Raiffeisen Capital Management
Member of RBI Group

marketview

Introduction

Should we be worried about monetary policy? Not yet!

When the central bankers meet in Jackson Hole to exchange ideas, the financial world holds its breath. And for good reason, because monetary policy is one of the key drivers of economic and market development. Particularly in the years since the financial crisis, **ultra-loose monetary policy** around the globe has blessed investors with a marked surge in prices – particularly on the equity markets. The price trend for the last 10 years on the US equity market, for instance, was in the best decile of the post-war period.
Against this backdrop, investors are understandably keeping a very close watch on when this enormous monetary policy support might come to an end. Memories of late 2018 – when a more restrictive Fed ultimately brought the equity markets to their knees – still linger. The subsequent about-turn in monetary policy not only prevented a more serious situation, but also provided the fuel for a very good year on the stock markets in 2019.

But hold on! We are about as far removed from restrictive monetary policy as we are from herd immunity against the coronavirus. It is generally believed that the Fed will **reduce its bond purchases around the turn of the year.** This means that bonds will continue to be purchased until into 2022. And only then will we see higher key rates – up from the current level near zero. Therefore, a **downturn** on the equity markets caused by monetary policy is not **likely before 2023**. Until then, the gains will likely flatten out and be accompanied by higher volatility. Following this extremely strong summer, setbacks are possible at any time due to temporary disappointments in economic or inflation data, for example. Over the medium term, however, an **overweighting of equities** remains the order of the day, especially because many bond segments continue to suffer due to the unattractive yield landscape.

Your team at **market**view

The price trend for the last 10 years on the US equity market, for instance, was in the best decile of the post-war period.

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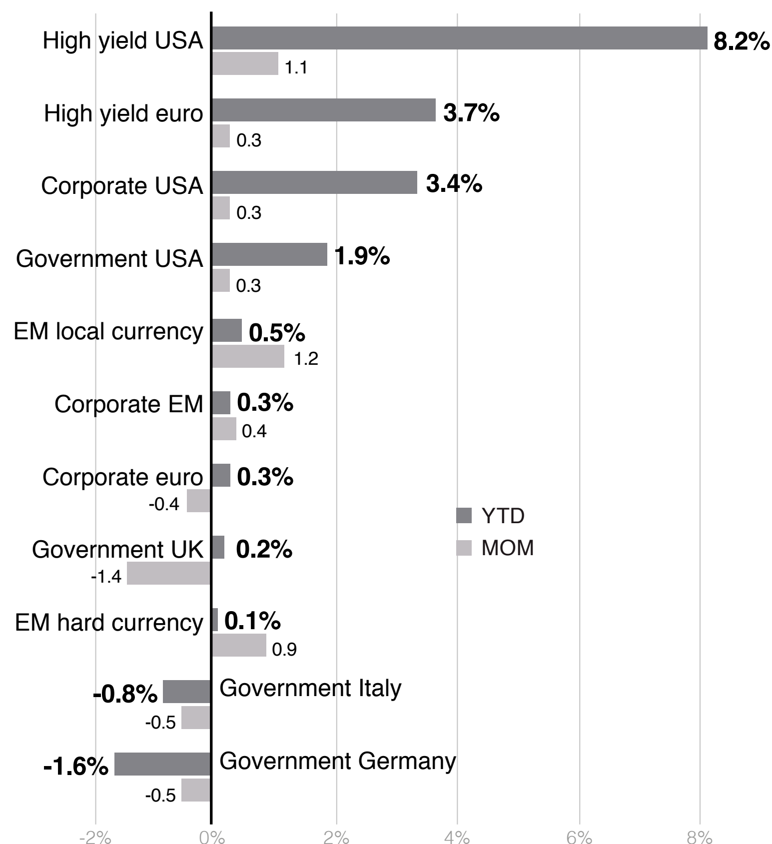
Market conditions

Rally on the bond markets flattening



Returns in EUR

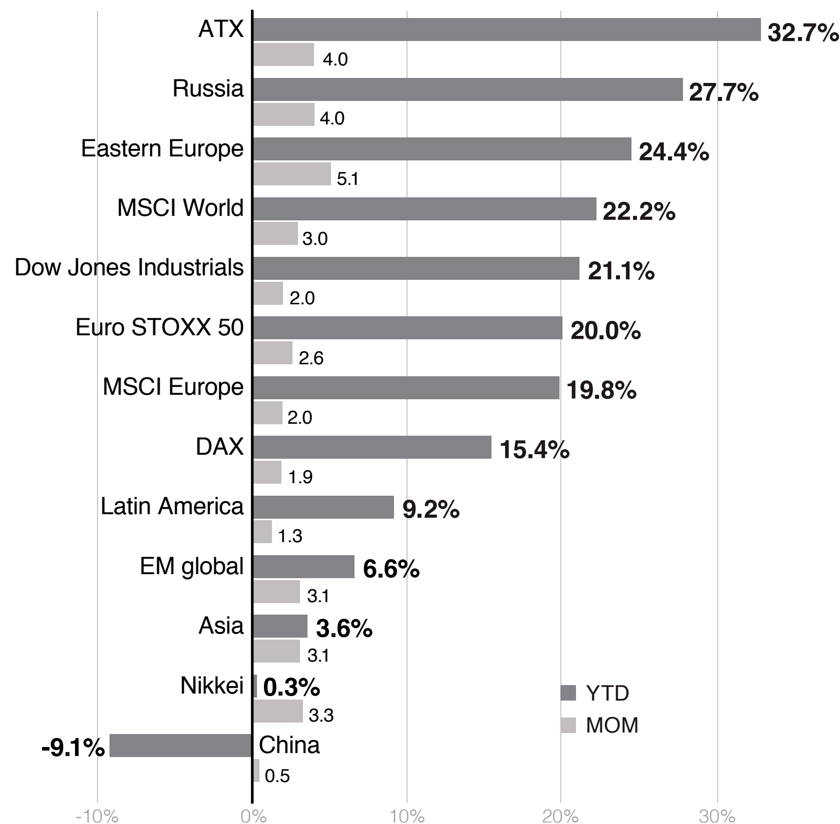
Source: Bloomberg Finance L.P., Raiffeisen KAG, 31 Dec 2020–31 August 2021; as of 31 August 2021

After the significant decline in the previous months, US bond yields settled in at low levels (ten-year maturities at around 1.3%) in August. Conditions on the European bond market were similar. The drastic **yield slide** from July **stopped** here as well, with ten-year German bond yields coming to rest below minus 0.4% in August. The performance of government bonds was correspondingly flat to slightly negative – only the somewhat stronger US dollar yielded a slight profit from USD bonds for euro investors.

August was also (slightly) positive in the high yield market, which continues to enjoy support from the positive overall conditions and climbing equity markets. August's top-performing bonds in the hard currency segment were USD high yield issues, which were boosted by the firmer US dollar. **Emerging Market bonds** (in hard currency) were not far behind with a gain of 0.9% for the month.

Market conditions

Equity markets: Continued boom in August – except for China



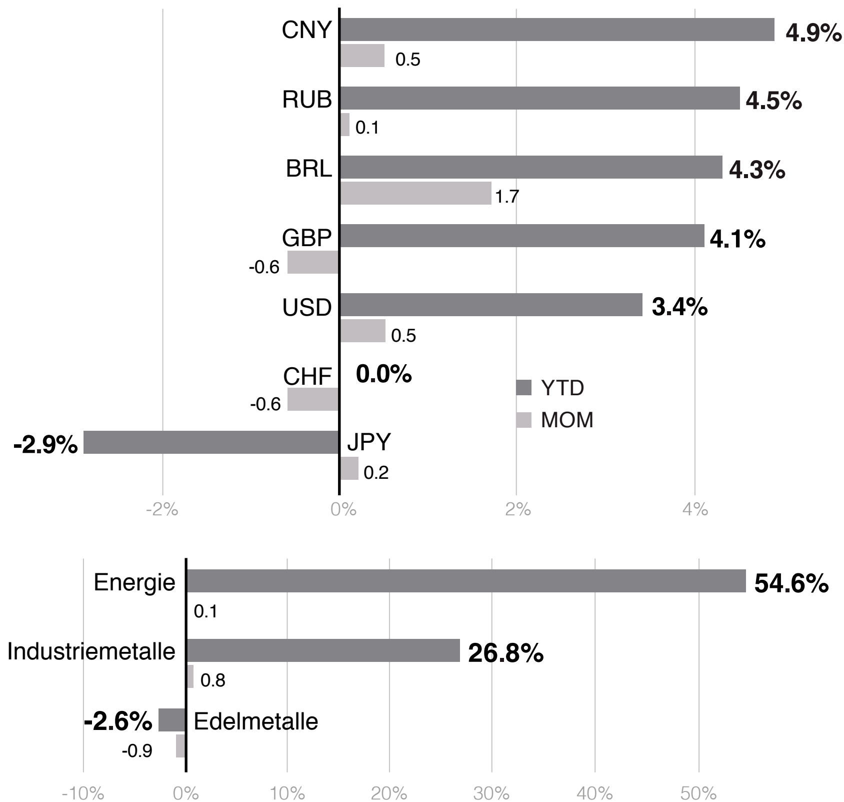
Returns in EUR

Source: Bloomberg Finance L.P., Raiffeisen KAG, 31 Dec 2020–31 August 2021; as of 31 August 2021

August went down as an **extremely positive month** in nearly all equity markets – in most cases with even higher monthly gains than in July. The **global equity market** achieved a **monthly gain of around 3%**, and Eastern Europe (including the ATX) did even better at 4–5%.
The major US indices have been surging from one all-time high to the next for around a year now, but many European indices also reached **new all-time highs in August** (such as the DAX at 16,000 points). This makes for impressive year-to-date performance overall, north of 20% for many indices and in excess of 30% for the ATX, which remains at the top of our list!
The major exception in this success story was again China. The regulatory actions of the Chinese authorities against many (especially Internet) companies again spurred investor fears in August. This put pressure on the prices of these companies (some of which are very highly capitalised exchange heavyweights) and brought **another month of significant underperformance for the Chinese equity market** (with in part substantial price slides for directly affected companies). And that in a month in which Asia and even the Emerging Markets as a whole shined with a monthly plus of around 3%.

Market conditions

Commodities: Consolidation at a high level



Returns in EUR

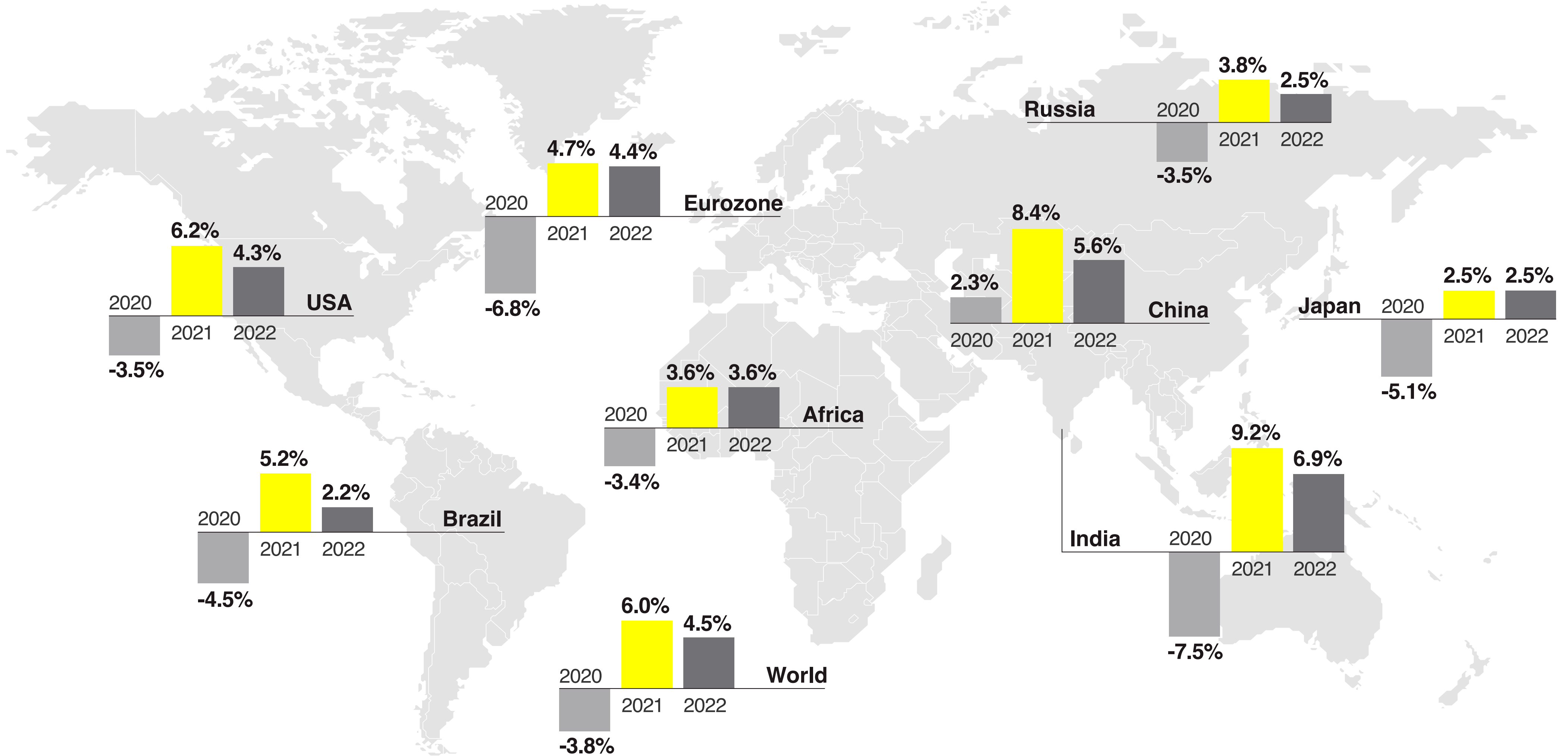
Source: Bloomberg Finance L.P., Raiffeisen KAG, 31 Dec 2020–31 August 2021; as of 31 August 2021

The **weaker euro trend** that began early in June continued in August. This was especially evident against the US dollar in the first half of the month, where EUR/USD even briefly fell below 1.17 in the middle of August before a slight trend reversal set in again until the end of the month. All in all, this was enough to cause the euro to depreciate (slightly) versus most of the currencies discussed here in August. The Swiss franc and British pound were even weaker than the euro during the month; individual EM currencies such as the Brazilian real were particularly strong.

After the global economic recovery and the prospects of overcoming the coronavirus sent most commodity prices on an impressive price rally until the summer, most **commodities** were **unable to continue these price increases** in August. There were no relevant monthly trends overall for precious metals, energy, or industrial materials.

Outlook

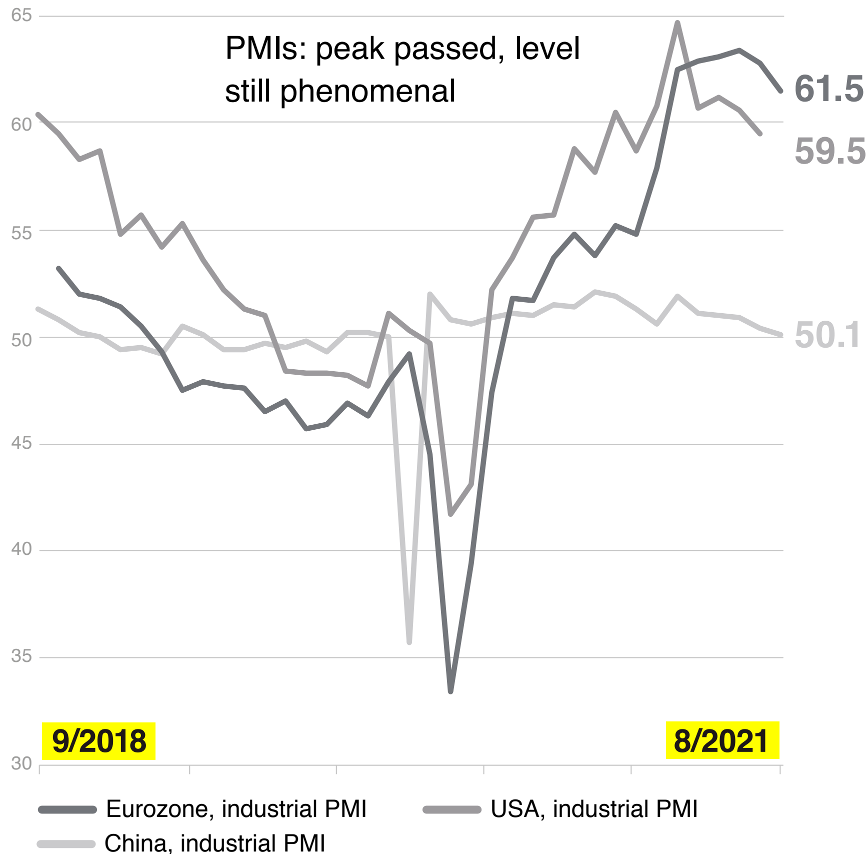
Global economic situation – GDP 2020–2022



Source: Bloomberg Finance L.P., as of: 31 August 2021

Outlook

Global economy: Highest annual growth rates behind us



Source: Bloomberg Finance L.P., Raiffeisen KAG

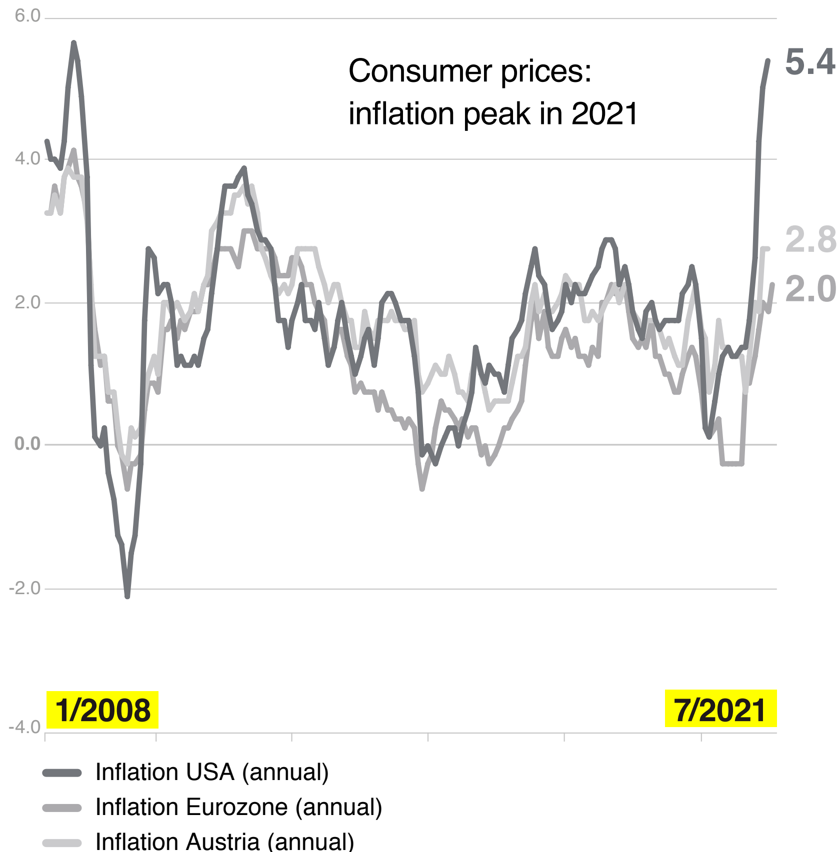
Even as the infection rates are rising again in many places due to the **delta variant,** we and the majority of market participants do not anticipate economically relevant lockdowns in future given the high vaccination coverage, especially among the most vulnerable age groups.

The **services sector** may suffer temporarily in some places due to increased consumer caution and specific restrictions, and some economic data may well bring short-term disappointments in autumn. The consensus expectation of (real) GDP growth of 4% for 2022 still seems realistic in our view.

This represents a **growth slowdown** compared with 2021 – but is still more than twice as high as in years with a "normal" economy. The recent peak and subsequent decline in many leading economic indicators, corporate earnings growth rates, and the like must be viewed in the same context. The most rapid increases in GDP, the highest corporate earnings growth rates, and the highest PMI levels are likely behind us. But this will be followed by very high growth levels that still qualify as an economic boom.

Outlook

Central banks: Waiting out high inflation



Source: Bloomberg Finance L.P., Raiffeisen KAG

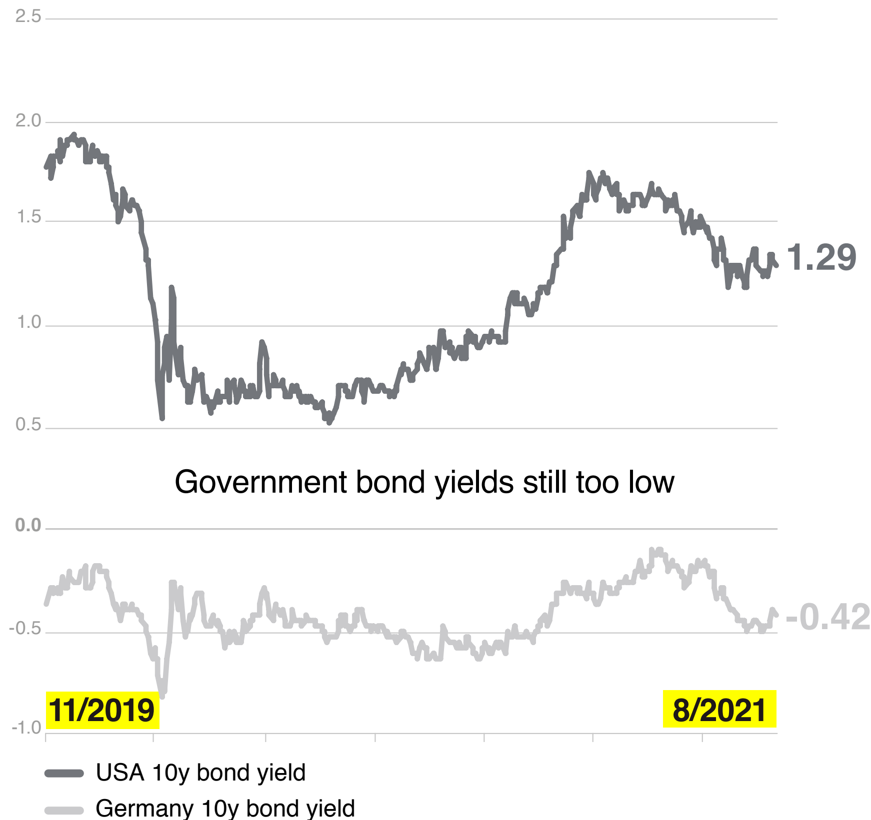
While the inflation rate persisted at 5.4% in the USA over the summer, the **inflation wave** has now also hit the **Eurozone.** Inflation there rose from 2.2% to 3.0% p.a. in August according to the preliminary figures – the highest level since November 2011! Even the core rate doubled from 0.7 to 1.6%. Dramatic at first glance, but a result of base effects, rebounding commodity prices, supply shortages, and coronavirus-related distortions.

Inflation is likely to remain unusually high for the rest of the year, but the **European Central Bank** (ECB) still believes that the majority of these effects will not recur in 2022. Price LEVELS will remain high in 2022, but price INCREASES (the inflation rate) will retreat back **below the target of 2%.**

In line with this, the ECB confirmed that it will continue its accommodative monetary policy course. The US Fed is farther along in the cycle and is expected to **gradually reduce its bond purchases in 2022** given the strong labour market and robust wage growth (announcement expected before the end of this year).

Outlook

Government and corporate bonds: Maintaining our clear position



Source: Bloomberg Finance L.P., Raiffeisen KAG

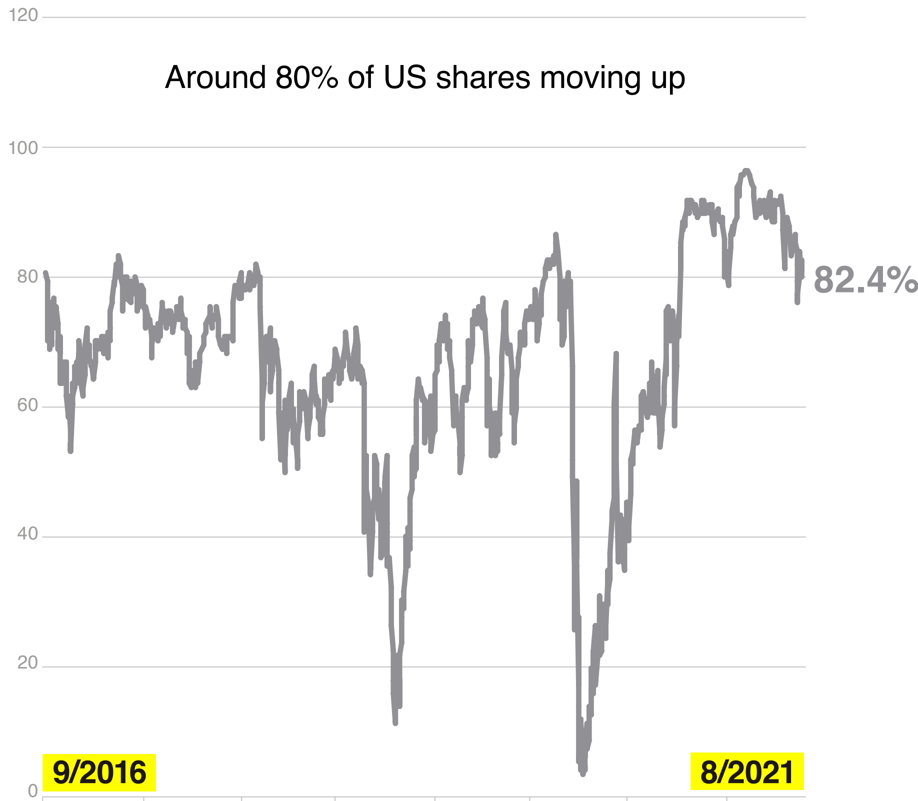
The bond markets are largely sharing the view of the central banks at present and were **not thrown off course by the latest inflation increase**. Even though we share this view of the future course of inflation for the most part, we still think that the current bond yield level is too low. **Established government bonds remain unattractive** in our view: in the Eurozone because the negative yield level itself means disappointing return prospects; in the USA because bond yields will rise again next year with the reduction of bond purchases and a continued strong economy and robust labour market, which will likely put prices under pressure.

At the same time, these are still good conditions for **corporate bonds,** including high yield issues (which have already paid off this year) – we remain optimistic and **significantly overweighted** here.

We are also keeping **EM hard-currency bonds** overweighted in light of the attractive spreads.

Outlook

Equities: Short-term hiccups, but bullish trend

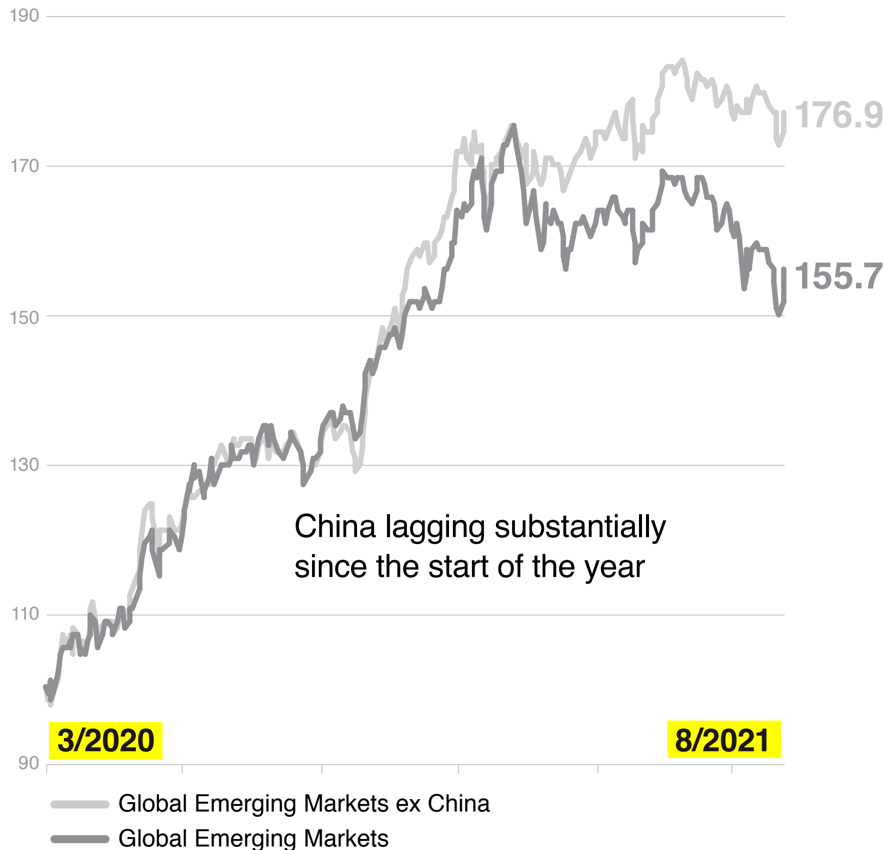


Source: Bloomberg Finance L.P., Raiffeisen KAG

After a nearly linear, steep uptrend on the equity markets since May 2020, investors should prepare for the n**ext market phase** to bring a return to a "normal", **less steep market trend.** This may also include minor **corrections** at times. Potential triggers for this in the coming months: temporarily weaker economic data, high inflation (combined with the prospects of reduced bond purchases by the Fed), and political events. We are slightly reducing our heavy equities overweighting (versus government bonds) in light of this – also to reap some of the profits after the outstanding summer and to have the capacity to use potential corrections to increase positions.
Overall, however, we remain **clearly overweighted on equities** and expect further respectable price increases over the next 12 months. The economic and monetary policy conditions will remain a source of strong support for corporate earnings and the equity markets in 2022. In light of the continuing economic boom and lack of investment alternatives, it would be a mistake to pull out of the equity market now.

Outlook

Emerging Markets: Sell-off in China over?



Source: Bloomberg Finance L.P., Raiffeisen KAG

The development of the EM equity markets was again dominated by the **turbulence on the Chinese exchanges** in August. But regions such as Latin America (and the Emerging Markets as a whole) still achieved a small monthly plus in the wake of the booming established markets despite China. However, China has a high weighting in most EM indices because of its substantial market capitalisation, so the further developments in China will likely remain decisive for the relative development of the broad EM segment.
We used the double-digit price decline on the Chinese equity market in July to set up a new China overweighting within the EM. The downtrend has slowed considerably in the meantime, but China was again listing slightly lower at the end of August. Reason enough to **increase the overweighting in China** again (including the region, i.e. Hong Kong and Taiwan), as we still feel that the sell-off in China is overblown.

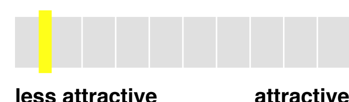
Strategic Asset Allocation

The Strategic Asset Allocation refers to the assessment of the various asset classes over a long-term horizon.

Equities

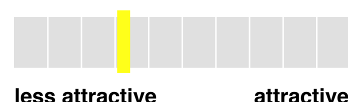
We recently lowered the equities allocation (from around 26% to around 24%) and are thus positioned more cautiously in shares. Our only holdings in the USA since December have been a position in value equities. Aside from this, we prefer attractively valued "more cyclical markets" like in Europe, Japan, and the Emerging Markets.

Government bonds



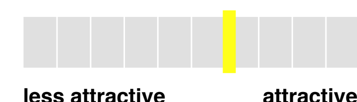
Yields on the European government bond markets are at extremely low levels. Over a five-year horizon, we expect low returns on these markets (or even negative returns in some cases).
We still hold positions in non-euro government bonds and have used the recent yield decline to reduce these holdings slightly (AUD interest rate risk).

Corporate and EM bonds



Spreads on corporate bonds narrowed further. Risk premiums for euro non-financial IG bonds and EM USD bonds are now close to the most expensive quartile since 1998. We are using this situation to take profits in these markets. Nevertheless, we are still holding investment grade and EM-currency corporate bonds and EM hard-currency bonds.

Real assets



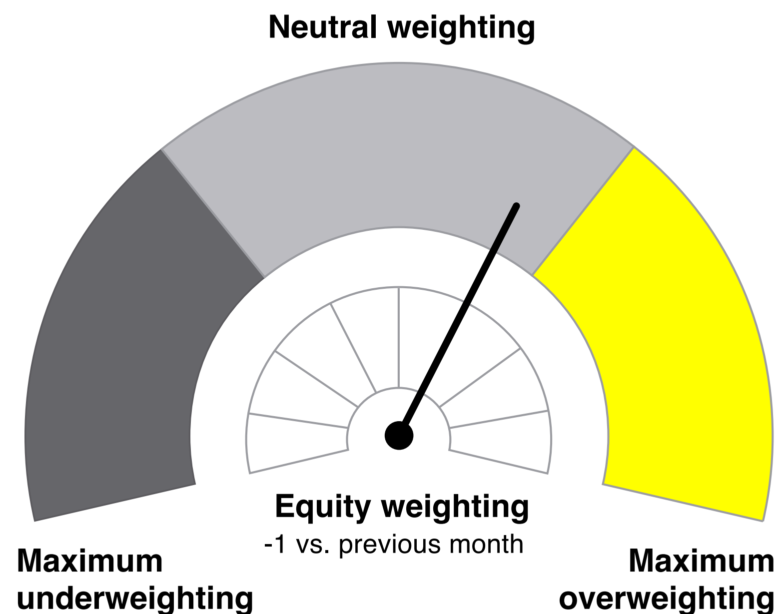
We used the strong performance of inflation-sensitive assets (duration-hedged inflation protection bonds, cyclical commodities, inflation-sensitive shares and currencies) in the first half of the year to reduce this position. Nevertheless, we believe this segment to be attractive over the longer term and still hold substantial and key positions here.

*all statements refer to the SAA of the funds Raiffeisen 337 – Strategic Allocation Master and Raiffeisen-GlobalAllocation-StrategiesPlus.

Source: Raiffeisen KAG; this forecast/estimate is no reliable inference to the future performance.

Tactical Asset Allocation September

The Tactical Asset Allocation steers market-oriented mixed funds such as the Raiffeisen strategy funds over the short to medium term. The positioning of the fund management can differ from that of other capital market analysts (e.g. Raiffeisen RESEARCH GmbH).



This forecast/assessment is not a reliable indication of future performance.

- **Economy:** Global production is booming – the strongest year-on-year gains are behind us, temporary sentiment dampener from the delta variant and supply shortages, but economic outlook for 2022 still very bullish
- **Corporate sector:** Corporate earnings also posted the strongest year-on-year growth for this cycle in Q2; these growth rates will begin normalising now, but low double-digit growth still expected for 2022
- **Sentiment:** Institutional investors currently more bullish than small investors
- **Technical analysis:** Uptrend unbroken for most equity indices (including the MSCI World); market volatility holding at low level, market breadth decreasing
- **Special topics:** Strong (and persisting) inflation increase, generally viewed as transient at present (by central banks and markets); further vaccination coverage growth, delta variant (only) a residual risk; ECB affirmed loose monetary policy; Fed nearing first bond purchase tapering (starting at the beginning of 2022?)
- **Positioning:** Overweighting of equities over government bonds being maintained but reduced in scope; commodities remain overweighted versus the money market

Indicators

Overview of market development

Equity indices	31.8.2021	Diff. YTD	Diff. YTD	5 years p.a.
		in local currency	in euro	in euro
MSCI World	3,141	19.2%	22.2%	13.5%
Dow Jones	35,361	17.0%	21.1%	15.3%
Nasdaq 100	15,583	21.5%	25.7%	26.5%
Euro Stoxx 50	4,196	20.0%	20.0%	9.3%
DAX	15,835	15.4%	15.4%	8.4%
ATX	3,620	32.7%	32.7%	12.4%
Nikkei	28,090	3.2%	0.3%	10.2%
Hang Seng	25,879	-2.9%	0.1%	4.7%
MSCI EM	1,309	3.6%	6.6%	9.1%
Exchange rates				
EUR/USD	1.18		3.4%	-1.1%
EUR/JPY	129.92		-2.9%	-2.3%
EUR/GBP	0.86		4.1%	-0.2%
EUR/CHF	1.08		0.0%	0.3%
EUR/RUB	86.72		4.5%	-3.4%
EUR/CNY	7.63		4.9%	-0.5%
Commodities				
Gold	1,814	-4.5%	-1.2%	9.1%
Silver	24	-9.5%	-6.4%	7.4%
Copper	9,528	23.0%	27.2%	18.2%
Crude oil	71	39.2%	44.0%	11.5%

Bond yields	31.8.2021	Diff. YTD
	10Y. in %	in BP
USA	1.31	40
Japan	0.03	0
UK	0.71	52
Germany	-0.38	19
Austria	-0.15	27
Switzerland	-0.32	23
Italy	0.71	17
France	-0.03	31
Spain	0.34	29
Money market rates	**3M. in %**	
USA	0.12	-12
Euro zone	-0.55	0
UK	0.07	4
Switzerland	-0.77	-1
Japan	-0.10	-2
Key rates of central banks	**in %**	
USA - Fed	0.25	0
Eurozone - EZB	0.00	0
UK - BOE	0.10	0
Switzerland - SNB	-0.75	0
Japan - BOJ	-0.10	0

Source: Bloomberg Finance L.P., 31 August 2021, YTD = change compared to previous year-end; past performance is not a reliable indicator for future development.

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Mooslackengasse 12, 1190 Vienna

Contact

Photo: David Sailer

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Raiffeisen Kapitalanlage GmbH
Raiffeisen Immobilien Kapitalanlage GmbH
Raiffeisen Salzburg Invest GmbH

Mooslackengasse 12
1190 Vienna, Austria

t | +43 1 711 70-0
f | +43 1 711 70-761092
e | info@rcm.at
w | www.rcm.at
www.rcm-international.com