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INVESTMENT CONVICTIONS

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"We did not come to fear the future. We came here to shape it."

Barack Obama

OUR KEY CONVICTIONS

- **The economic rebound should continue as many economies are recovering from the COVID crisis. Yet much of this rebound has already been discounted by the markets and Equity valuations are not cheap**
- **Central banks policies and government stimulus packages are likely to be less supportive going forward as the global economy is recovering from the pandemic**
- **Investors will need to be more discerning as return opportunities are likely to be scarcer in the second half of the year**
- **A normalization of the economy implies higher long-term bond yields. We therefore continue to prefer equities over bonds**
- **A combination of past and current strong stimulus measures and high pent-up consumer demand in the US can lead to short-term inflationary concerns**

As we are entering the second half of the year, it is time to pause and reflect on the year so far. Since January, we witnessed a slow but accelerating roll-out of vaccines. As more people got vaccinated and economies reopened we saw an acceleration of global economic growth. This in turn provided a boost to company earnings and lifted equity markets and other risky assets.

The second half of the year is likely to be more challenging. Indeed, positive news about the reopening of the economies are now largely priced in and analysts have already revised up company earnings. Moreover central banks will start thinking about reducing their supportive policies now that the economies are recovering from the pandemic.

Reflection on the year so far – from gloom to boom!

We argued at the start of the year, that the global economic picture was not as gloomy as expressed by many commentators in the media. Indeed, whilst many countries were experiencing unprecedented increases in new COVID cases in January (see chart 1), effective vaccines were on the way. Therefore our conviction was that the worst of the pandemic was behind us and that equity markets would start focusing on better economic prospects. In the meantime, analysts have sharply revised up their earnings forecasts for companies (see chart 2) and equity markets have witnessed a strong rally.

But towards a more challenging second half of the year...

The second half of the year is presenting more challenges. Firstly, the economic momentum generated by an opening of the economies is now already largely priced in. Therefore, equity markets are unlikely to benefit from further strong upwards revisions in company earnings. Secondly, the support from central banks and governments is likely to diminish. Such an environment is prone to bring higher volatility into financial markets and lower returns going forward. For fixed income assets, the prospects of higher interest rates as central banks remove the extraordinary monetary “crisis support” will provide strong headwinds for developed markets government bonds in particular (see chart 3). On the other hand, challenging valuations and less supportive economic stimulus measures are likely to slow the momentum witnessed in the first half of the year in risky assets such as equities (see chart 4).

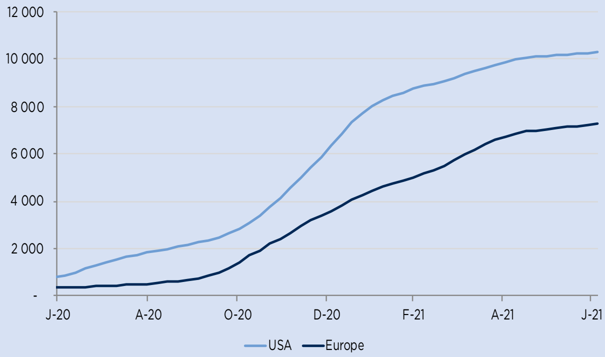
In this environment, where should investors be positioned?

Our conviction remains that equities will continue to outperform bonds. However returns will be more difficult to achieve going forward. This is especially true for economically sensitive stocks, which have already benefited strongly from the reopening perspectives.

Investors will therefore need to be more discerning and invest in sectors and stocks exhibiting faster growth than the overall economy. Such growth can be found in Megatrends such as the future of Healthcare or agriculture for instance. Both these areas are in the process of being radically transformed. Within the healthcare sector, the adoption of new technologies such as telemedicine and artificial intelligence is likely to provide a strong boost to productivity. Within the agricultural sector, new techniques such as vertical farming, will enable us to produce closer to consumers, with less consumption of natural resources and chemicals. Since these Megatrends are long-term themes, they are less dependent of economic cycles.

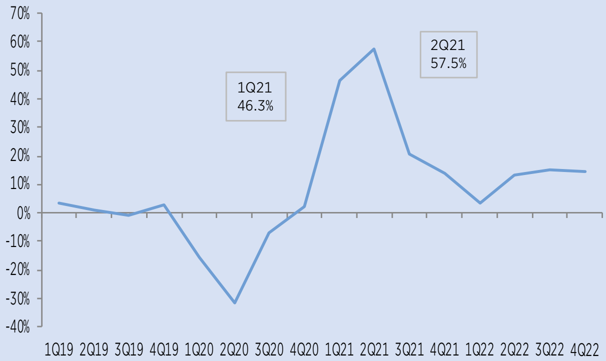
Within Fixed Income, government bonds are likely to continue to be under pressure as central banks will gradually remove their supportive measures. Indeed an increase in interest rates and/or lower bond purchase programs would both hurt long dated bond holders. We therefore continue to be positioned in shorter maturity credits and specific pockets of fixed income such as subordinated financial debt for instance.

1 Coronavirus (2019-nCoV) Europe Confirmed Cases per 100’000 people in January 2021



Source: Bloomberg, Edmond de Rothschild

2 S&P500 earnings per share growth forecasts, in %, YoY, per quarter



Source: Refinitiv, Bloomberg

What are the key risks?

There are two main risks for investors in our view. The first one is the spread of a new COVID variant for which the current vaccines would not be effective. Whilst current vaccines have proven effective against the various mutations of the virus so far it is not impossible that another mutation proves to be resistant. This would trigger a sharp economic slowdown on the back of renewed lockdown measures, further stimulus programs and a sell-off in risk assets for "safe haven" assets such as gold. Whilst the new m-RNA vaccines would rapidly be adapted in order to be effective against the new variants, it would take many months to produce and distribute them.

Another risk remains inflation. We have stated in our previous Investment Convictions publications that we do expect a temporary but not a structural increase in inflation. Yet a pick-up in inflation which may be a bit more prolonged could trigger investors' fears that the past decade of low inflation would be over. This would trigger a sell-off in long-term government bonds and hurt companies with low pricing power.

What does this mean for our investment strategy?

1- We continue to prefer equities over bonds

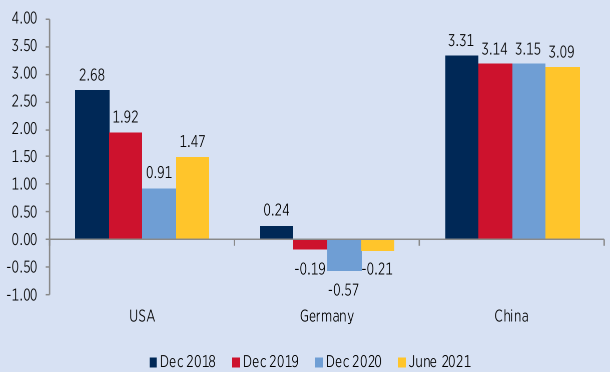
2- We are underweight government bonds and Investment grade credit

3- We continue to invest in long-term Megatrends which are likely to benefit from higher secular growth. We added Farming 4.0 in our portfolios

4- We keep on having a preference for pockets of credits such as subordinated financial debt and hard currency EM bonds

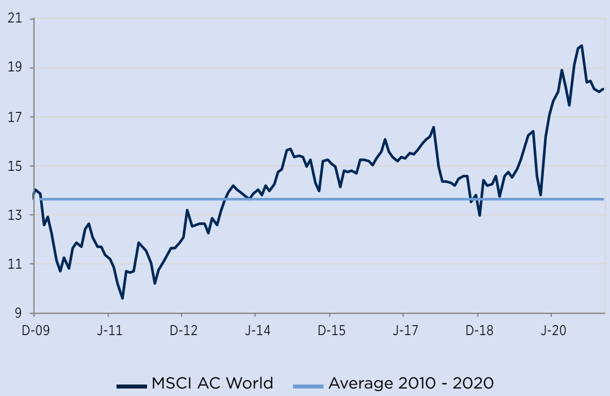
5- We own Treasury inflation protected notes (TIPS) in our portfolios and we maintain strategic gold positions

3 Evolution of 10Y rates by region



Source: Bloomberg, Edmond de Rothschild

4 Equity valuations (MSCI AC World, Price to estimated Earnings at 12 months Ratio)



Source: Bloomberg, Edmond de Rothschild