

## Recovery on track – time to take a break

**The economy is coping well with Covid-19 but we continue to expect low interest rates. The conditions for risk investments would look good if it weren't for valuations.**

“As encouraging as the recovery is, the consequences of the pandemic and the structural changes it has accelerated remain unforeseeable. In addition, inflation spikes could still cause instability this year. Our forecasts are therefore cautious.”



Stefan Kreuzkamp  
Chief Investment Officer and  
Head of Investment Division

Summer is just around the corner, case numbers are going down, reopening euphoria is spreading. For many parts of Europe and the United States it almost feels like it did twelve months ago, if the differences were not so obvious. A year ago, people were still naively optimistic about the pandemic and hoped that it would subside naturally over the course of the year. That did not happen. Since then the virus has surprised negatively in terms of its persistence and mutability, while the speed with which vaccines have arrived and their efficacy has surprised positively. Also surprising has been the resilience of the global economy, despite high Covid-19 case numbers in the fall and spring. The biggest difference, however, can be seen in the capital markets. The MSCI AC World Index is now 85% above its March 2020 low and over 20% above its February 2020 pre-crisis high.

The extent and speed of the change over the past twelve months makes us somewhat humble in formulating our forecasts for the coming twelve months. Our macro picture is positive. We expect global growth of 5.8% for 2021 and 4.6% for 2022. The main drivers of growth this year are expected to be Asia and the United States. In our core scenario, we expect this year's inflation spikes to subside, averting a sell-off in government bonds. But equity and corporate-bond valuations leave

little room for upside and presuppose accident-free central-bank behavior, to the extent that this is possible. Keeping the economy and labor markets buoyant without giving inflation and financial-market bubbles room to expand further is likely to become more difficult.

Central bankers face the same challenges as investors: properly classifying a multitude of potential structural changes. Covid-related changes in behavior aside, these include: the return of the strong state, which implies an end to tax cuts and new waves of regulation (see ESG); questioning of globalization in the face of current supply chain disruption and the desire for more (domestic) production security; an aging population and ever higher debt, to which the generous U.S. stimulus packages are contributing. And so there are many uncertainties, including for the central banks. Until now, they have been running on crisis autopilot, so to speak, but given the complexity of the challenges ahead their responses are also becoming more difficult to predict.

The high level of uncertainty may trouble markets. The inflation issue in particular is likely to preoccupy investors for some time to come. Twelve months ago, the specter of deflation, not inflation, was still around. Today, we have record-high com-

modity prices, labor markets that are tight in some segments, rising minimum wages and pent-up demand for consumption – and all this while the supply side is still troubled. Our core scenario, that many of these factors are transitory and that inflation expectations will not rise further in 2022, is not universally shared.

Against this backdrop, we have adjusted our price targets for equities only slightly upward – in line with higher earnings estimates. We want to wait and see how margin pressure and real interest rates develop before adjusting valuation multiples. Asia remains our preferred region, also, and precisely because, it has had such a weak start to the year. For bonds, we continue to assume slightly rising yields. This means a negative total return for most developed-market government bonds. In corporate bonds, we prefer the high-yield segment, which is benefiting more than average from the economic recovery. Regionally, we continue to favor Asia.

Since we also see hardly any upside potential for gold, the question is what investments could still be interesting. We see two themes. First, in the rather sluggish real-estate market, we believe that prices are not yet reflecting structural changes sufficiently. Logistic centers and apartments remain our favorites here, while we continue to see difficulties for office and retail properties.

The most exciting topic, even if its omnipresence currently has a bubbly taste, remains sustainability. Particularly in the "E" of ESG, i.e. the environment, we continue to expect substantial momentum, for example in the area of CO2 avoidance. But it is by no means the only area where investors can still position themselves.

Look at our forecasts to see our 12-month outlook in numbers.

## GLOSSARY

A **central bank** manages a state's currency, money supply and interest rates.

A **corporate bond** is a bond issued by a corporation in order to finance their business.

A **developed market (DM)** is a country fully developed in terms of its economy and capital markets.

Investors increasingly take **environmental, social and governance (ESG)** criteria into account when analyzing companies in order to identify non-financial risks and opportunities.

**High-yield** bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

**Inflation** is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

**Margin** describes borrowed money that is used to purchase securities.

The **MSCI AC World Index** captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

The **real interest rate** is the nominal interest rate adjusted for inflation as measured by the GDP deflator.

**Valuation** attempts to quantify the attractiveness of an asset, for example through looking at a firm's stock price in relation to its earnings.

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