2pm PERSONALIZED PORTFOLIO MANAGEMENT

Quarterly market review

JULY 2021

Editorial

Around the world, the pace of vaccination campaigns against Covid-19 intensified during this second quarter, so much so that in mid-June, vaccination coverage was around 50% in the United States and Europe, and over 60% in the UK. And the spectacular drop in hospital admissions in intensive care units has allowed restrictions to gradually lift, with good consumption figures all over the world in Europe and in the United States, even if in recent weeks, the very virulent Indian variant (or Delta as it is now called), may have worried and forced certain cities to reconfigure (in Portugal where this variant now represents 90% of new cases, in Australia, etc.). The UK has even postponed the complete lifting of restrictions by one month, as have some Southeast Asian countries such as Indonesia, with the area lagging behind in terms of vaccination.

Reopening of bars in Paris (Montparnasse)

Faced with this fairly global macroeconomic improvement (although more spectacular on the American side than on the European side) and the very good figures published by companies overall, operators now seem to want to focus on three subjects: The strength of economic growth and the sustainability of the rebound, the implications for inflation and the timing with which central banks will reduce their asset purchases each month (“tapering”) and possibly raise rates. With the hope that a certain collective immunity will be put in place and prevent further re-lockdowns in the fall.

Strength of economic growth ... It is true that better management of the impact of the virus on global activity, coupled with the gradual reopening of economies, have favored growth figures higher than what was initially anticipated, both for developed countries as well as emerging countries. Growth with services highlighted more than manufacturing, especially in the United States, but this is true in all developed countries, while in emerging countries, it is more the exports of technological goods and raw materials which have been the recent engines of the takeover. In recent weeks, with the acceleration of vaccination and the drop in the number of hospitalizations, other sub-sectors are now more in the spotlight in services (catering, travel, tourism, etc.), with here and there a few shortages of labor have being observed.

This stronger-than-expected growth was accompanied by higher-than-expected inflation figures and clouded the minds of operators with foreboding thoughts that had not been observed for years: the famous fear linked to inflationary pressures, traditionally associated with profit taking on the equity markets. Fortunately, this scenario did not occur and the first half of 2021 materialized with double-digit performance on most equity markets (see table opposite). One of the reasons lies in the fact that for a majority of operators, this peak of inflation would be essentially transitory, linked on the one hand to base effects resulting from the violent fall in the American consumer price index during the initial lockdown of last year and temporary bottlenecks on the other hand, combined with the surge in many commodities in recent months. It is therefore difficult at this stage to draw hasty conclusions on the return or not of inflation. Inflation, which is not in itself bad news for developed countries after all these rather deflationary years, as outlined in our Special Topic. But if, as many believe, this spike in inflation is more cyclical than structural, then long-term rates should not shift sharply upwards in the coming months, which would indeed be problematic for the valuation of the equity markets.

Other factors also explain the good performance of the equity markets during this first half of the year. First of all, cyclical factors: We are just emerging from a major crisis, the magnitude of which has caused the disappearance in 2020 of about 9.4 million jobs in the United States and we are therefore barely at the very beginning of a cycle of growth, and this on both sides of the Atlantic. This is traditionally a time in the cycle when stocks perform very well and especially sectors like cyclicals, technology and financials. This is exactly what happened with the added bonus of a catch-up of the "value" style compared to the "growth" style which has largely outperformed for 10 years. Plus the excellent performance of "small and mid-caps".

Another element of support: the always very accommodating attitude of central bankers. The

	Q2 2021	FY 2021	Close 30/06/21
DOW JONES	4.61%	12.73%	34 502.51
S&P 500	8.17%	14.41%	4 297.50
FTSE 100	4.82%	8.93%	7 037.47
EUROST.50	3.70%	14.40%	4 064.30
CAC 40	7.26%	17.23%	6 507.83
FTSE MIB	1.84%	12.90%	25 102.04
MSCI EM	1.95%	6.46%	1 374.64
CRUDE OIL	21.93%	51.42%	73.47
GOLD	-10.04%	-6.76%	1 770.11
EUR/USD			1.1858
EUR/CHF			1.0968
EUR/GBP			0.8572
EURIBOR 1M			-0.569%

US Federal Reserve has always warned markets it would exit accommodative policies when the economy regains cruising speed after the pandemic shock. It is in this spirit that the FED therefore announced on June 16 a probable rate hike ... but not before 2023 when full employment should be reached by then, with inflation that could have returned to this date around its long-term average. In addition to raising rates, the FED will also have to steer the reduction of its asset purchases ("tapering"). But as Loretta Mester, Chairman of the Cleveland FED said a few days ago, it will take several months to accelerate job creation before considering a reduction in the asset buyback program. For its part, the ECB has to face a slightly different environment with deposit rates in negative territory, inflation which should remain below its target of 2% in 2022 and short-term rates which should not return to a positive level before two/three years. The Frankfurt-based institution should therefore take longer than the FED to "normalize" its policy.

So accommodating monetary policies and, the icing on the cake, massive support plans on the part of the US. Since the inauguration of Joe Biden, the waltz of the US fiscal stimulus puts you on the edge of vertigo. From the 1900 billion dollars of the American Rescue Plan, voted in March, to the preliminary announcements on May 28, of a plan of 4.4 trillion in additional spending over 10 years, the gigantism of the support given to the American economy is crushing somewhat the 750 billion euros of the European recovery plan, the concrete implementation of which is also slow to be put in place.

China is also not left out with ambitious carbon neutrality objectives for 2050 which also require massive investments. These billions in public money flowing into the economy is rather good news for many companies, whether they work in the infrastructure sector or in the energy transition sector.

We therefore maintain a rather constructive view on equity markets until the end of the year, even if the recent rise makes us cautious and attentive in the short term. The S&P500 Index is now trading at 22.75 times forward earnings, well above its historical average, which will make this US market probably more sensitive to unpleasant surprises in the coming months. The European market is showing more reasonable valuations around 18x next year's earnings. It still forms the heart of our equity allocations on the eve of important election deadlines, which we will obviously follow closely. Starting with the German elections on September 26, where the suspense remains uncertain for the succession of Angela Merkel: will the Germans be seduced by the ecological temptation represented by the young and charismatic Annalena Baerbock, who has recently accumulated a few missteps? Or will they opt for the change in continuity with Armin Laschet of the CDU? We will soon be focused on this first element of a Franco-German partnership which is still essential for the future of Europe. We will have to wait until April 2022 to know the other element of the duo with French presidential elections which promise to be very open. Will we be entitled to a remake of the 2017 elections with a Macron-Le Pen duel? Can the Republican Right rally around a single, undisputed leader? Can Xavier Bertrand be this leader? Will more emerge by then? Can the French Left be reborn from its ashes around an Anne Hidalgo or a Yannick Jadot? Everything still seems very open in a country where abstention has reached record heights and where divisions appear numerous. We are keeping our allocation intact to emerging countries and China in particular, which did not perform miracles on the stock market at the start of the year, due in part to the more restrictive attitude of the monetary authorities since the end of 2020, an attitude which could change during the second half of 2021 to support somewhat mixed growth. In the 3 zones - US, Europe, Emerging, a single watchword: diversification and quality of the instruments used.

We will also be watching the situation on the interest rate front. As we mention in our Special Topic, the bond bull market of the past thirty years is probably coming to an end, the levels observed last summer on US and European long rates probably constituting a floor level. Since then, the situation has slowly normalized, but any news in the coming months/years pointing to an overheating of the US economy (not impossible given the importance of the budgetary stimulus) could cause long-term rates to shift more significantly than what we have seen for a year, especially if the FED begins a “tapering” in 2022. We are therefore maintaining a rather cautious and targeted allocation on bonds, with a more marked focus overall on our flexible funds, having the capacity of a short duration in case the need arises.

Christophe Carrafang

The Big Picture

Commodities - A real hedge against inflation ?

Industrial raw materials, agricultural, energy ... From copper at its highest since 2011 to soybean at its highest since eight years, including corn, iron ore and even sugar: the global material index of raw materials has risen by almost 60% since the dip in March 2020. The fact that all raw materials progress at the same time is a phenomenon rare enough to be labelled a "supercycle". A long period of high prices due to demand greater than supply.

The reasons for the increase can be observed from several angles: the massive liquidity poured out by central banks, governments issuing numerous support and stimulus plans, the rebound of the post-health crisis economy in China - the first consumer in the world of raw materials - and the catch-up effect of consumption and investment in the United States. And finally the "ecological transition" which sparks a rush on certain raw materials.

The prices of “commodities” are cyclical and, until recently, the environment was not favorable for this asset class. But commodities are benefiting from a general economic recovery and investors searching for inflation hedges.

The recent rally in oil reflects hope that progress on the health front will lead to a robust recovery in demand. In the US, President Biden's supply stimulus in the form of infrastructure spending and increased attention to renewables will support metals, especially copper.

In general, the reopening of economies has supported commodity prices, which in the current context could offer protection in times of inflation. There is indeed a mismatch between growing demand, as we are gradually emerging from the recession, and supply that is struggling to catch up, which creates bottlenecks in the supply chain.

The debate around a possible commodities supercycle is at the center of discussions because of the phenomenon of "reflation" that can be observed and the "green fiscal stimulus" which is beginning to be implemented at the global level.

The significant increase in the demand for raw materials in green infrastructure programs is precisely what raises the debate about a possible supercycle. This "green" revolution will undoubtedly cause demand for certain metals to explode upwards, but the phenomenon should not be expected be generalized for all "commodities".

GOLD

After two very positive months for metals, the FED’s speech - which hinted at an imminent beginning of “tapering” on bond buybacks and two rate hikes in 2023 - was the catalyst for a sell-off wave, especially on precious metals. Despite concerns about inflation and optimism about jobs, gold is consolidating, alongside rising US long-term rates. From this perspective, a slowdown in massive bond purchases by the US central bank will normally lead to a subsequent rise in US rates, making US Treasuries more attractive, as well as the US dollar. A stronger dollar makes gold, which is denominated by that currency, less attractive to investors based in other currencies. But the debate remains open because if higher inflation persists, gold will remain an effective "hedge". The yellow metal has always performed well in times of inflation.

(Continued on page 4)

Macro-economy

Inflation: The talk of the town

- In the USA, it went from +2.6% at the end of March to +5% at the end of the semester. An expected increase, but not in these proportions.
- Excluding cyclical items, food and energy, the rate increased from +1.6% to +3.8%.
- Producer price indicators point in the same direction; rising commodity prices, production and supply bottlenecks are at the root of this situation.
- In Europe, the rise in prices is less obvious. From +1.3% at the end of March, it rose to +1.9% at the end of June.

Manufacturing activity: Surge of investment in Western countries

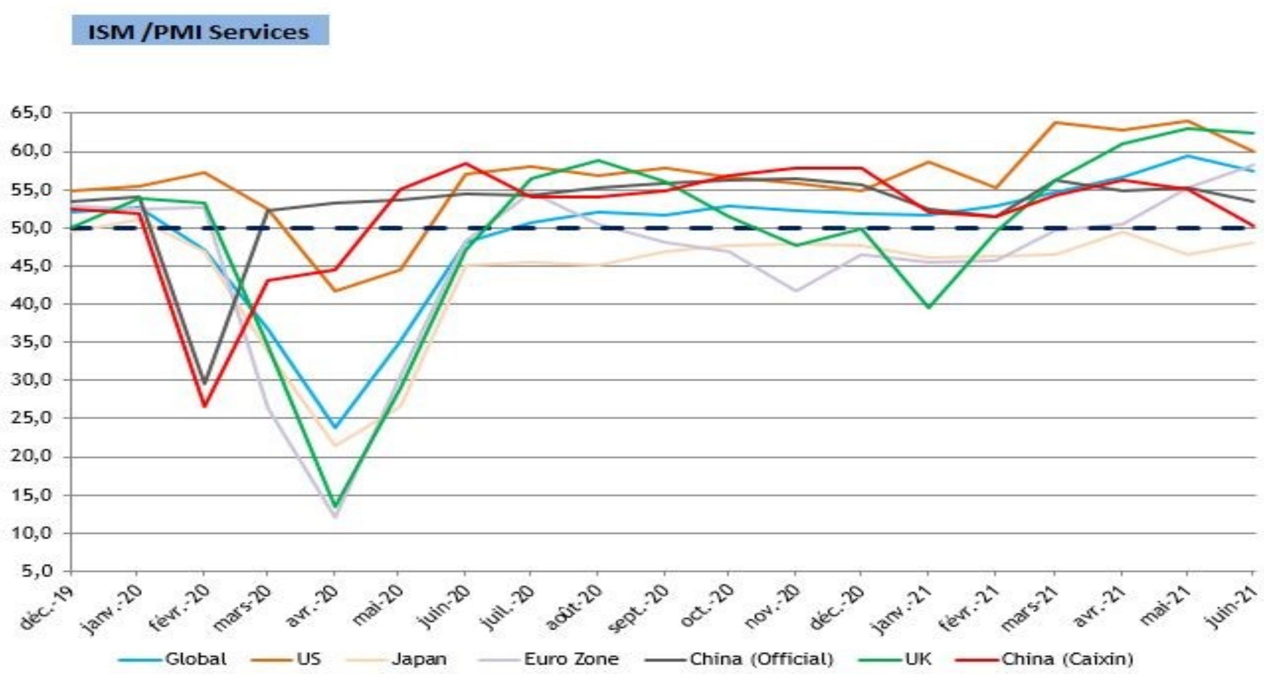
- Manufacturing activity is in full swing, especially in developed countries.
- In Europe, the indicator has stabilized for several months at high levels around 62.
- It is the same in the USA on levels slightly lower than 60.
- The health situations in Russia and India brought the indicators back below 50 in June.
- China is posting more measured growth rates, restrictive policies weighing heavily.

Services: In accordance with restrictions

- Spending of surplus savings have begun with the reopening of places of leisure.
- Employment figures are very strong, which help boost consumer confidence.
- In the USA, 2.5 million jobs were created over the first 6 months (in comparison to 2 million jobs created over the whole of 2019).
- The Eurozone is particularly dynamic with a return to growth since May at 58.3 after a winter below 50.
- The US services indicator for June is below expectations but still high at 60.1.
- Deceleration continues in China, however with indicators that still indicate growth.

Damien Liegeois

ISM/PMI Services Indices since december 2019



Special Topic

Inflation: Is the news really that bad ?

Inflation is on the rise, that's a reality. It will obviously be higher than in 2020 when everything stopped, and probably the next decade will see higher price levels than the previous decade. We don't have to dig too far to remember that two years ago the main concern of our central bankers was not to fall into deflation. And our eminent economists and strategists figured on waiting for an inflation that was not coming. This drop in prices weighed on company margins, prevented any increase in wages and limited job creation. The factors were well known: globalization, the generalization of e-commerce and the structural weakness of the price of raw materials …

With the health crisis, everything has changed. Usually a crisis carries with it disinflation or even deflation. On the contrary, after the first shock, this caused a general rise in prices. Reason being the periods of "stop and go" of activity, the powerful recovery of manufacturing production (which caused bottlenecks), a rush in residential real estate (outside urban areas), of strong investments in the digital realm, and an overall increase in health-related costs. The high point was the challenge to the idea of globalization pointed out as the culprit for the many supply concerns.

Is this price change problematic? Yes and no.

Yes, because it is a probable paradigm shift which in terms of investments will change a lot of things and will inevitably cause interest rates to rise. Rather than a rise, it is appropriate, for the moment, to speak of a normalization of an abnormal situation of negative or very low returns on quality bonds. Likewise, in the future, it should come as no surprise when the bonds of excessively indebted companies or states will come under market pressure, discrimination will be significant. The bond bull market of the past 30 years is set to end and as an investor you need to be prepared.

However, inflation also has positive points in that it is contained between 2% and 3% on average with equivalent growth. Even to the extent that there is talk about an increase in costs that companies could pass on to prices without touching their margins, which would perpetuate employment with wage increases. A virtuous cycle could result. This is a conceivable scenario for the simple reason that we are in a world where production capacities have been greatly reduced in recent years and this increase in prices is linked to vigorous demand and a global change in the energy mix. For the first time in a long time, companies must invest to increase production capacities, for energy transition, digitalization ... With a snowball effect favorable to growth and employment.

Another positive effect of higher price levels is a mathematical one. While it limits the valuation of future flows of certain assets, it limits the expansion of debt ratios or even reduces them for the most virtuous States, through higher nominal growth and the double effect of growth and inflation. The Americans always had a very solid history of lowering their debt in this way. This is the least painful way ... if it works.

Higher inflation in this rather rosy scenario is therefore good news, and currently, it is quite amusing to see the prophets of doom who were screaming at the inability of our central bankers to create inflation, worrying strongly about this new price regime which will push central banks to come out with ultra-accommodating policies, useful in their time but which may have had their day; only time will tell.

Damien Liegeois

(The Big Picture - continuation & conclusion)

OIL

Crude prices have risen sharply over the past two months, supported by very strong economic figures and pragmatism from OPEC members. In the longer term, the alternatives to oil in land transport are there, technically efficient, increasingly competitive, economically and globally available. The last time oil was $100 a barrel, in 2014, there were just 300k electric vehicles sold; last year this figure had risen to 3.1 mm. The growing fleet of electric vehicles will lead to a sharp reduction in the demand for oil. The decreasing demand for one raw material will "boost" the demand for another and this can continue for years to come. If metals enter a supercycle, it will be "cleaner" than before, with the goal of decarbonizing part of the economy while reducing emissions in the process.

COPPER

Global metal producers will benefit from the "electrification" phenomenon and not just in the transport sector. The global demand for copper in the clean energy and transport sectors is expected to double in the next decade (at least 5 mm tons/year). In this context of energy transition and green fiscal stimulus, the momentum should remain favorable for copper in the coming months with prices expected to remain high. However, the abundance of reserves should mitigate this trend: by 2023 the market will be impacted by an increase in supply (+20% vs 2019), a consequence of all the exploitation projects that will be commissioned in the next years. In the Chinese market, which guided the rally last year, we are seeing the first signs of weak demand. China is pursuing a campaign aimed at slowing the rise in commodity prices. Among the measures adopted, the Middle Kingdom intends to put back large stocks of metals including copper, aluminum and zinc on the market, strategically accumulated during favorable price periods. They also intend, to avoid speculation, to control the activity of commodity trading on the onshore and offshore markets through public companies.publiques.

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