisis. Our

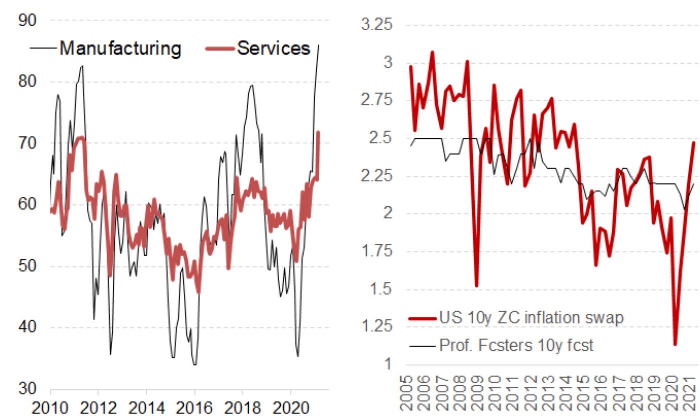
Vaccination, policy support and spending 'revenge' to drive a strong upswing

spending habits have changed, at least temporarily, simply because many services were shut down. This has led to higher spending on goods, and an overheated manufacturing sector, but also excess savings. We estimate that in the US, about $1.7tn of excess savings, compared to pre-crisis trends. The same pattern of surging saving rates was observed in Europe. While not all this war chest will be spent into summer, we do expect it to provide strong support to the recovery. Some talk about 'revenge travel' for instance, which may be premature given the residual restrictions, but surely such behaviour can apply to many Services (leisure, hospitality etc.)

Is inflation about to show its ugly face? Bond under pressure

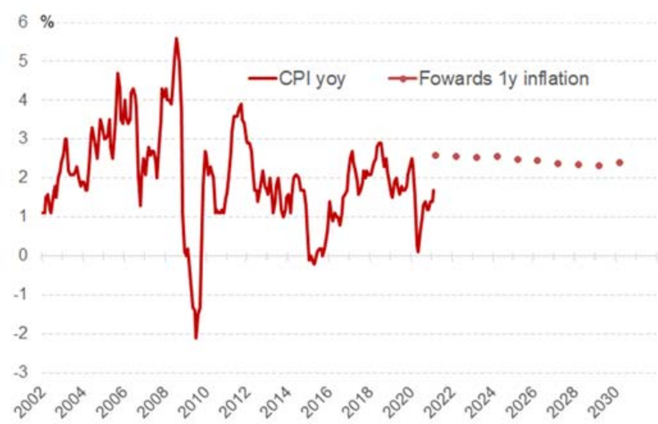
How transitory? There is no doubt that inflation will spike in Spring, with yoy CPI inflation set to surge well above 3.0% in the US. Likewise, in the euro are, core CPI has already jumped from 0.4% to 1.1%. Those pressures are essentially transitory and technical, amid a strong rebound in commodity prices, shortages in the manu-

Graph 3: ISM PRICE INDICES; INFLATION, ECONIMISTS* VS MARKET



* Quarterly survey from Philadelphia Fed

Graph 4: US INFLATION, PAST, PRESENT & FUTURE**



** Forward inflation rates extracted from US Zero-Coupon inflation swap curve

Inflation uncertainty has increased

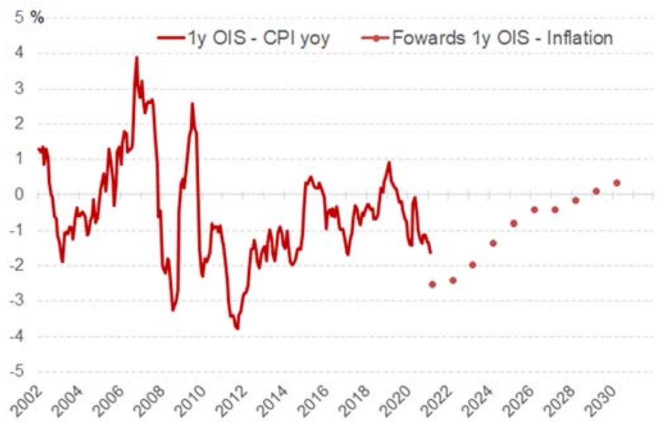
The market has not priced a sustained change of inflation regime; room for inflation risk premia to rise further

facturing sector (e.g. semiconductors, or microchips) and supply disruptions in Services (Graph 3a). Yet investors are starting to wonder about the medium-term inflation outlook – and more in the US. First, the **US output gap** is set to close very quickly, as the exogenous shock fades out and the massive policy support facilitates a quick return of US real GDP to pre-crisis level this autumn already. The $1.9tn ARP, followed by the upcoming infrastructure plan, are likely to push the US output gap not only in positive territory over the coming years, but to levels unseen since the 60s. Second, we may have entered a **new fiscal age**, with governments focusing more on infrastructure, supply chain security, climate change, inequality etc. As such do not expect a quick return to the fiscal rectitude that we saw in the past after large recession-induced surges in budget deficits. We are also in a **new monetary age**, symbolised by the new Fed's AIT (Average Inflation Targeting), which implies greater tolerance towards inflation. Central banks want to not only exit the under-inflation regime, but also run the economy hot to help boost potential growth. As the ECB concludes its strategic review this summer, expect the inflation target to become more symmetrical. Third, other structural forces such as deglobalisation, climate changes and demographic forces are seen as potentially pushing inflation higher. Of course, selected headwinds remain, e.g. automation, digital competition, productivity gains from working from home. So the jury is still out, but at the very least **inflation uncertainty has increased**. This has started to be priced in (Graph 2b), but we seen room for inflation risk premia to rise further. So far, while inflation breakevens have recovered from their deep post-Covid fall, the market has not priced a sustained change of inflation regime, following the 2021 spike (Graph 4, where forward inflation swaps include an inflation risk premium, i.e. do not reflect a pure inflation expectation).

The end of secular stagnation?

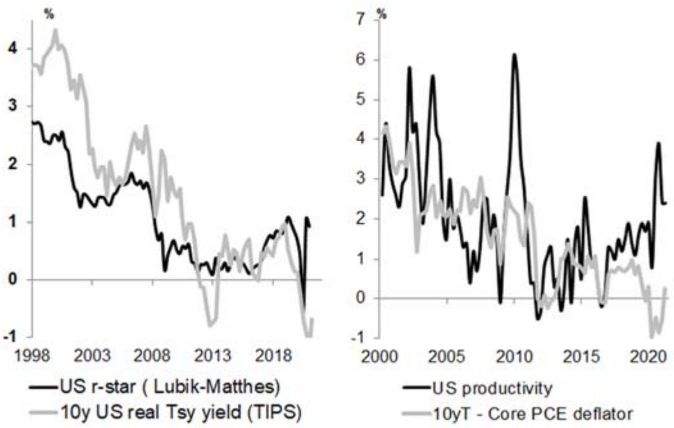
A new policy age. It is premature to declare victory. Secular stagnation – a theory rejuvenated by Lawrence Summer at an IMF conference in late 2013 – encompasses various phenomena, including a drop in potential growth, a persistent undershooting of actual output relative to potential due to chronic excess saving and hysteresis effects preventing output from returning to pre-recession trends following a deep drawback (recession). Those forces are largely held responsible for the secular decline in nominal yields, by pushing both real rates and inflation down. May the new fiscal age, along with efforts by central banks to run the economy hot, defeat secular stagnation? It is still early days, but a change of perception there has the potential to push long-term real rates higher. So far, the market is pricing only a slow normalisation of short-term real rates (Graph 5), which in the US are seen moving above water only at the end of the decade. By some measure, long-term real rates appear too low (Graph 6).

Graph 5: US 1Y REAL RATES, PAST, PRESENT & FUTURE*



Forward inflation rates extracted from US Zero-Coupon inflation swap curve

Graph 6: LONG-TERM REAL YIELDS TOO LOW?



May the new fiscal age, along with efforts by central banks to run the economy hot, defeat secular stagnation?

For now, central banks will do all they can to keep long-term real rates low, to protect financial conditions and the economic recovery. The ECB has been vocal about this, and even took the step of beefing up PEEP purchases for the next three months. Fed Chairman Powell has also pledged the Fed would take a very cautious approach to pulling back support, "very, very gradually, over time and with great transparency, when the economy has all but fully recovered." To avoid a repeat of the taper tantrum, one can imagine for instance that the Fed may launch an operation twist when it decides it is time (towards the end of 2021) to taper purchases. In all, while we expect nominal bond yields to rise further in the coming months and quarters, we assume an orderly process – and for now not too disruptive for risky assets, though of course selected sectors (Tech) and styles (Growth) are more exposed.

Central banks want any rise in real yields to be moderate and orderly – which reduces the risk of a 'taper tantrum' risk sell-off

Real rates matter

We focus on real rates because they matter much for global markets. Graph 7a shows that equity multiples last year surged as real rates declined. We expect that relation to hold as real rates are the anchor of global asset valuation. That said, equity markets may survive a slow normalisation of real yields, and more so in a period of fast-growing corporate earnings, like in 2021. This is particularly true in Europe, where we find the **Equity Risk Premium still generous**; there is room for bond yields to increase and the ERP to fall in the process without creating much damage on equities.

Reassuringly, as global equity markets wobbled in late February as US long-term real yields crawled up, global credit markets offered great resilience. The risk for

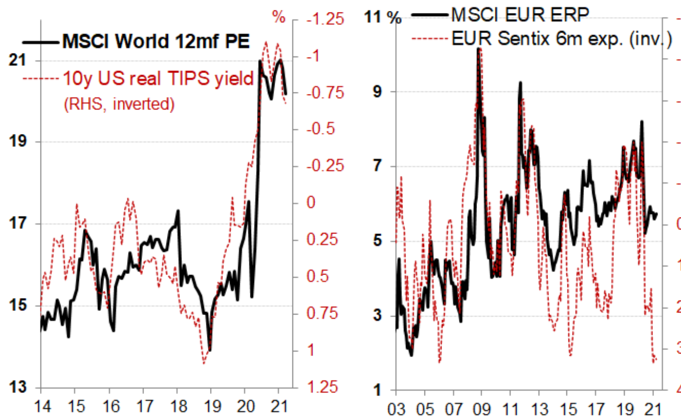
Credit spreads to stay tight or tighten even further into the summer boom

Credit is that negative FI returns would cause fund outflows. We will monitor that closely, but expect **credit spread to stay tight or tighten even further into the summer boom**: the cyclical upswing tends to be positive for spread products, while the rating momentum has shifted (more rating upgrade this year in HY than downgrades). Even in IG, spreads are tight but the carry/vol ratio is still attractive relative to Govies offering similar level of yields (Graph 8a).

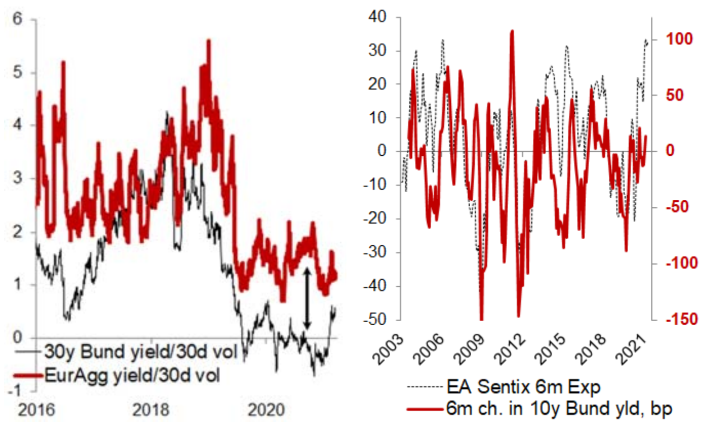
Bund yields less exposed than Treasuries, but not fully immune

The risk of rising yields is smaller in Europe than in the US, if only because the recovery is slower, the output gap will take much longer to close, and the ECB is obsessed with keeping yields low. But Bund yields are not totally immune to the cyclical upswing (8b). Also, on a currency hedged basis Bunds have become unattractive relative to US Treasuries, which will cause some contagion as investors turn away.

Graph 7: RISING REAL YIELDS DEFLATE MULTIPLES; EQUITY RISK PREMIUM STILL GENEROUS IN EUROPE



Graph 8: POOR FI YIELD/VOL, BUT EURO IG STILL BEATS 30Y BUND; 10Y BUND (6M CHANGE) VS EA SENTIX EXPECTATIONS



Tactical asset allocation recommendations

Overweigh Equities (Value) and Credit, under-weigh core Govies

We keep a close eye on sentiment, positioning and frothy markets, but do not lose sleep on them just yet. Inflows towards cash in late March, as well as the normalisation in the equity put/call ratio, are healthy developments. We keep our largest Underweight (UW) in core Govies, though we expect the rise in yields to be orderly. We stay OW stocks, especially in the most cyclical indices (Europe, UK, Japan), with a preference for Value over Growth (and to a much lesser extent Cyclicals over Defensive, given the large correction there already). It is too early to fade those trends, as we enter the booming phase of the cycle as Biden is about to announce his infrastructure plan ($2-4tn over 10 years). How much of this will be funded by tax and/or debt will be key for markets, especially bond yields. We expect most of the implementation to be delayed to the autumn, though (new fiscal year). We stay long credit, and still like to go down the rating scale and capital structure (Hybrids, AT1, HY). We limit duration exposure for now, and see value in High Yield, given the lower duration there and the expected deleveraging through the upswing. We keep a bearish USD bias (anticyclical currency), but less so given the US economic outperformance and rising USD yields. We cut our OW in EM currencies, exposed to China tapering and rising Treasury yields. In this new policy paradigm and stretched valuation environment, corrections will be more frequent and hedging matters more. EUR payer spreads, cheap credit spread volatility and selected currency pairs (AUD/JPY) are good hedging vehicles.

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Macroeconomic Outlook

- **The global economy is headed for a strong rebound over the spring and summer. Vaccinations will allow for a 'grand reopening', led by the UK and US. The euro area, still burdened by a third wave of Covid-19 infections, will likely be able to accelerate the so far sluggish vaccination from April onwards. Pent-up demand will amplify the rebound, with consumers able to draw on large savings accumulated over the pandemic.**
- **The massive US$ 1.9 tr new fiscal package in the US will boost US growth to +7.5% in 2021, triggering positive global spill overs. In the euro area, activating the Recovery Fund will underpin the transition to the post-Covid-19 normal.**
- **EMs will lag in the reopening rebound amid significant difficulties in accessing vaccines. China's V-shape recovery will flatten out as authorities will gradually withdraw policy support while the credit impulse is turning into a mild headwind.**
- **Inflation will jump in the spring on technical factors and the reopening, before flattening out in H2. Risk of a protracted overshoot are more sizeable in the US, but by far less of a concern in Europe.**
- **Major central banks incl. the Fed and ECB will look through inflation spikes, leaving the tapering of asset purchases for 2022. Any rate hikes are still off for years, though markets may increasingly question the Fed's patience on a lift-off.**

Following its worst contraction over the pandemic since WWII, the global economy is headed for a strong recovery over the coming quarters. Vaccinations are gaining in speed and scale, and once the most vulnerable parts of populations are protected, governments will speed up the removal of restrictions, allowing for closed sectors (incl. hospitality, traffic, tourism) to resume activity. Consumers, who have accumulated large stockpiles of savings over the crisis, will lead the spending spree, supporting the upswing with strong pent-up demand. Investment will follow suit amid favourable financial conditions, even if many firms will feel the strains from harmed balance sheets. Finally, persistently strong fiscal and monetary policy support will continue to underpin aggregate demand in most advanced economies.

Resuming activity in closed services sectors and pent-up demand will trigger a strong growth rebound over the coming quarters

Uneven recoveries amid divergent vaccination speed

The pace of the recovery will be highly uneven, however. The US and the UK, the leaders of vaccination among major economies, will enjoy a strong rebound. An early opening of their economies will additionally be boosted by the US$ 1.9 tr (8.5% of GDP) fiscal package pushed through by the new Biden administration. US growth may reach 7.5% this year as a result, which would be the strongest bounce in 70 years. Meanwhile, the euro area is still struggling with tightened lockdowns amid a third wave of infections. As vaccinations are set to gather speed from April onwards, however, we still expect a significant lift of restrictions (and thus economic acceleration) from May onwards.

The combined impact of fast vaccination and a strong fiscal package will boost the US economy to the fastest expansion in 70 years

Most EMs will lag the recovery amid very tight access to vaccines. That said, continued strong dynamics in global manufacturing and trade and the rebound in advanced economies will also be felt here. China has led the rebound from the pandemic already last year in a V-shaped fashion, largely on the back of very tight infection controls. A gradual withdrawal of Chinese policy support will cool activity, but this will not meaningfully impact the strong global rebound in demand also underpinned by highly favourable financial conditions.

EMs will benefit from strong export demand, but likely lag in the recovery on tighter access to vaccines and easing growth in China

These conditions remain closely tied to the highly accommodative policy stance by major central banks, led by the Fed and the ECB, who have cut rates to zero and/or ramped up asset purchases when activity and price pressures faltered during the pandemic. This backdrop has materially changed amid vaccination progress, large fiscal packages and rebounding commodity prices. Investors have materially repriced inflation expectations for the coming years (Graph 2) and have discounted earlier lift-off in US rates. So apart from the evolution of the pandemic, the key question for the coming quarters will be about inflation – where the outlook and risks somewhat differ between the US and the euro area.

Inflation worries are raising questions about the duration of ultra-accommodative monetary policy

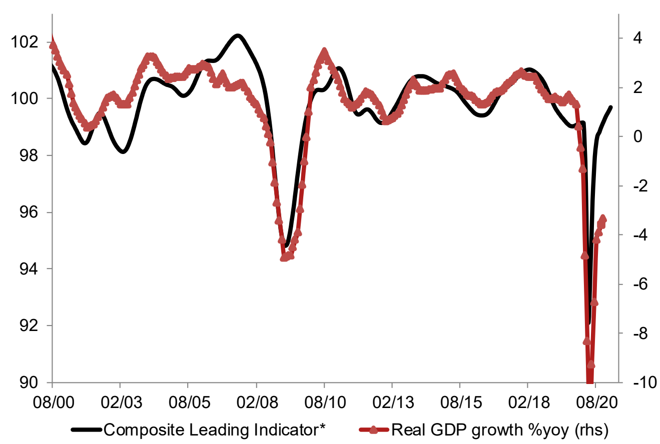
Reflation in the US: too much of a good thing?

Inflation will spike on base effects and higher oil price in the spring, before moderating again

The unprecedented acceleration in demand the US economy will experience in the coming months has triggered fears of a rapid escalation in inflation, especially if one looks at asset-based expectation measures. Too quick a rebound in inflation to above the 2% target, it is feared, would force the Fed to reduce accommodation when the labour market remains far from recovering from the Covid-19 shock: more than 9 million people are still jobless, and the official unemployment rate (6.2% in February) understates the true state of the labour market, due to the sharp drop in labour force participation. Inflation will shoot up in the coming months due to base effects (especially due to the projected 80% rise in oil prices from last spring's trough) and possible supply bottlenecks, which may increase price pressure as the economy reopens, but this jump will be largely transitory: after the summer inflation will moderate before embarking on a mildly upward path. We expect PCE inflation to hit the Fed's 2% target no earlier than in the second half of 2022. The push to demand will be driven largely by one-off income support measures and by consumers tapping the large pot of savings the relatively more well-off households have accumulated over the pandemic. This should not lead to the persistent demand supply imbalance needed to drive inflation permanently high. Moreover, we believe that the pandemic has not affected the structural factors which have moderated inflation during the last ten years, above all the low responsiveness to labour market slack, largely related to trade openness. That said, uncertainty is high and risks are titled to the upside, as bottlenecks may prove stronger and longer lasting than in the past and the higher tolerance to inflation embedded in the new Fed's monetary policy framework may allow for a larger than expected upward slippage. We believe that this uncertainty plays a big role in driving up bond-based inflation expectations by raising the risk premium component.

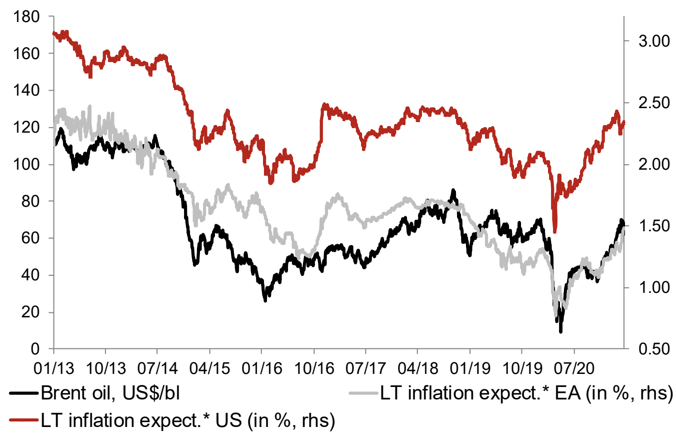
Inflation uncertainties will remain high for the US given potential bottlenecks, the big fiscal stimulus and Fed tolerance for an inflation overshoot

Graph 1: G7 LEADING INDICATORS AND GROWTH



* by OECD, amplitude adjusted

Graph 2: BOUNCE IN OIL PRICE AND INFLATION EXPECTATIONS



* 5Y5Y forward as implied by inflation swaps, 5-day averages

Fed's tapering of QE is unlikely before 2022 while rates should be kept close to zero through end-2023

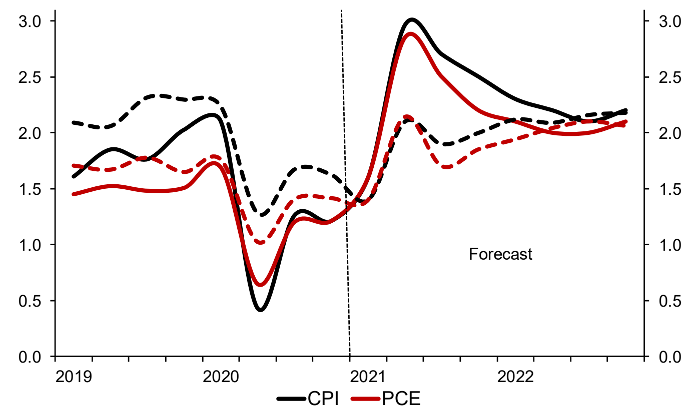
Indeed, the Fed has repeatedly stated that the unemployment vs. inflation trade-off is not relevant now and returning to full employment has the priority. Therefore, any talk of tapering bond purchases remains premature. In our view, the issue will resurface later in the year, with a slowdown in asset purchases expected for the first half of 2022. Longer term, the economic projections presented at the March meeting show that the employment target should be reached by 2023, with inflation only marginally above 2%. The limited upside risk to inflation, in the Fed's view, would be consistent with keeping the policy rate at near zero until at least the end of 2023. Shorter term the Fed thinks that the rise in bond yields is a healthy reflection of the improvement of the economy and has not negatively impacted financial conditions. Should the bond rise become a threat to the recovery, the Fed has ample room for manoeuvre. The most effective measure would be twisting its bond portfolio towards longer maturities by swapping T-bills for Treasuries. This could be complemented by extending the maturities of the bonds the Fed purchases.

Euro area reflation no reason for concern

Energy-price induced inflation spike ahead but price pressures to stay muted further down the road

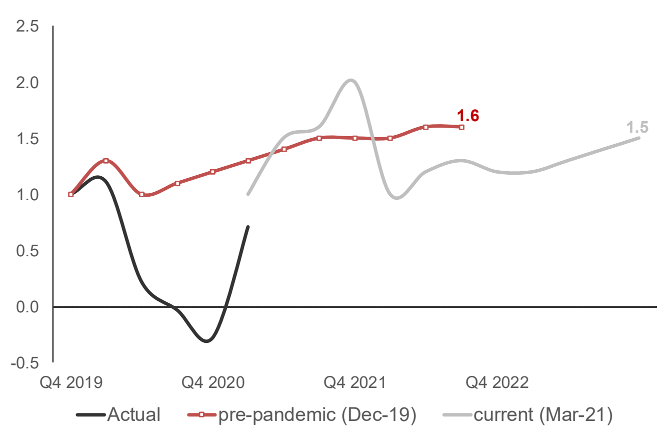
At the outset of the year euro area inflation advanced significantly. It increased by 1.2 pp to 0.9% yoy as of late. However, a combination of special factors (end of temporary German VAT cut, new HICP weighting scheme, later winter sales in some countries) as well as energy prices pushed inflation back into positive territory. These factors will contribute to inflation volatility and the energy-inflation spike in April/May will likely lift headline inflation above the 2% threshold. Annual inflation will likely rise to 1.5% in 2021. In contrast, the fundamentals for higher underlying inflation will remain weak. The pandemic hit the economy hard and closing the output gap will take beyond 2022. Until then muted wage growth amid an only gradual reduction of the labour market slack will keep the underlying inflation pressure muted. Therefore, we look for a moderation of annual inflation to 1.2% by 2022.

Graph 3: US INFLATION



% yoy, monthly data. Doted: core rate

Graph 4: ECB: PRE-PANDEMIC INFLATION PATH STILL DISTANT



HICP, % yoy, quarterly data, according to ECB staff projections

ECB to look through inflation spike, recovery supported by Recovery Fund

The ECB will look through the temporary inflation spike and made also clear at its March meeting that ongoing monetary policy support is warranted. Its latest macro projections foresee that reverting to the pre-pandemic inflation path will not happen before 2023. That said, with the pandemic being overcome, the PEPP (whose € 1850 bn envelope we expect to be fully deployed) will be gradually the end of the programme (scheduled for March 2022). Moreover, to avoid a monetary policy cliff, the ECB may also increase its regular QE (currently € 20 bn per month). Monteary policy will carefully withdraw the pandemic-related support while more conventional tightening measures like key rate hikes are not in the cards before 2024 in our view. However, the Recovery and Resilience Facility means will sustain a mildly positive fiscal impulse thereby partly compendating for less extreme monetary policy measures. Together with the overcoming of the pandemic in 2021 this will help to trigger a recovery. Following another contraction of GDP at the outset of 2021, we see activity expanding from Q2 again and annual growth to average 4.0% in 2021 and 5.3% in 2022.

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Government Bonds

- **Amid the strong economic rebound and a temporary spike in inflation, we see even more leeway for US yields to extend their bounce from the first weeks of the year. This will also move euro area yields moderately upwards.**
- **However, underlying dynamics are likely to differ. While in the US the main driver is expected to be a further increase in real yields, we see more scope for euro area inflation expectations to rise.**
- **Euro area non-core government bonds should continue their outperformance. Increased purchases by the ECB and a more friendly cash flow are forecast to trigger a moderate spread tightening in Q2.**

In our Outlook 2001 – Repair and Despair we stressed that the trend for government yields in 2021 is likely to be upwards and that there is more leeway for US yields to rise than for euro area ones. That turned out to be right in Q1, although the rise in yields was more pronounced than expected. Despite the worst start into a year in a long time, we still see potential for the sell-off to continue – albeit at a slower pace.

Sell-off has not run its course yet

Forthcoming economic rebound to dominate bond markets in the months to come

The brightening of the economic outlook is seen to trigger a further increase in government yields. This applies particularly to the US where the fiscal package will give an additional boost to the economic rebound and the vaccination is progressing fast. Despite the sharp rise in long-dated yields and the dismal performance of US Treasuries (10-year yields up by more than 70 bps and Treasuries yielding almost -4% since the start of the year) the economic environment warrants a further rise in yields.

It is noteworthy that the driving factor in the US is forecast to remain the real component. Although US inflation expectations have risen as well, around two thirds of the rise has been triggered by real yields (unlike 2020 where inflation expectations were the key driver). Meanwhile, US inflation expectations are close to a long-term high and despite the temporary spike in inflation rates in the months to come we see only limited scope for US inflation expectations to rise sustainably more. The inversion of the inflation curve (2-year inflation swaps higher than 10-year ones) confirms this view. However, this does not rule out the possibility that the uncertainty about the effects of the fiscal package in combination with a dovish monetary policy stance can trigger a temporary further rise of the inflation term premium.

Closing output gap and technicals to drive US real yields further up in the months to come

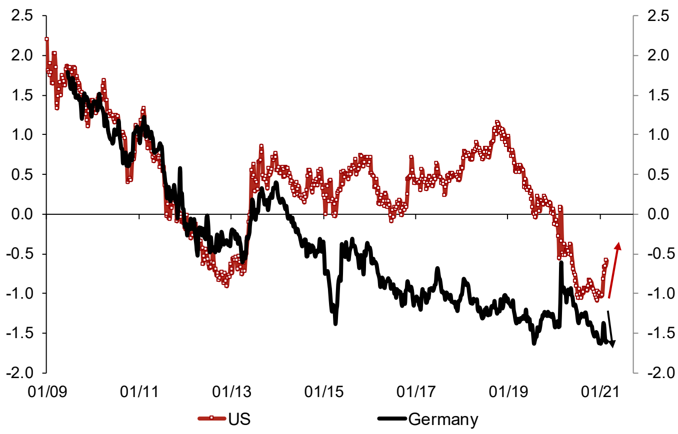
Accordingly, real yields are expected to contribute significantly to the increase in US yields. The closing of the output gap already by the end of this year opens up scope for a further yield increase and the level of US real yields is still well below the pre-crisis level. While the long-term average of 10-year real yields is in slightly positive territory the current level of around -0.70% indicates further need for adjustment. The technical situation calls for caution as well. Not only can the rise in yields trigger adjustments by financial market participants which can strengthen the increase further (e.g. negative convexity hedging), but the massive US fiscal budget deficit will drive the supply of US Treasuries to a new historical high. Gross and net supply will be much higher in 2021 than last year. Net supply (including Fed purchases) will exceed more than USD 1900 bn this year. As the Fed is forecast to decrease its purchases further next year it will remain on a high level in 2022.

One caveat applies, however. Financial markets have priced the first key rate hike of the Fed for Q1 2023. This appears too early and sooner or later financial markets are expected to correct. Additionally, the US central bank has tools to fight a too strong and too fast increase in yields. Hence, the short end of the curve is expected to remain well anchored. Overall, the rise in US yields is likely to continue in the months to come, albeit at a slower pace. We see 10-year US yields to rise to 2.10% on a 12-month horizon.

Real yields in euro area at a historical low – some scope upwards

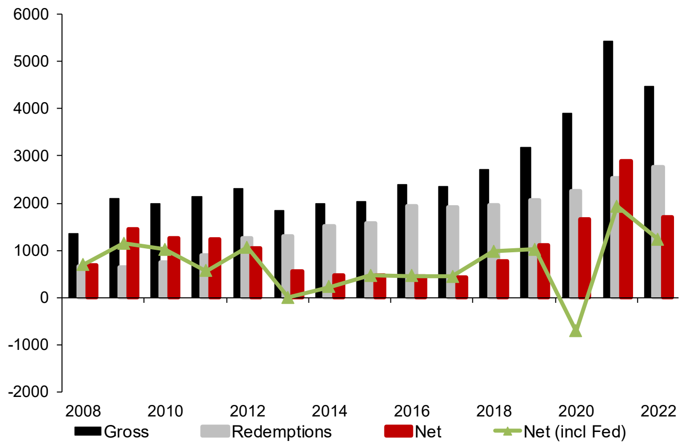
While euro area inflation swaps have mirrored the US development for some months, real yields have escaped the US increase. In fact, 10-year euro area real yields have even fallen further and mark new lows almost daily. The reasons for this (slower vaccination and economic recovery, interventions by the ECB) will also persist in the coming months. Hence, the leeway for considerably higher real yields in the euro area appears more limited. Nevertheless, a rise in real yields is warranted as the lockdown measures are likely to be slowly removed in the euro area and economic momentum is forecast to strengthen over the course of the year.

Graph 1: 10-YEAR REAL YIELDS



In %

Graph 2: US ISSUANCE TO MARK A NEW HIGH IN 2021



In bn US-dollar, maturity > 1 year

Additionally, we see room for higher euro area inflation expectations. Despite the strong increase, 10-year inflation swaps are still slightly below the long-term average and are currently trading around 1.45%. Digging a bit deeper, it can be shown that a soaring inflation risk premium has triggered higher inflation expectations. However, the risk premium is still in negative territory and well below the long-term average. This appears unsustainable in an environment of an expansionary monetary and fiscal policy and a forthcoming economic rebound. The development of commodity prices represents an upside risk as well. Moreover, the high degree of uncertainty about the future development (incl. the forthcoming new ECB strategy) justifies a higher term premium, too. All in, we forecast euro area core yields to lag the increase in US yields but they are not immune. We expect 10-year Bund yields to rise to -0.10% on a 1-year horizon.

Ongoing outperformance of euro area non-core bonds

Increased ECB purchases and more friendly cash flow to support euro area non-core government bonds in Q2

Euro area non-core bonds are expected to continue their moderate outperformance in the months to come. Although the ECB does not appear to target a specific yield level it announced to increase its purchase volume in Q2. In combination with a more cash flow friendly supply pattern this is expected to help to trigger slightly tighter spreads. Rating risks remain limited for this year as agencies regard the pandemic as a temporary shock. Actually, the lower yield level has even improved the debt sustainability despite higher debt ratios for the time being.

Looking further down the road, financial markets are likely to scrutinize the plans for the EU Recovery Fund. The share of grants and the overall volume is considerable. It enables a sustainable recovery if it is used to tackle structural problems.

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Credit

- **We continue to expect credit spreads to remain relatively resilient to interest rate volatility, mainly because the central banks put remains, with a strong focus on financing conditions.**
- **Higher rates should not trigger any deterioration either of credit quality or default outlook, given that we start from a very low level of interest rates.**
- **Moreover, we continue to expect the very strong cyclical upswing to support the fundamentals recovery that is already very rapid.**

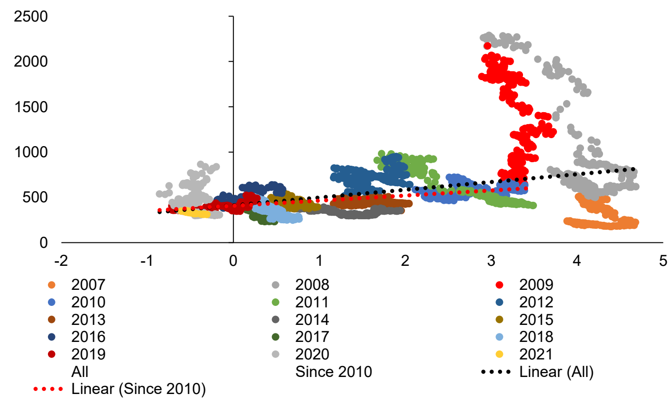
Many things could be said about the relationship between interest rates and credit spreads, but theoretically a negative correlation between credit spreads and nominal interest rates, in a phase of a strong cyclical upswing, should be considered as normal.

Too soon to worry about rates

Higher yields will not affect credit quality

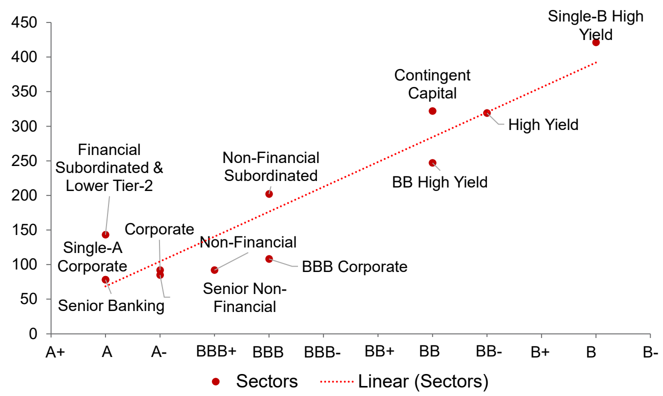
The correlation tends to be more positive between real interest rates and credit spreads. Over the last few weeks, credit spreads have proved fairly resilient to the volatility in the rates market. We believe that higher interest rates, given they come from very levels and have increased for economic reasons, will not lead to a deterioration in credit quality.

Graph 1: BOFAML HY CORP VS 10Y BUND



OAS gvt bp, %

Graph 2: EUR IG SPREAD VS RATING



OAS bp

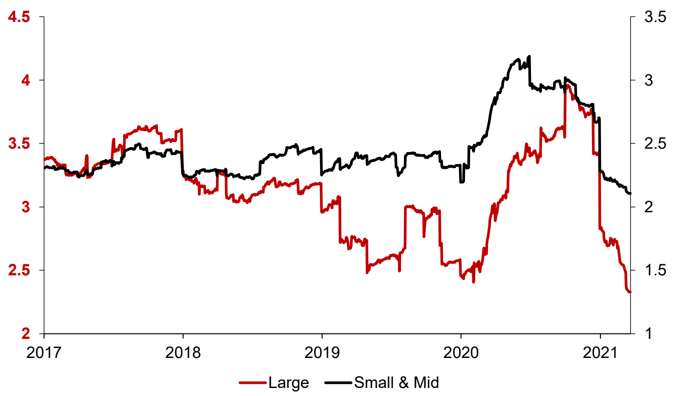
The main challenge for credit spreads will be to withstand the negative total returns implied by higher interest rates, particularly in the long end of the market where total returns were close to –5% year-to-date on the EUR 10+ segment, with barely moving spreads. HY is theoretically less sensitive to interest rates than IG, but counterintuitively they have proportionally faced the biggest outflows globally, although they have already started to stabilise. The question is to what extent, traditional asset managers will be replaced by LDI investors, that are scrutinising every rate increase to step back into the credit market. The question is particularly important to the HY market as 1/ it is more sensitive to flows than IG and 2/ the appetite for HY from LDI investors in a case of higher rates remains uncertain as they are largely new players in this space.

In our view, for credit spreads to suffer, especially in Europe, it would take interest rates to move much higher than the highest levels witnessed recently.

The ECB wants credit spreads to remain low

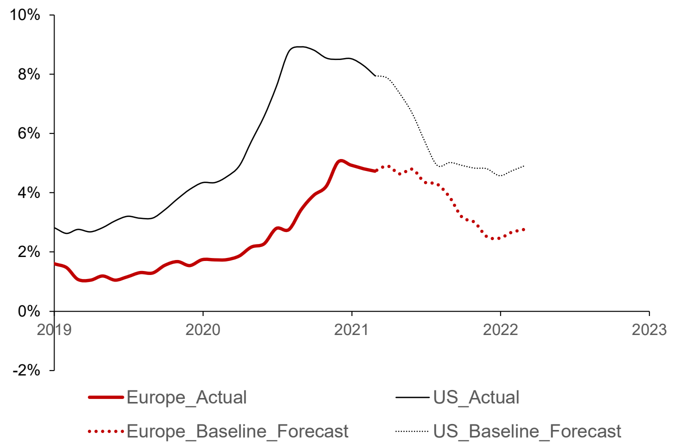
Firstly, the fundamentals are improving extremely fast, and this is already being acknowledged by rating agencies. There are already more upgrades than downgrades in the US HY as shell gas producers are boosted by higher oil prices but also in Europe. Secondly, we continue to expect default numbers to peak in March this year around 5% before declining to about 4% by the end of 2021, while bankruptcies in SMEs should remain elevated throughout 2021. We will have to wait for the withdrawal of the fiscal support to have more clarity on the magnitude. Thirdly, because central banks, and particularly the ECB, have a very strong focus on financing conditions, we expect them to protect credit spreads from rising. For instance, the ECB seems to purchase credit in the PEPP only when spreads come close to the threshold of 100bp vs Bund. Otherwise, they purchase private bonds only in the CSPP.

Graph 1: EURO LARGE CAPS VS SMALL CAPS NET DEBT TO EBITDA



12-month fwd, MSCI, Bloomberg

Graph 2: MOOODY'S EUROPEAN SPECULATIVE-GRADE DEFAULT RATES



In bn US-dollar, maturity > 1 year

Favour BBBs and BBs, subordination over credit risk

We think LDI investors sweet spot will be BBBs and single-Bs

Beyond the current volatility phase, the compression trade should resume, despite current expensive levels. We expect 10bp tightening in IG, 30bp in HY by year-end. Indeed, both technicals and fundamentals will remain very supportive.

Within IG, BBB should remain the sweet spot as it is among the highest carry products backed by the ECB. We remain neutral on financials versus non-financials and we keep an OW recommendation on cyclical sectors to benefit from the very strong recovery. EUR credit spreads should be more resilient than US peers, as the rate move should be more contained and the support from the central bank is stronger. As we expect further upside move in UST, there might be better entry points on USD credit swapped back in euros later this year.

In terms of duration, a neutral positioning is warranted to benefit from potential spread tightening with limited exposures to steeper rate curves.

Among HY, we retain our preference for BBs, as they seem to be more attractive from a valuation standpoint and they may benefit from new LDI inflows. Hybrids are probably the best quality yield in European credit markets, as they have been much more resilient than pure HY throughout Covid. Corporate hybrids trade very close to senior BBs, while AT1s are almost in line with single-Bs.

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EM sovereign credit

- **We turn neutral on EM external debt as the prospects of a higher UST rate will likely continue to pressure total returns and duration. The EM environment has been slightly deteriorating but the positive EM growth narrative is still valid. It is a UST rate story, not an EM story.**
- **We do not expect a repetition of the 2013 Taper Tantrum. EMs are less vulnerable with better external accounts. We expect spreads to tighten modestly in the quarter ahead, but risks are high.**
- **In a more challenging environment, the compression trade is coming to an end. We reduce our BB overweight exposure in favour of BBB names and favour bonds with shorter duration.**
- **In the HY space, the new G20 common framework is creating a risk for opportunistic restructuring. We prefer the BB bucket. The recent deterioration of the Turkish environment will likely have limited contagion effects on EMs.**

It is an UST story. High rates will keep capping total returns

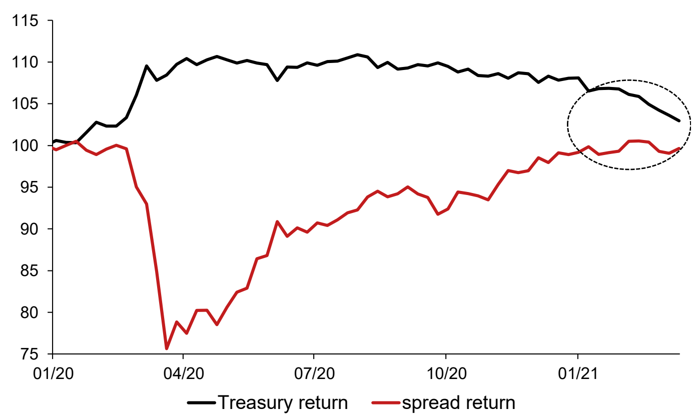
The EM environment has been deteriorating over the past two months and we now turn neutral on EM external demand with risks tilted to the downside. Some negative news across EM have emerged, like the deterioration of the sanitary situation and the slow recovery but it is above all the prospects of further long-term UST rate rise that will likely continue to cap the total return and to pressure duration. It is more a UST story than an EM story and the expected total return for this year has declined substantially between 1-3% .

The positive EM narrative is still valid. Spreads have finally been resilient

That said, a repetition of the 2013 *Taper Tantrum* is unlikely in our view. At that time, the US rate rebound was driven by real rates and EM vulnerabilities are currently different: external accounts are in a better shape and worries are coming from the fiscal/debt side. It leaves EMs less vulnerable to a UST rate rise. An illustration of this resilience is the limited widening of the external debt spreads during the UST sell-off. They have finally even recouped most of their losses to be back to their February lows. The stabilisation of the UST rate has allowed some spread compression and it is more the rapidity of the sell-off than the absolute level of yield that matters.

In our view, the positive narrative of the EM recovery is still valid. For sure, it is more challenging due to the UST gyrations and the margin of error is slim. That said, we continue to note appetite from investors with a stabilisation of the EM bond flows and continuous inflows into EM equity funds.

Graph 1: NEGATIVE TOTAL RETURN: IT IS A TREASURY STORY



EMBIG-D, base 100 = Jan. 20

Graph 2: LOW TOTAL RETURN IS EXPECTED IN 2021

OAS spread	US 9Y 0.47%	0.57%	1st Jan 0.77%	1.02%	1.27%	1.52%	End of the year? 1.77%	2.02%
250	8.35%	8.26%	8.09%	7.86%	7.64%	7.42%	7.20%	6.98%
260	7.47%	7.38%	7.20%	6.98%	6.76%	6.54%	6.32%	6.09%
270	6.58%	6.49%	6.32%	6.09%	5.87%	5.65%	5.43%	5.21%
280	5.70%	5.61%	5.43%	5.21%	4.99%	4.77%	4.55%	4.32%
290	4.81%	4.72%	4.55%	4.32%	4.10%	3.88%	3.66%	3.44%
1st Jan 300	3.93%	3.84%	3.66%	3.44%	3.22%	? 3.00%	2.78%	2.55%
310	3.04%	2.95%	2.78%	2.55%	2.33%	2.11%	1.89%	1.67%
320	2.16%	2.07%	1.89%	1.67%	1.45%	1.23%	1.01%	0.78%
330	1.27%	1.18%	1.01%	0.78%	0.56%	0.34%	0.12%	-0.10%
340	0.39%	0.30%	0.12%	-0.10%	-0.32%	-0.54%	-0.77%	-0.99%
350	-0.50%	-0.59%	-0.77%	-0.99%	-1.21%	-1.43%	-1.65%	-1.87%

2021 total return, Bank of America DGOV index

The compression trade to lose steam

We reduce our BB exposure in favour of BBB names

Within a rising rate environment, the compression trade will prove more challenging. Dispersion will likely keep rising with a higher UST rate. The margin of error is slim and relative-value trade should be favoured. To this extent, we reduce our BB OW exposure in favour of BBB names, especially low duration names with low cash prices in Asia or EMEA. We continue to reduce the duration and we expect quasi sovereigns to underperform sovereigns while cash should underperform CDS.

In the IG space, we dislike Colombia given the ongoing fiscal deterioration and we like GCC names that have mildly benefited from higher oil prices: we prefer Saudi Arabia over Abu Dhabi that is too tight in our view. CE4 countries will benefit from low supply this year. In the HY space, we continue to dislike the B bucket and below. The Ethiopian opt-in for the new G20 Common framework is creating a new risk of opportunistic restructuring. In this bucket, Egypt, and Ukraine thanks to the IMF anchor are attractive. In Turkey, the situation is fluid but we expect limited contagions to other EMs. We remain negative on credit as the positioning is heavy and most of the positive news was already priced in.

Region-wise, we continue to favour Asia over CEEMEA and LatAm which is the most vulnerable region to rising UST rates and is still hurt by the Covid. LatAm political risk will also run high in Q2.

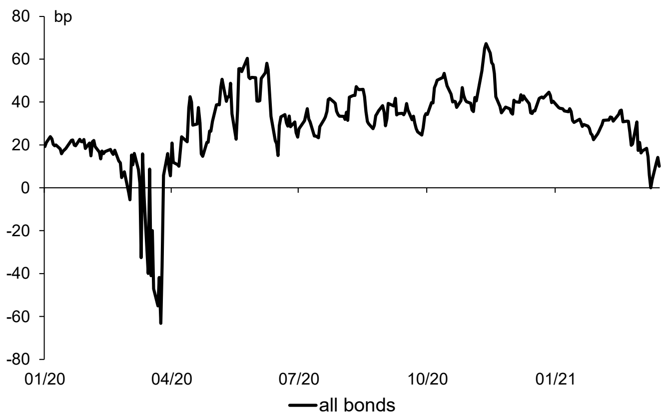
Prefer EUR bonds over USD bonds

We prefer EUR bonds over USD bonds given their lower duration

Despite the US rate rise, EM EUR bonds are still offering a better pickup over EM USD bonds. They have been more resilient in total return terms than EM USD bonds given their lower duration and the limited European rates rise. In the HY segment, the pickup is even more important. At a more granular level, B is the most attractive segment, after a relevant underperformance since the last summer rally.

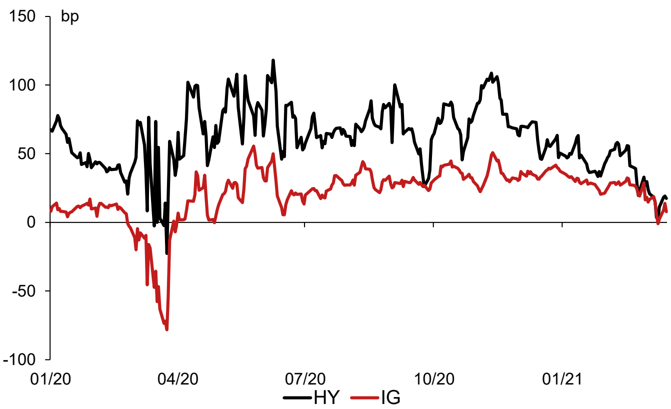
The IG segment is offering a less important pickup than the HY segment. We would expect this pickup to tighten as the supply of CEE issuers will decline significantly on a net basis. We see value in long Romania EUR bonds vs USD equivalents. The Chile EUR front-end is more attractive as well as the Kazakhstan EUR curve.

Graph 3: EUR BONDS OFFER A PICKUP OVER USD BONDS



ASW FX hedged issuer and maturity matched, 375 bond pairs

Graph 4: EUR HY OFFERS A BETTER PICKUP



ASW FX hedged issuer and maturity matched, 375 bond pairs

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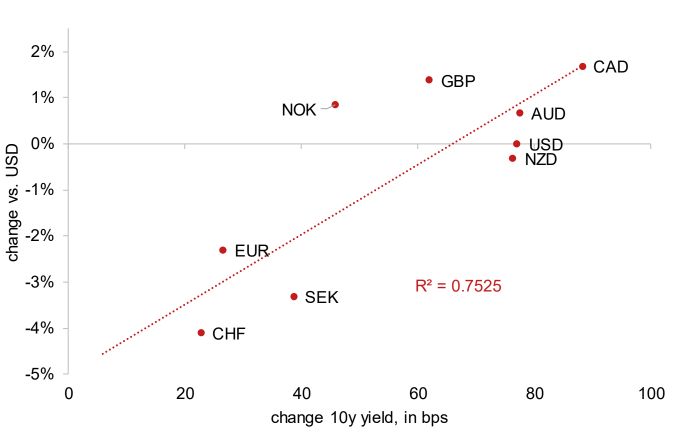
Currencies

- **Amid the global rout in yields, persistent risks of a further US yield overshoot and a shakeout of USD short positions we stay prudent on EUR/USD near term.**
- **Nevertheless, we expect renewed USD weakness in the spring/summer as economies will reopen globally. The US fiscal stimulus' boost to the USD will be largely offset by a widening twin deficit and a recovery of the main trading partners. The Fed's persistent dovish stance amid a rising US inflation premium is weighing too.**
- **A persistent EUR/USD rebound will require evidence of more significant vaccination progress in Europe and the end of lockdowns as a trigger. The RFF agreement, Brexit deal and a new Italian government have tamed tail risks for the EUR.**
- **The global yield surge's squeeze on JPY and CHF may still extend short term. While we see further moderate upside on EUR/CHF, we anticipate some retracement in USD/JPY later in the year on improving portfolio flows, a more benign real yield gap and a strongly undervalued JPY.**

A mild further extension of the USD recovery cannot be ruled out, but we expect broader USD weakness to dominate amid a global recovery into summer

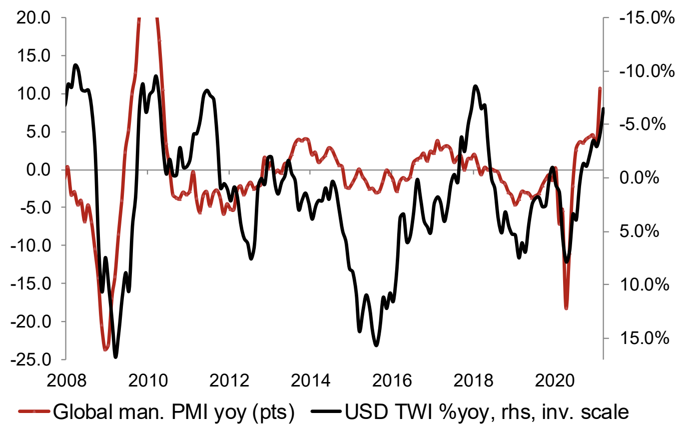
The 2% bounce in the USD (TWI by March 24) is likely to prove a breather, rather than a trend reversal amid the upcoming global reopening. However, we would not rule out some moderate further USD relief short term. The USD is still enjoying exceptional support from the jump in US yields (Graph 1), which may not have run its course yet, with a spike in inflation looming for spring (see Macro section) while speculative net USD short positions are still elevated. Also, US growth will outpace other advanced economies thanks to its vaccination lead and big fiscal stimulus. Conversely, uncertainties about the euro area's reopening remain high amid prolonged lockdowns amid a bumpy vaccination campaign.

Graph 1: YIELDS AND EXCHANGE RATES



changes ytd (as of March 22)

Graph 2: ANTICYCLICAL USD



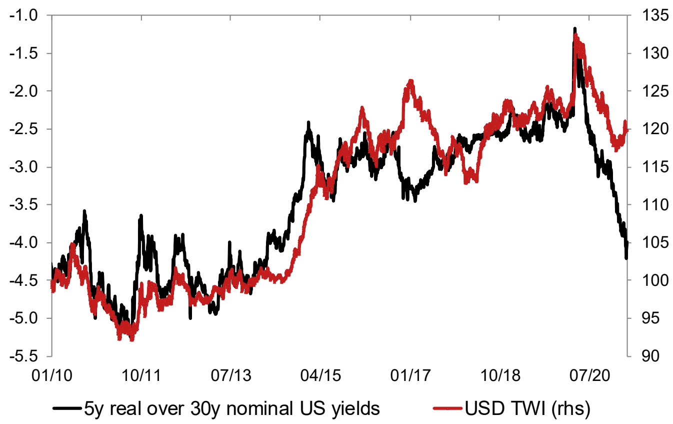
A USD breather, not a trend reversal

A global rebound and a widening US twin deficit will weigh on the USD as the Fed maintains its dovish stance

Yet vaccination progress should still allow for a substantial easing of constraints from May onwards, triggering a strong economic bounce in the EA and increasingly also across other advanced economies and EMs, who will also benefit from spillovers from the US fiscal package. Meanwhile, the US trade deficit will widen, while the fiscal balance will remain deep in the red. In the past, such twin deficits have been associated with USD weakness. Most importantly, the US dollar is an anticyclical currencies, which is sought in global downturns but sold in global recoveries (Graph 2). With the recovery gaining in global breadth into summer, the USD will suffer. The Fed's dovish stance neither helps. With the Fed set to take its average inflation targeting (AIT) and full employment target seriously, the short end of US yields (which is most FX relevant) will remain anchored, while longer-dated UST yields may suffer from rising inflation uncertainties. The steep US yield curve (especially vs. short term real rates, reflecting concerns that the Fed may be falling behind the curve) is already signalling a significant gap (Graph 3), which may widen even further. Meanwhile, global reserves diversification away from the USD keeps progressing.

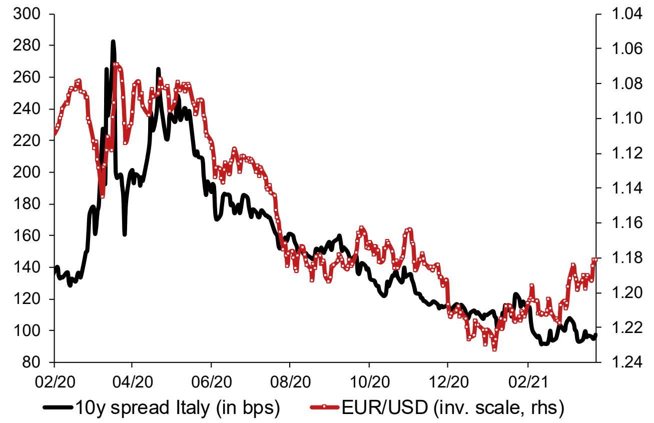
Conversely, the EUR has been relieved of two key risk: a no-deal Brexit is off the table (many unresolved details notwithstanding), while the new Italian government under Draghi has helped to tame anti-European sentiment and makes an effective deployment of funds from the EU Recovery and Resilience Facility (RRF) likely. Indeed, current levels of Italian BTPs spreads would be more consistent with EUR/USD readings in the 1.20-.25 range (Graph 4).

Graph 3: US YIELD CURVE AND USD



real rate based on USTs and inflation swaps, in % p.a

Graph 4: EUR/USD AND EMU DEBT CONCERNS



10y spread of Italian BTPs over Bunds

We expect the EUR/USD to resume its upward trend towards 1.25 over summer

Following a more balanced near-term outlook, we thus expect the EUR/USD to resume its uptrend over the spring and summer – even though we have cut our 12-month target to more moderate 1.25 owing to the US growth lead and higher yields forecasts. We also like the Scandis (SEK, NOK) as cyclical winner and thanks to their historically elevated betas to USD weakness. We see some further upside to GBP, with the UK economic bounce to prove particularly impressive thanks to fast vaccinations and a high exposure to (recovering) services. Also, we see the BoE among the first major central bank to taper its asset purchases over the summer. With the euro area catching up and the fallout from the Brexit showing up more clearly, however, we see some EUR/GBP recovery later in the year. We stick to our forecast of gradual further upside in the EUR/CHF, with the Swiss currency harmed by reversing safe-haven flows and a fading appeal amid recovering Bund yields.

The Japanese yen has suffered strongly on the rebound in US yields over recent weeks. This move may extend temporarily, but ultimately, we expect broader USD weakness to be reflected also in the USD/JPY. Japan's current account surplus (>3% of GDP) contrasts a widening US deficit, while ebbing net portfolio outflows and recovering equity inflows amid a pro-cyclical rotation will lend support to the JPY. We also expect markets to refocus from wide nominal yield differentials to real yield gaps that are more favourable for the strongly undervalued JPY and see USD/JPY reverting closer to 105 again on a 12-month view.

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Equities

- **In the last 3 months US equities rallied, while EMU and Japan overperformed due to rising US yields and an accelerating recovery momentum.**
- **Stocks can cope with an orderly rise in bond yields. The earnings rebound will offset decreasing PEs, producing positive total returns, thanks also to lingering policy support.**
- **Our US models forecast an earnings growth of around 25% in 2021 and 20% in 2022. For the EA, the earnings recovery will be higher in 2021 (+35% but coming from a lower base) and aligned to the US in 2022.**
- **The bulk of rotation into Value (less) and Cyclical (more) sectors is behind us but it can linger as GDP and M1 momentum remains sanguine, together with yields one.**
- **We stay OW equities notwithstanding higher positioning and more stretched tactical indicators. We see positive total returns in 12 months (high-single digit) to remain more attractive compared to fixed-income ones.**

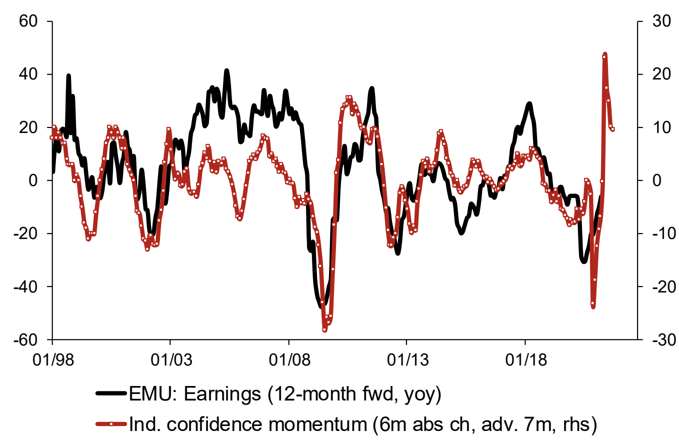
Since mid-December 2020 US stocks posted a +5.7% performance. US Nasdaq underperformed (+1.8%), while the MSCI EMU and the Topix did better (+8.1% and +8.4%, respectively). A rotation into value-cyclical sectors (+10%) and countries was fueled by rising US yields (+70 bps) and an accelerating recovery momentum.

Stocks can cope with an orderly rise in bond yields, as earnings will do the job

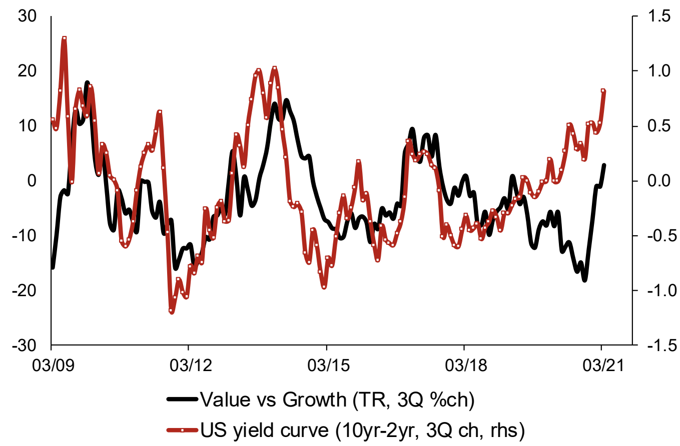
Earnings rebound to offset decreasing PEs

Economic recovery, vaccine roll-out, higher capacity utilization plus declining unit-labour costs are sustaining earnings revisions, especially in the US. Here, a weaker USD and higher oil prices have helped further. The recent fiscal stimulus of 1.9 TN USD will prolong the positive earnings momentum. For the longer term, the discussion

Graph 1: EMU: EARNINGS & IND. CONF. INDICATOR



Graph 2: VALUE vs GROWTH STYLE AND US YIELD CURVE



Euro area

on a big infrastructure plan can extend the benign sentiment towards corporate profitability. The euro area (EA) is lagging but will profit anyway from a catch-up in economic momentum and the positive effects of the US growth on the global economy.

Our US models forecast an earnings growth around 25% in 2021 and 20% in 2022. For the EA, the earnings recovery will be higher in 2021 (+35%) and aligned to the US in 2022. Given our earnings forecast and target prices - nearly 7% total return in 12 months - we implicitly expect the risk premium to increase and PEs to slightly decrease as one could expect due to a maturing economic momentum and higher real yields going forward. S&P 500 fair value is 4,000-4,200 in 12 months, using a US yield of 2.1% (base scenario). Should yields rise to 2.8%, we get 3,800 in 12 months.

Historically, current real yields favour equity returns. We would need an increase of nearly 1pp bps to hurt relative equity returns vs bonds (adjusted for risk).

Equity styles: (Milder) rotation phase two

Keep exposure to assets that will benefit from higher GDP and inflation expectations, e.g. value stocks

Expectation of a strong macro recovery is reinforced by a reaffirmed policy support for the mid-term. Higher yields have put pressure on long duration sectors (Growth, Defensive), supporting lower ones, Cyclical and Value. That said, the rotation has already gone far: since 10/2020, EU Value overperformed Growth by 20% (underperforming 10% since 1/2020). Cyclicals beat Defensive by 43% since 4/2020, outperforming by more than 10% since the end of 2019. In addition to this, positioning and sentiment have become consensual in backing such rotation. Our quant models look stretched for Cyclicals and, to a lesser extent, for Value. That said, we think the rotation can linger, albeit two thirds of the move might be behind us: GDP and M1 momentum remains sanguine, together with yields and commodity's one. They all deserve a positive correlation with Value and Cyclical sectors and countries.

Short term, we maintain an OW on equities, favouring EMU, Japan and secondarily EMs. The ISM and the IFO indicators are high and overall supportive for the continuation of the earnings rebound, for Value and Cyclicals especially (financials, energy and materials). OW: Financials, energy, materials and software. UW: media, TCM and HPP. Risks are: temporary set-backs mainly due to high positioning/consensual optimism and spikes in yield volatility.

EM: exposed to higher yields in the shorter term

EM stocks have been recently correcting and shall be put further under pressure in the short term due to a stable USD, rising US yield volatility, falling EM macro surprises and reduced money growth in China.

Table 1: US CAPE-BASED VALUATION

US CAPE-based valuation (adj. for inflation)	10Y	CPI	Real 10Y Rate	EPS	Current (e/p - 10y real)
Scenario 1 (current input with consensus CPI & 12m fwd earnings)	1.47	1.37	0.10	176.5	4.29
Scenario 2 (consensus 12m forward in 1 year)	1.51	2.18	-0.67	202.6	5.03
Scenario 3 (GI 12m fwd in 1 year)	1.92	2.20	-0.28	208.6	5.18
Scenario 4 (downside macro scenario)	0.70	1.40	-0.70	115.0	2.86
Scenario 5 (upside macro scenario)	2.80	2.40	0.40	220.0	5.07

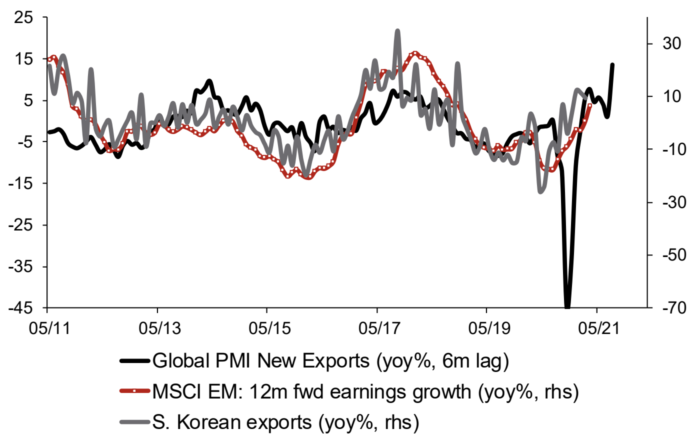
using 20% of risk (SD)	Scen. 1	Scen. 2	Scen. 3	Scen. 4	Scen. 5
Implied PE Trailing IBES	25.2	29.5	30.4	16.8	29.4
Avg S&P500 valuation	3,643	4,274	4,402	2,428	4,258
	-4.6%	11.9%	15.3%	-36.4%	11.5%

Note: **Base risk** scenario: using 20% of risk premium's stand. deviation (SD=2.7) adds around 50 bps to the average risk premium calculated since 1872 (4.6% + 50 bps = 5.1%). Target ERP (4.6) is the average ERP during periods of low inflation (b/w 1.3% and 2.5%).

using 40% of risk (SD)	Scen. 1	Scen. 2	Scen. 3	Scen. 4	Scen. 5
Implied PE Trailing IBES	22.5	26.3	27.1	14.9	26.5
Avg S&P500 valuation	3,258	3,812	3,926	2,165	3,833
	-14.7%	-0.2%	2.8%	-43.3%	0.4%

Note: **High risk** scenario: using 40% of risk premium's stand. deviation (SD=2.7) adds around 100 bps to the average risk premium (4.6% + 100 bps = 5.6%).

Graph 3: GLOBAL EXPORT ORDERS, S. KOREAN EXPORT GROWTH AND EM EARNINGS EXPECTATIONS



We expect total returns in the range of 6-7% for DMs and 7.7% for EMs (in euro)

We remain constructive on EMs in the longer term as relative valuations are attractive and we see an ongoing rebound in GDP growth, a superior long-term real earnings growth, a weakening USD and higher commodity prices. Additionally, long-term positioning on EM stocks remains below average. OW: Korea, India, and Poland due to attractive valuation scores. India should benefit from progressing vaccinations. We expect a total return of around 7.7% (in euro) over the next 12 months.

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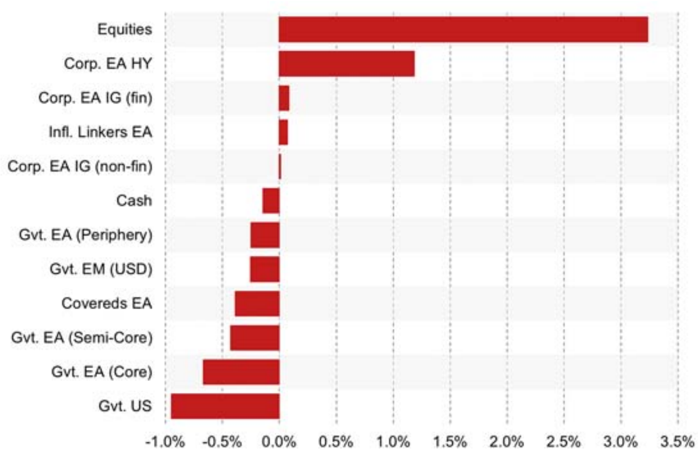
Asset Allocation

- **Ongoing Covid-19 measures and sluggish vaccination will continue to weigh on economic activity in Europe. Nonetheless, advanced economies are on the verge of a strong rebound in spring/summer.**
- **Vaccination success and a US$ 1.9 tr stimulus flanked by supportive financial conditions will boost US Growth to >7% in 2021. This will once again give the US a leading role in the forthcoming recovery and additionally allow the rest of the world to benefit through spill-over effects.**
- **Despite overextended positions, inflated valuations and residual risks from Covid-19 mutations, the imminent economic recovery should continue to support risk assets. Inflation concerns could intensify and impose risks on fixed-income securities (especially in the US).**
- **Both conditions (risk assets underpinned while fixed-income ones at risk) basically set the tone for tactical positioning. Thus, as in previous months, this is mainly characterised by overweighting in equities and EA credit.**

Backed by a strong equity performance as well as a slump in US yields, our model portfolio roughly generated +40 bps outperformance in the first quarter of 2021 so far. The overweight in equities and the underweights in US Treasuries as well as in EA core government bonds paid off particularly well.

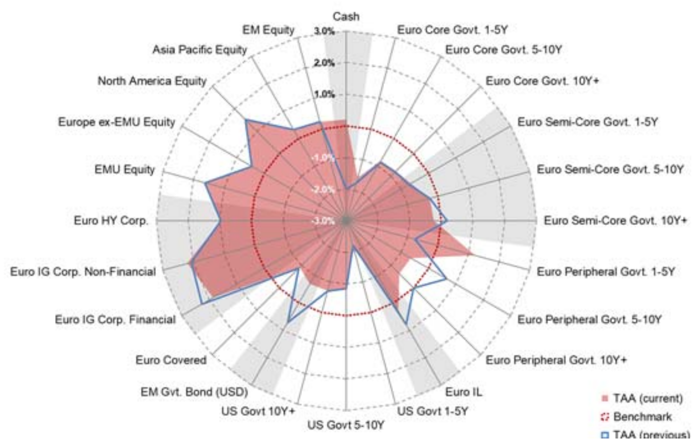
Looking ahead, Covid-19 will continue to have a firm grip on markets. Nevertheless, a strong economic upswing is expected for spring/summer, driven by the "grand reopening" made possible through progressive vaccination as well as policy support, both fiscal and monetary. These are fundamentally favourable conditions for the relative attractiveness of risk assets. Furthermore, a rising US inflation heavily weighs on the total return perspectives for fixed income assets.

Graph 1: AGGREGATED TOTAL RETURN FORECASTS



Hedged into EUR

Graph 2: BALANCED MtM MODEL PORTFOLIO (ACTIVE POSITIONS)



In pp; Semi-Core = Spain; Periphery = Italy

Equities and EA HY most attractive from a total return perspective

On balance, we stick to our overweight recommendations for equities and EA HY which we deem the most attractive asset classes from a total return perspective. Prospects for US Treasuries and EA Core Govies clearly suffer from rising inflation expectations and they should thus be underweighted. As credit spreads have proven quite resilient, we maintain our OWs in IG credit. Particularly financials might be considered as a hedge against inflation. We switch our USD EM govie position to an underweight position exclusively due to the expected rise in US yields. We recommend the opposite switch for Cash now offering more return than all govie markets.

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Forecasts

GROWTH

	2019	2020	2021		2022	
			forecast	*Δ vs. cons.*	forecast	*Δ vs. cons.*
US	2.3	- 3.5	7.5	*2.8*	4.7	*1.1*
Euro area	1.2	- 6.8	4.0	*- 0.4*	5.3	*1.2*
Germany	0.6	- 5.0	3.2	*- 0.3*	4.7	*0.9*
France	1.3	- 8.8	5.3	*- 0.2*	6.0	*2.4*
Italy	0.2	- 8.9	4.0	*- 0.3*	4.1	*0.2*
Non-EMU	1.5	- 7.9	4.2	*0.4*	4.6	*- 0.2*
UK	1.4	- 9.9	4.8	*0.6*	5.3	*- 0.3*
Switzerland	1.1	- 3.7	3.0	*0.0*	3.0	*0.0*
Japan	0.3	- 4.9	2.3	*0.0*	2.4	*0.1*
Asia ex Japan	5.1	- 0.8	7.6	*- 0.4*	5.2	*- 0.2*
China	6.1	2.3	8.4	*- 0.0*	5.4	*- 0.1*
CEE	2.3	- 2.1	4.4	*0.9*	3.3	*- 0.3*
Latin America	- 1.1	- 8.5	3.1	*- 0.4*	3.0	*0.3*
World	**2.6**	**- 3.7**	**5.8**	***0.4***	**4.5**	***0.3***

INFLATION

	2019	2020	2021		2022	
			forecast	*Δ vs. cons.*	forecast	*Δ vs. cons.*
US	1.8	1.3	2.4	*0.1*	2.3	*0.1*
Euro area	1.2	0.3	1.5	*0.3*	1.2	*- 0.0*
Germany	1.4	0.4	1.9	*0.2*	1.6	*0.0*
France	1.3	0.5	1.0	*0.2*	1.1	*0.0*
Italy	0.8	0.4	0.5	*- 0.0*	1.0	*0.1*
Non-EMU	1.5	0.6	1.3	*- 0.0*	1.6	*- 0.0*
UK	1.8	0.9	1.5	*- 0.0*	1.9	*- 0.1*
Switzerland	0.4	- 0.5	0.3	*0.0*	0.5	*0.0*
Japan	0.5	0.0	0.1	*0.3*	0.4	*- 0.0*
Asia ex Japan	2.7	2.9	2.4	*0.2*	2.7	*- 0.0*
China	2.9	2.5	1.7	*0.3*	2.3	*0.2*
CEE	6.9	5.6	6.7	*0.7*	5.0	*- 0.1*
Latin America	3.6	3.1	3.1	*0.2*	3.4	*0.6*
World	**2.5**	**2.2**	**2.5**	***0.2***	**2.5**	***0.0***

Regional and world aggregates revised to 2015 IMF PPP weights; Latin America Inflation excluding Argentina and Venezuela

FINANCIAL MARKETS

3-month LIBOR	**Current**	**3M**	**6M**	**12M**
USD	0.20	0.20	0.20	0.20
EUR	-0.55	-0.55	-0.55	-0.55
JPY	-0.07	-0.10	-0.10	-0.10
GBP	0.09	0.05	0.05	0.05
CHF	-0.75	-0.75	-0.75	-0.75
10Y Government Bonds	**Current**	**3M**	**6M**	**12M**
US	1.65	1.85	1.95	2.10
Euro-Area	-0.34	-0.25	-0.20	-0.10
France	-0.09	0.00	0.05	0.15
Italy	0.58	0.65	0.70	0.85
Japan	0.08	0.10	0.15	0.20
UK	0.78	0.90	0.95	1.05
Switzerland	-0.29	-0.20	-0.15	-0.10
Spreads	**Current**	**3M**	**6M**	**12M**
GIIPS	75	75	75	80
BofAML Covered Bonds	34	30	30	35
BofAML EM Gvt. Bonds (in USD)	289	280	275	280

Corporate Bond Spreads	**Current**	**3M**	**6M**	**12M**
BofAML Non-Financial	90	85	80	75
BofAML Financial	92	85	80	75
Forex	**Current**	**3M**	**6M**	**12M**
EUR/USD	1.19	1.20	1.23	1.25
USD/JPY	109	109	107	106
EUR/JPY	129	131	132	133
GBP/USD	1.38	1.41	1.43	1.44
EUR/GBP	0.86	0.85	0.86	0.87
EUR/CHF	1.11	1.11	1.13	1.14
Equities	**Current**	**3M**	**6M**	**12M**
S&P500	3,913	4,015	4,055	4,130
MSCI EMU	136.9	139.0	140.5	143.5
TOPIX	1,963	2,030	2,045	2,070
FTSE	6,713	6,900	6,935	7,010
SMI	11,070	11,205	11,335	11,530

As of 24.03.21 (3-day-average)

FORECAST-INTERVAL* – 3-MONTHS HORIZON

Government Bonds (10Y)	US	1.52	1.85	2.18
	Germany	-0.34	-0.25	-0.16
	UK	0.70	0.90	1.10
	Switzerland	-0.25	-0.20	-0.14
Spreads	10Y-GIIPS Spread	56	75	94
	BofAML Covered Bonds	23	30	37
	BofAML IG Non Financial	56	85	114
	BofAML IG Financial	48	85	122
	BofAML EM (in USD)	208	280	352
Forex	EUR/USD	1.17	1.20	1.23
	USD/JPY	107	109	112
	EUR/GBP	0.82	0.85	0.88
	EUR/CHF	1.10	1.11	1.13
Equities	S&P500	3,703	4,015	4,327
	MSCI EMU	126.2	139.0	151.8
	TOPIX	1,877	2,030	2,183
	FTSE 100	6,368	6,900	7,432
	SMI	10,471	11,205	11,939

FORECAST-INTERVAL* – 12-MONTHS HORIZON

Government Bonds (10Y)	US	1.54	2.10	2.66
	Germany	-0.28	-0.10	0.08
	UK	0.67	1.05	1.43
	Switzerland	-0.25	-0.10	0.05
Spreads	10Y-GIIPS Spread	46	80	114
	BofAML Covered Bonds	22	35	48
	BofAML IG Non Financial	31	75	119
	BofAML IG Financial	20	75	130
	BofAML EM (in USD)	170	280	390
Forex	EUR/USD	1.19	1.25	1.31
	USD/JPY	99	106	113
	EUR/GBP	0.81	0.87	0.93
	EUR/CHF	1.10	1.14	1.18
Equities	S&P500	3,623	4,130	4,637
	MSCI EMU	122.5	143.5	164.5
	TOPIX	1,794	2,070	2,346
	FTSE 100	6,124	7,010	7,896
	SMI	10,291	11,530	12,769

*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5 year history of percentage changes, equally weighted in the case of the 12-month forecast and exponentially weighted in the case of the three month forecast. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

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