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MIRANTE FUND MANAGEMENT

Market Overview

JULY 2021

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EVENTS OF THE MONTH.

In this second quarter, the global economy has surpassed the peak in real GDP reached in 2019 prior to the pandemic. Asia has been the fastest rebounding region, with China already accelerating strongly in late 2020. Since the beginning of the year, the United States has taken over, bringing the global economy along in its wake. Europe will have to wait until the last quarter of this year to complete its comeback. This vigorous recovery has generated rising inflation in the context of exacerbated demand, congestion of supply chains and increasing raw material prices.

Against this background, central bankers in the developed world have continued to hammer the message that there is no urgency to tighten monetary policy and that the surge in inflation will be transitory. Inflation is expected to ease by the end of the year as supply bottlenecks are resolved. At the same time, some macroeconomic indicators do show that supply chain pressures were easing. In commodities, for example, lumber prices fell sharply after rising to historic highs. In addition, metals prices came under downward pressure as China released some of its stocks to cool the market.

IMPACT ON THE FINANCIAL MARKETS.

These mentioned factors reduced investors' fears that persistent inflation could undermine the stability of financial markets.

As usual, bond investors remained more fearful than equity ones. The latter, convinced that central bankers would not reduce stimulus and raise interest rates, focused on strong economic growth. As a result, they pushed most equity markets to historic levels. Regionally, the Swiss equity market was the best performer, led by their leaders Nestlé, Novartis and Roche. The US benefited from good news from US banks, which announced a significant increase in distributions to shareholders. At the sector level, technology performed spectacularly well with encouraging news flow about their dominant positions. For example, a US federal judge has dismissed two antitrust cases against Facebook, and Chinese authorities appear to be reducing their pressure on internet companies. On the other hand, cyclical sectors, such as materials and financials, suffered from investors' appetite for growth.

Despite the numerous interest rate hikes announced in emerging countries, long-duration bond indices, particularly in the US, benefited from the weakening of interest rates in the global indices. The 10-year US Treasury yield fell back below 1.5%. Shorter maturity government bonds were under pressure as investors preferred to seek returns in long-duration and high-yield bonds. In this context, convertible bonds have benefited from the risk appetite of equity and bond investors.

Real estate continued to show robust growth. This month, growth sectors such as data centers, warehousing and logistics were the significant contributors to performance. However, hotel property lost some performance due to the impact of the delta variant, particularly in Asia. Office property also suffered as a result of announcements by major companies to institutionalize home office policies.

MACRO-ECONOMIC OUTLOOK.

As policymakers and central bankers are determined to achieve their inflation targets, interest rates and asset purchases will remain stable, even if the economic outlook has improved.

If investors remain calm and patient enough about inflation in the coming months, the most significant risk is likely to come from economic growth. Economists predict that economic growth will peak in the second quarter in the US and in the third quarter in Europe. Thus, although the outlook for the next corporate earnings season is positive, a reduction in overall growth could weight on financial markets.

POSITIONING OF OUR INVESTMENT STRATEGIES.

Despite the strong performance of equities, the fall in US interest rates was enough to increase our World Equity Risk Premium indicator. This indicator has been strengthening since March. It indicates that it is still relevant to allocate to the equity asset class and more generally to growth assets than bonds.

In this euphoric environment, an overly concentrated portfolio could suffer during the following market corrections. The magnitude of these corrections may come as a surprise, as the very definition of «defensive» assets is shifting. Thus, the primary benefit of diversification remains to mitigate the amplitude of these declines that occur suddenly and recurrently in the financial markets.

As we enter the earnings season, stocks' selection remains essential in this environment. We prefer companies that will benefit from growth linked to the secular trends of this new economic cycle with a bias for quality. This health crisis will have confirmed a bipolar world led by China and the US at the regional level. The pressures on supply chains and the redefinition of global trade push us to diversify between these two poles. At this level, we continue to prefer assets with relative inflation protection, short duration and the ability to generate sufficient returns. It seems to be the case for inflation-linked bonds (TIPS), emerging market corporate bonds, convertible bonds and high yield strategies.

FIGURE OF THE MONTH

140 billion dollars – expensive chips!

Semiconductor manufacturers will have begun construction of 29 new factories by the end of 2022 to meet accelerating chip demand. Capital spending on these 29 plants is expected to exceed $140 billion over the next few years.

Summer quiz: what is the impact of lockdowns on road accidents?

In 2020, the number of traffic deaths in the United States reached a 13-year high, with an annual increase of 7%. Even though roads were much less congested last year due to lockdowns, the near-empty roads may have led to less safe driving and a spike in road deaths in 2020

Source: National Highway Traffic Safety Administration, US.

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MAIN DRIVERS.

Main markets' drivers

GLOBAL GROWTH
neutral

- → Consumption boom
- → Almost at the peak of recovery (in terms of growth)
- → Covid-19: new variants risks
- → Increasingly a multi-polar world

EARNINGS GROWTH
positive

- → Earnings growth will dictate performance of equities as multiple expansion is unlikely
- → Positive outlook from management, but margins at risk on raw material prices and supply chain congestion

INFLATION
negative

- → Commodity, consumption, salary increase generates short-term inflation but "not persistent"
- → Inflation could be a self-fulfilling prophecy

INTEREST RATES
neutral

- → Fast movements on rates generates discount-rate shocks affecting growth names
- → Central banks (ex-emerging market) will not move on rates on the short-term
- → Structurally low due to demographics & low productivity gains

Main global risks

RECESSION RISK
neutral

- → Entering a new fiscal cycle: economic growth will be stimulated by fiscal policies
- → Pandemic risks decline
- → Uneven recovery with divergences between regions

FINANCIAL STABILITY
low risk

- → Fiscal and monetary stimulus has worked
- → Banks are more robust than in the past
- → Combination of low liquidity and automatic trading (ETF & algorithmic) increase potential sharp drawdowns

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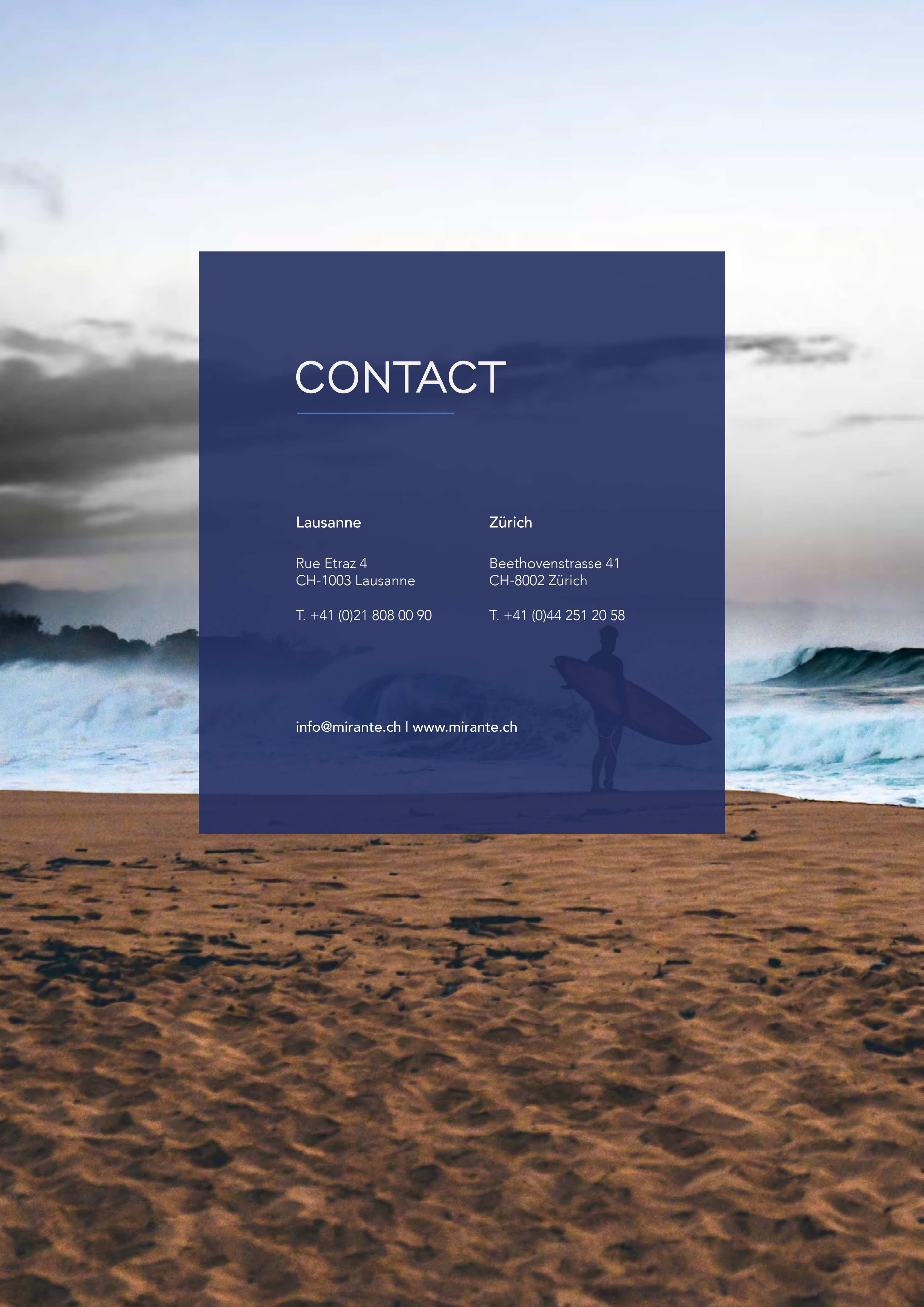
MONTHLY PERFORMANCE / JUNE 30TH.

Equities Market (LCL)	
Switzerland (SMI)	4.52
US (S&P 500)	2.22
World (MSCI All Countries)	1.24
United Kingdom (FTSE 100)	1.21
Brazil (Ibovespa)	0.99
Germany (Dax)	0.07
Europe (EURO Stoxx 50)	-0.15
Japan (Nikkei 225)	-1.23
China (CSI 300)	-1.82

Equities Sector	
Information Technology	6.77
Health Care	2.84
Energy	2.73
Communication Services	2.23
Consumer Discretionary	2.17
Consumer Staples	-0.59
Industrials	-1.91
Utilities	-3.54
Financials	-3.70
Material	-4.36

Fixed-Income	
U.S. Corporate long duration	3.70
US Long Treasury	3.57
Global Convertibles Bonds Hedged	1.51
US Corporate High-Yield	1.34
Emerging Markets Corporate	0.72
Pan-European Corporate High-Yield	0.64
Swiss Bond (SBI / AAA-BBB)	0.33
Global Corporate Credit	0.06
Emerging Market Local Sovereign	-0.82
Global Treasury Bonds	-0.95
Global Inflation-Linked Bonds	-1.27
International Treasury Bonds (ex-US)	-2.12

Others	
Real-Estate (FTSE NAREIT)	2.61
Commodities (BCOM)	1.85
Hedge Funds	0.38



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