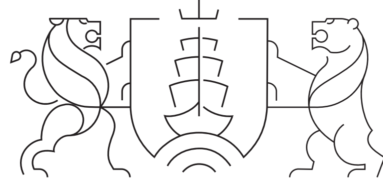


BERGOS

REFLEXIONS

Q2 21

A Capital Market Publication by the Private Bank Bergos

Reflexions - No 10 April 2021

BERGOS

Bergos AG is an internationally operating, independent Swiss Private Bank with headquarters in Zurich and a branch in Geneva. We have been active in the Swiss financial centre for over 30 years and can trace our history to the founding of Joh. Berenberg, Gossler & Co. KG in 1590. Our international team is dedicated to all aspects of wealth management and advisory, with a special focus on private individuals, family entrepreneurs, next generation and shipping clients. With a business model focused on pure private banking, we advise our clients on all liquid and non-liquid asset classes and alternative investments.

PUBLISHED BY
BERGOS AG
ZURICH, APRIL 2021
ALL RIGHTS RESERVED

CONTENT

04 **EXECUTIVE SUMMARY**
MAXIMILIAN HEFELE

08 **COMPASS**
TILL C. BUDELMANN

10 **MACRO**
DR. HOLGER SCHMIEDING

16 **EQUITIES**
TILL C. BUDELMANN

24 **BONDS**
RENÉ BOLHAR

32 **COMMODITIES**
SOUMAILA TÉKÉTÉ

40 **CURRENCIES**
DR. JÖRN QUITZAU

50 **TOPIC: INFLATION**
MAXIMILIAN HEFELE

BERGOS

EXECUTIVE SUMMARY

Dear Investors,

Almost exactly one year ago, we were forced to examine in detail the initial impact of the Covid crisis: First, of course, on a human level, but in the context of our capital market publication Reflexions, also economically. Investors suffered capital losses that took on historic proportions in these dynamics. But even more impressive was the subsequent recovery experienced by investors who were faithful to their strategy. The globally recognized benchmark index, the S&P 500 Index is currently at historic highs. From last year's lows to the editorial deadline on 13 April 2021, the index increased by 83% in value, including dividends. This development was hardly imaginable for most investors and for me personally in the crisis environment at that time.

The development clearly shows how superfluous forecasts of points are in capital markets. In this context, I take the liberty of quoting from the April 2020 Reflexions:

„(...) For this, it is not necessary to predict the exact turning point in a crisis. However, it is crucial to have the imagination of how the world can develop from one crisis to the next upswing."

The core statement at that time shows the basic attitude of our countercyclical investment philosophy. It played a key role in enabling our clients to benefit fully from the recovery as part of our capital market assessment.

But what is the next step after such a brilliant "rally"? The current situation is diametrically different from last year. Economically, we are already in the midst of a new dynamic upswing, and share prices at current valuations paint an optimistic picture of future growth. Central banks and governments on both sides of the Atlantic are fuelling further development with exuberant liquidity. The question of the further development of inflation and yields on the bond markets is therefore the subject of lively debate. We also take up these aspects in our current issue of Reflexions and put them into perspective at the same time.

Our new Bergos Compass on the following pages is a good place to start. Our Chief Investment Officer, Till Christian Budelmann, provides an overview of our main scenario and our assessment of future economic developments. This is the basis for our detailed analysis of all relevant asset classes.

Our TOPIC section highlights the much discussed issue of inflation. I hope you enjoy the reflection!

Stay healthy and confident!

Maximilian Hefele
HEAD OF ASSET MANAGEMENT

EDITOR

MAXIMILIAN HEFELE CFA
HEAD OF ASSET MANAGEMENT

Maximilian Hefele is Head of Asset Management at Bergos since 2003. He is responsible for all discretionary investments solutions offered by the bank. He is Managing Director and member of the bank's Investment Committee.

COMPASS

BASE CASE SCENARIO FOR 2021

BY TILL C. BUDELMANN, CHIEF INVESTMENT OFFICER

We expect the global economy to continue its recovery and corporate earnings to rebound significantly.

Key central banks are expected to remain on hold for the time being (especially the Fed with a stable Fed funds rate of 0-25 bp).

A majority of the western population will be vaccinated by the end of 2021 and lockdown measures will fade. We still expect further fiscal stimulus in the meantime.

A Biden presidency provides for a more conventional foreign and trade policy. Thanks to the narrow distribution of seats in Congress, dramatic shifts in tax policies will be prevented.

GDP ESTIMATES FOR 2020/2021

EUROZONE
2020: -7.0%
2021: +4.0%

GERMANY
2020: - 5.5%
2021: + 3.5%

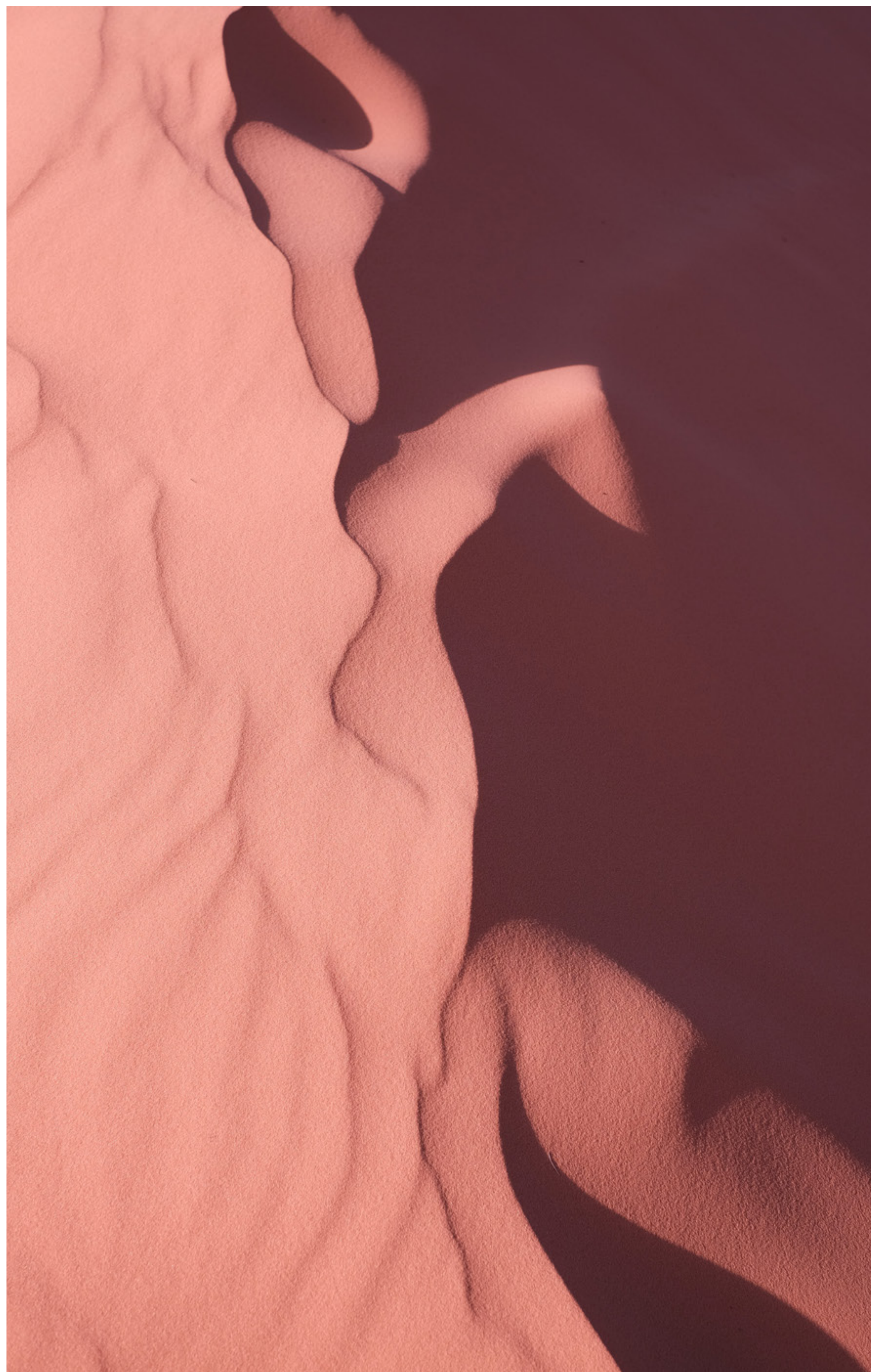
SWITZERLAND
2020: - 3.0%
2021: + 2.5%

GREAT BRITAIN
2020: -10.0%
2021: + 6.0%

UNITED STATES
2020: - 3.5%
2021: + 6.0%

CHINA
2020: + 2.0%
2021: + 10.0%

JAPAN
2020: -5.5%
2021: + 3.5%



MACRO
STRONG ECONOMY

STRONG REBOUND FROM THE PANDEMIC

BY DR. HOLGER SCHMIEDING

The world economy has entered the early phase of a strong rebound from the deep recession caused by the SARS-CoV-2 virus. Although the pandemic continues to rage badly in many parts of the world with the notable exceptions of most of East Asia, the US as well as the UK, Spain and a few other countries seem to have brought the situation under control.

The recession of 2020 differed from usual economic downturns in one crucial respect. Normal recessions are caused by a drop-in demand, for example in response to a tighter monetary policy or as a correction to investment, housing or consumption excesses during a preceding boom. However, the recession of 2020 reflected temporary changes in behaviour and restrictions on mobility and economic activity to contain the spread of the virus. As governments supported incomes while households had less opportunity to spend the money, households across the advanced world built up excess savings last year. Relative to normal times households, saved almost twice as much as usual in the US in 2020 and roughly 50% more than in a normal year in the Eurozone. As a result, households now have ample means to step up spending rapidly once the restaurants, theatres, shops and holiday destinations have reopened.

All components of demand are likely to contribute to a solid rebound in economic activity. Private consumption should be boosted by pent-up demand fuelled by excess savings. Although governments will be able to scale back their direct support for workers, consumers and companies as the economies start to heal, they look set to raise their spending on public investment significantly in coming years. Because sales of goods have recovered faster than the production of goods, shops and factories need to replenish inventories. Despite occasional frictions that are much less prevalent than they were under the Trump administration in the US, leading indicators for international trade point to solid gains to come.

A record monetary and fiscal stimulus supports demand on both sides of the Atlantic. In addition, China continues to inject as much stimulus as it deems adequate. As a result, the global environment remains unusually favourable for now.

However, the near-term outlook differs between regions. While the US economy is already roaring ahead and the UK looks set to follow suit from early April onwards, albeit from a much lower base, the near-term risks for the Eurozone are still tilted to the downside. Many countries in the Eurozone are extending and tightening restrictions to contain the spread of the B.1.1.7 variant of the SARS-CoV-2 virus first detected in southern England.

The slow vaccination progress in Eurozone countries makes it difficult to predict the precise timing of when economies will begin to reopen. We should put these near-term travails into perspective, however:

1) The number of daily recorded SARS-CoV-2 infections per capita in the Eurozone has so far increased to some 40% of the US and UK peaks of early 2021.

2) With a rise in vaccine supply, many EU countries can probably give the jab to almost as many people in the five weeks after Easter as they did in the first three months of 2021 taken together.

3) Survey and mobility data suggest that Eurozone economic activity started to pick up strongly in March. This points to a solid underlying momentum that will come to the fore again once the April restrictions can be eased in coming months.

4) The outlook for Eurozone manufacturing could barely be more auspicious, at least in terms of demand.

Manufacturing matters. It generates 16.4% of Eurozone gross value added. Record increases in the readings for output, new orders and exports pushed the Eurozone PMI index for manufacturing from 57.9 in February to a new high of 62.5 in March. Whereas the fiscal stimulus in the Eurozone is more measured than in the US, the export-orientated Eurozone stands to benefit more than many other regions from the strength in global trade powered by the rebound in global consumer demand, business investment and a need to replenish inventories. As usual, the US and Chinese stimuli are spilling over into the Eurozone, directly by fuelling US and Chinese imports and indirectly by lifting global sentiment and hence global demand for the high-end investment goods which the Eurozone sends to the world.

Strong demand is not yet showing up in the hard data for Eurozone production, though. Whereas orders in German manufacturing edged up in February, output in the sector fell by 1.75% mom as a lack of semiconductors caused a 7% mom plunge in the production of cars and car parts. In France, the 8.3% mom drop in car output also contributed heavily to the 4.6% mom decline in manufacturing output after a solid 3.3% gain in January. As these supply constraints ease over time, output will likely advance strongly in coming months.

In continental Europe, lockdowns weighing on parts of the service sector and supply chains in manufacturing that cannot yet fully cope with the surge in demand are not the only temporary factors holding back activity. For example, a spell of unusually frosty weather contributed to a 7.4% fall in German construction output in January and February relative to the Q4 average. The advent of warmer weather should help. With luck, it will underpin not only a rebound in construction in the March and April data but also an easing of pandemic risks from May onwards. If so, gains in manufacturing, construction and services could add up to solid economic growth soon after a weak start to the year.

We expect economic activity to get back to its pre-pandemic level in Q2 2021 in the US due to the huge US fiscal stimulus, in Q1 2022 the Eurozone, which is held back by structurally weak Italy, and in Q2 2022 in the UK which continues to suffer from the Brexit damage to its trend rate of growth.

Strong gains in GDP in the USA, China, Japan and the UK coupled with the prospect for a significant rebound in the Eurozone in the near future bode well for export-dependent emerging markets, especially for those with little dollar-denominated debt which is becoming more expensive to service. Whether or not these emerging markets will grasp the opportunity will depend on their policy choices and the way in which they tackle the pandemic that is afflicting some countries such as Brazil rather badly.

We base our economic outlook on the following assumptions:

1) In continental Europe, restrictions, warmer weather and vaccination progress will allow for some easing of restrictions from the end of April onwards. Otherwise, a delayed rebound would shift growth from Q2 into Q3, lowering the average rate for 2021 below our 3.9% call while raising 2022 above our current 4.9% forecast.

2) Vaccinations will have progressed enough by mid-year to allow Southern Europe to have at least half a normal summer season. If tourists cannot return to the beaches in significant numbers, 2021 growth in Spain, Portugal and Greece could fall some 2 percentage points short of our expectations with a more limited but still significant hit to Italy and - to an even lesser extent - to France as well.

3) Virus mutations will not render the vaccines ineffective, which may be adapted anyway over time to tackle such problems. Otherwise, the entire world would have to go through a rough autumn until new vaccines have become widely available.

MACRO
OUR EXPERT

DR. HOLGER SCHMIEDING
CHIEF ECONOMIST, BERENBERG

Since 2010 Chief Economist of Berenberg Hamburg and one of the best-known German bank economists. He has received several awards for his forecasts and analyses. In 2016, for example, he was named forecaster of the year by the Süddeutsche Zeitung and in 2015 he was voted best banking economist for Europe for the third time in a row by more than 16,000 international financial experts in the renowned Extel Surveys. He has worked at the Kiel Institute for the World Economy and the International Monetary Fund, among others, and served as Chief Economist Europe for Bank of America Merrill Lynch.

MANUFACTURING MATTERS

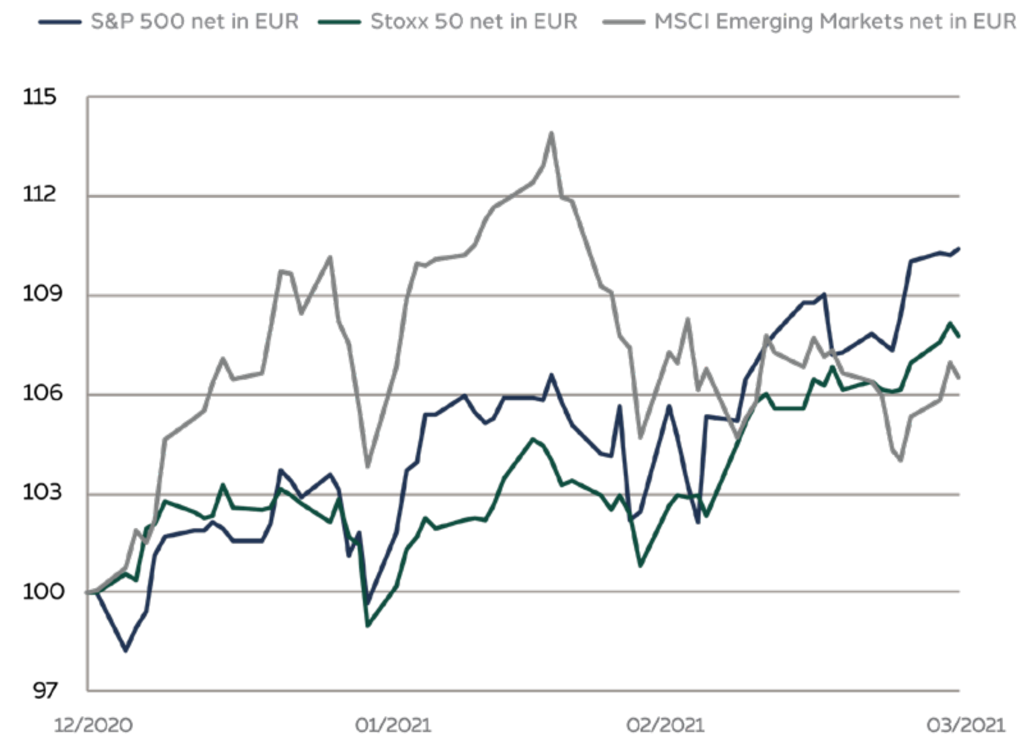
EQUITIES

GLOBAL RECOVERY SUPPORTS EQUITY MARKETS

BY TILL CHRISTIAN BUDELMANN

The strong recovery continues, both on a macroeconomic level and the global equity markets. Not only US equities continued to rise in the first quarter, posting new highs, but emerging market equites, led by Asia, also showed at least some temporary relative strength in the first quarter. Support was provided by encouraging macroeconomic numbers, positive Covid 19 vaccine progress, particularly in the US, and continued accommodative monetary and fiscal policies. The increased optimism has also been reflected underneath the surface of equity markets. There is renewed demand for value stocks, while things have been tougher for long-celebrated growth stocks recently. However, investors seem to be only interested in cyclical value stocks from the financial and energy sectors, while defensive value segments such as consumer staples and utilities have been lagging recently.

Performance of International Equity Markets in 2021
Indexed to 100; Source: Bloomberg; Illustration: Bergos Data as of 03/31/2021



SIGNIFICANTLY BETTER THAN EXPECTED Q4 EARNINGS SEASON PROVIDES SUPPORT

At the corporate level, the strong earnings season for the fourth quarter in particular had a supportive effect recently. Contrary to what analysts had assumed at the beginning of the year, the earnings trend in the fourth quarter of 2020 was slightly positive on average for the companies in the S&P 500 compared with the same period of the previous year. In fact, nearly 80% of US companies were able to exceed earnings expectations – the long-term average stands at 65%. This is impressive considering that companies were able to increase their profits compared to the same period last year (a quarter not impacted by Covid measures) despite the drastic policy measures. After a significant decline in corporate earnings in 2020, we now expect strong year-over-year growth for the following quarters.

HIGHER BOND YIELDS CANNOT SLOW EQUITY MARKETS

In the wake of the broad economic recovery, bond yields have also risen sharply in recent weeks, albeit from a very low level. While the rise in bond yields is in line with the strong economic recovery of recent months, it is nevertheless causing some nervousness among market participants, as bonds are seen as a direct alternative to equities. Essentially, we see the return of bond yields from an extremely low level (0.7 percent in the fall of 2020) to a still low level (of currently 1.7 percent) not necessarily as an obstacle to the further development of equities, but rather as a consequence of the economic recovery starting to take effect. Yields at the current somewhat higher level fit much better with the strong economic upswing in the US. After all, US Treasuries were yielding 1.9 percent before the start of the Corona crisis and slightly more than 3 percent in the fall of 2018.

CENTRAL BANKS HAVE HIGHER TOLERANCE FOR INFLATION

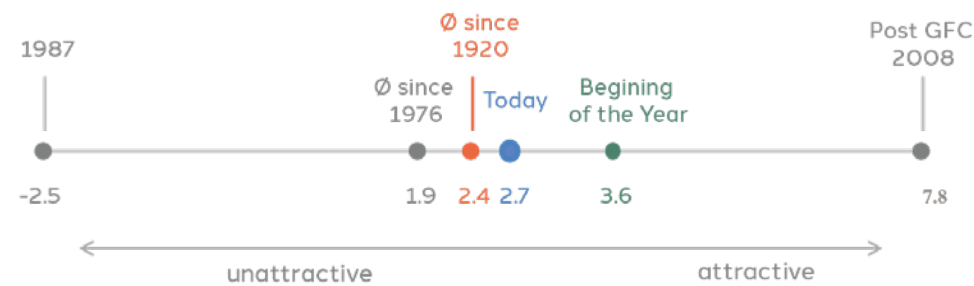
Nevertheless, equity markets currently appear to be torn between reflation hopes and inflation fears. With rising bond yields, highly valued technology stocks fall, and vice versa. At the same time, however, the rotation towards cyclical value stocks mentioned at the beginning is providing some market breadth. One reason for the rise in long-term interest rates is inflation expectations. Despite the recent rapid recovery, we believe it will take longer for inflation to accelerate to the point where central banks need to intervene – partly because inflation has been repeatedly overestimated by central banks and analysts over the past decade. Central banks will therefore want to be certain that the economic recovery is on track and inflation is approaching targets before reducing stimulus. If central banks succeed in calming the market with moderate rate hikes, this would be positive for equities. At least, the US Federal Reserve has already signalled that it will not raise interest rates for the time being and is willing to accept higher inflation.

EQUITIES CAN WITHSTAND THE RISE IN BOND YIELDS SO FAR

Due to increased bond yields, the relative attractiveness of equities has declined significantly compared to 2020, but it is still slightly higher than the historical average. Currently, the price-earnings (PE) ratio of the S&P 500, which relates to the expected profits for the next twelve months, is approximately 22-fold. This corresponds to a yield of 4.5 percent on equities, meaning that there is a gap of almost 3 percent to ten-year bonds. Although this yield gap is considerably smaller than in 2020, it is still somewhat higher than the historical average of 2 to 2.5 percent. Assuming constant yields, interest rates in the US could climb to between 2 to 2.5 percent in the long-term. At that level, equities would then be fundamentally fairly valued compared to bonds.

S&P 500 Earnings Yield Minus 10 Year Bond Yield from a Historical Perspective
Source: Bloomberg, Refinitiv, Bergos, Data as of 03/31/2021

S&P 500 (closing price 03/31/2021)	3'972.89 Points
Forward EPS (Q2 2021 - Q1 2022)	175.54 USD
Earnings Yield	4,42%
10 Year Bond Yield	1,74%



NEW CYCLE WITH A SHORTER LIFE SPAN

We expect the new cycle to be noticeably shorter than the previous three cycles on average, which in the US lasted for ten, six and ten years, respectively. Since the Second World War, the average interval between two recessions has been five years. One reason for this is that the sharp recession last year was followed by a rapid recovery. The US economy is likely to return to pre-Covid levels in just a few months. In addition, we believe it is quite realistic that the labour market will improve much more quickly than was thought possible up to now. With regard to equities as an asset class, this raises the question of when to expect the shift from „early cycle" to „mid-cycle" in terms of investment policy.

WE CONTINUE TO FAVOUR US AND ASIAN EQUITIES

Risks for equity markets remain, despite progress on the vaccination front, further possible political measures to contain Covid and, increasingly, sentiment among market participants. A survey by the American Association of Individual Investors (AAII), which is a widely followed measure of sentiment among market participants, recently showed much more positive readings compared to the historical average. If investor sentiment continues to rise in the direction of euphoria, this may well be a contrarian indicator and a sign of possible setbacks. After all, the rotation towards cyclical value stocks mentioned at the beginning ensures a certain market breadth. While 2020 was dominated by highly capitalized companies, we have recently seen relative strength in mid- and smaller-capitalized companies. As the positives currently slightly outweigh the negatives, we remain overweight on equities overall.

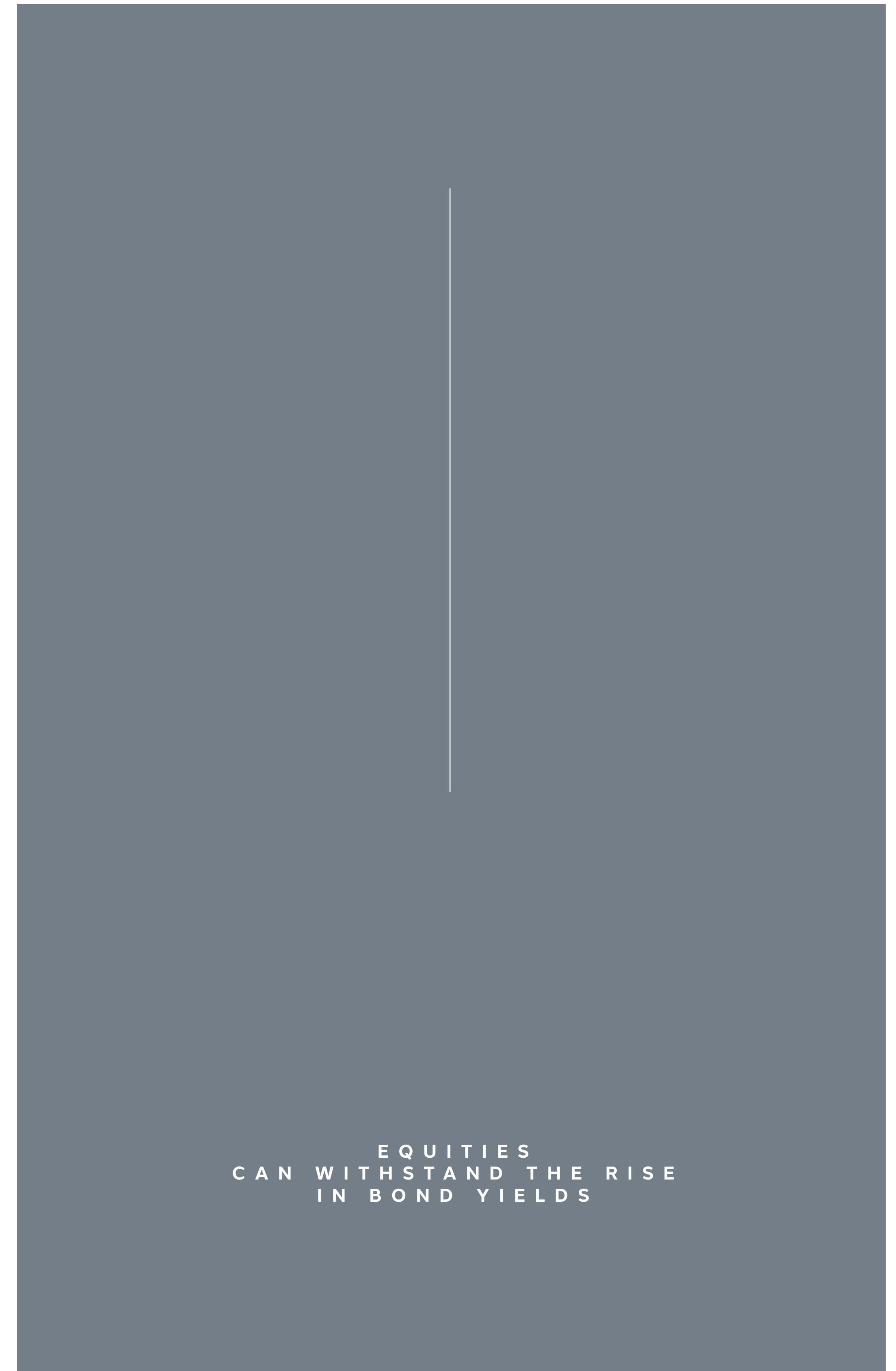
Regionally, the extensive government relief measures put the United States at an advantage over Europe. In addition, the weaker lockdown measures and a higher vaccination rate also benefit the US economy. Next to the US, emerging market equities, especially those in Asia (China, South Korea and Taiwan), should also continue to show relative strength – even if a stronger US dollar has caused some headwinds recently. However, as we expect a trend reversal for the „greenback", we remain overweight here as well. On a sectoral basis, the Bergos matrix remains relatively balanced. On the one hand, we remain exposed to structural winning sectors, but due to the undeniable reflationary tendencies, we are not underweight in value stocks at this time.

B E R G O S

E Q U I T I E S
O U R   E X P E R T

T I L L   C H R I S T I A N   B U D E L M A N N
C H I E F   I N V E S T M E N T   O F F I C E R

As Bergos´s CIO, Till Christian Budelmann regularly comments on events on the international capital markets and examines them in the context of economic and political trends. Since 2004, Budelmann has been responsible for various investment strategies and sits on the bank’s Investment Committee. He has been Managing Director since 2013.



BONDS

THE CENTRAL BANK'S PREDICAMENT

BY RENÉ BOLHAR

For bond investors, as with every other year, 2021 started with discussions largely centering around one defining question: will the long-term bull run of fixed income markets and rates specifically finally come to an end now reversing the almost 40 yearlong trend towards lower yield levels? As in 2013, the year of the famous "taper tantrum", 2016 and 2018, there are arguments both from advocates and opponents. But there is, however, reason to believe it might indeed be different this time. Let us take a closer look on where we stand.

After the great reset that has been brought to markets last year - mainly due to developments from a geopolitical side (US election, Brexit) and of course the significant effect Covid19 had on major parts of the investment universe - the economic cycle can no longer be described as in it's late or even final stage. Indeed, we find ourselves at the beginning of a new cycle, although the length of the new economic upturn can be expected to be shorter than in the past.

The positive factors are obvious: spurred by significant central bank support and fiscal stimulus packages, corporates have an easy time refinancing. This can be seen in the stable demand for corporate debt globally and the push towards tighter credit risk spreads. Especially those companies on the lower end

of the investment grade (IG) spectrum and high yield (HY) names will disproportionately benefit.

On the other hand, this rather risk-seeking dynamic makes the need for "safe haven" assets like US or German sovereign debt to appear less necessary with a likely continuation of decreasing demand and hence rising rates levels.

But this puts especially the big central banks worldwide, first and foremost the European Central Bank and the US Fed, between a rock and a hard place. Market participants and investors are getting increasingly sensitive to any comments indicating central banks leaning toward one or the other direction. Withdrawing supportive measures too early might be detrimental and eventually choke off the upswing. Slacking the reins for too long, however, might fuel an overheating of economies and finally lead to elevated levels of price surges not seen in decades.

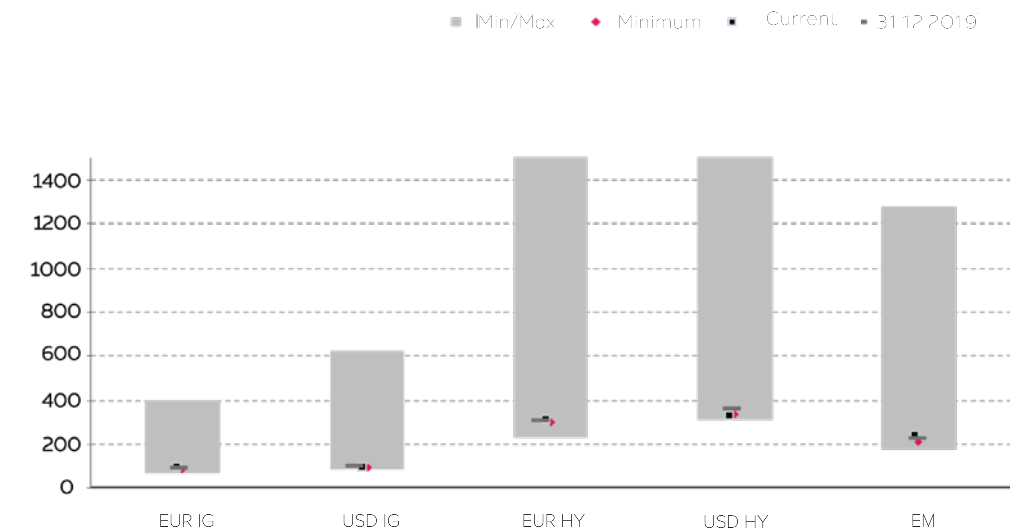
SO, WHERE DO WE STAND CURRENTLY?

Especially at the beginning of the new year, a significant increase in inflation expectations has become visible. Base effects on energy prices certainly contribute to the jump in inflation expectations. Excessive household savings, expected to pour into consumption once lockdown measures are being lifted, a very constructive economic growth trajectory as well as shortages in some parts of the markets like cargo and containers in the global supply flow, fuel the fear of a sustained and significant price pressure.

Central bank officials, however, emphasized their opinion, that those factors will remain transitory with inflation figures only modestly rising above the much observed 2% threshold and even that only temporarily. This together with the latest, rather tame, inflation readings put the fear indicated by inflation expectations into perspective. This does not mean yields will not rise anymore from their current, already heightened levels. The spectre of uncontrolled levels of inflation however, is not the predominant source of rising benchmark rates anymore but rather the confidence in higher growth going forward.

BUT WHAT DOES THAT MEAN FOR FIXED INCOME INVESTMENTS?

To give a short answer, all those securities with a certain credit risk component will likely benefit further, although spreads on corporate credit, regardless of the currency, maturity, or region of incorporation are at, or at least close to, the pre-Covid lows. With the confirmation by central banks to keep the pace of purchases for the time being, debt securities are well bid. Fundamental factors, the closer look on corporate balance sheets, again take the backseat for now. As oftentimes in the past the flood of central bank money 'lifts all the boats'. It is not that different this time. Besides the purchase programs and the healthy demand from real money investors, a steady but controlled rise in underlying rates levels, also have an additional positive effect on financial issuers. High yield debt, so far only included to a little extent in central bank programs, will continue to benefit from a more constructive outlook, higher expenditures and, indirectly, also from purchase programs alike.



Risk premiums of investment grade, High Yield and emerging market bonds in EUR and USD
Period: 01 August 2007 - 31 December 2020
Source: Bloomberg; Illustration: Bergos

AS SO OFTEN, THERE IS A "YES, BUT…"

The expectation of strong growth in the years to come also has negative implications elsewhere in the fixed income space. Some of those will be transitory, others have the potential be more prolonged.

To start with the elephant in the room let us take a closer look on the highest quality part of the fixed income universe and their prospects in light of the constructive growth outlook. With uncertainty fading and robust growth numbers looming, the presumed "need" for highly rated debt from sovereigns will likely continue to decrease further. Less demand means falling prices and consequently higher yields. Additional infrastructure and stimulus plans like the one intended by the new US-government will also increase the supply of government debt going forward putting additional pressure on yields and valuations. In times of rising yields and especially with the

current still merely flat yield curve in historic comparison, longer portfolio duration can be costly. In case of an unexpected setback those securities, however, still offer the best protection by acting as a negatively correlated asset and hence provide more stability. Investors keeping exposure to sovereign debt and duration risk should though weigh the pros and cons and considering sovereign and duration exposure as a form of insurance for their respective portfolios.

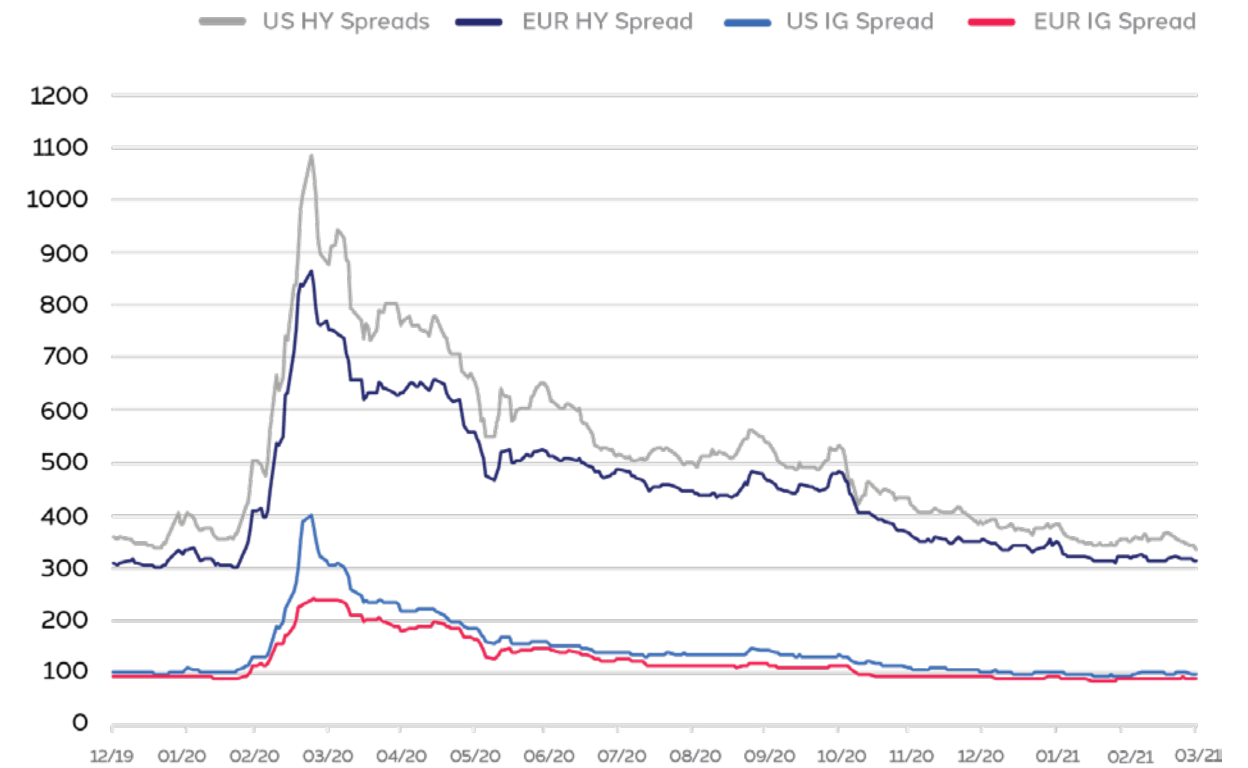
But rising rates can also have an impact on more opportunistic areas of the bond universe, namely on Emerging Market (EM) exposure. As in the past, a rise in US yields also proved to be detrimental for EM- securities this year. Higher yields on Developed Market (DM) debt changes the relative attractiveness of EM issuers. In addition, foreign issuers from a US perspective face higher costs due to changing exchange rates. Although we don't see an immanent risk of an appreciating US Dollar, the prospects of higher refinancing rates increase uncertainty and have to be incorporated into prices. Looking at how the markets are structurally set up compared to the past, the investor landscape obviously has changed somewhat. While asset flows mainly came from DM investors in the past, the share of domestic holdings, especially in the Asian region, is nowadays substantially higher. The effect of rising US rates to our belief will hence be less pronounced this time. With the stronger outlook for economic activity, we see an improving picture for EM corporate bonds. Within the emerging markets debt universe, corporates suffered the most from the slowdown in economic activity that defined 2020. Despite this, credit metric deterioration was not only manageable but indeed far better than initially feared. As economic activity returns, a strong broad-based rebound in earnings and metrics in the current year will benefit EM corporates in the IG as well as HY space. The higher yields on EM stemming from rising interest rates makes EM investments even more compelling. The market hence should not only be included as a strategic long term holding but also promises attractive returns in the short to medium term.

HIGH YIELD CONTINUES TO OFFER FURTHER SPREAD TIGHTENING POTENTIAL

Aside the EM space, within the Developed Market region there are other pockets with attractive yields. High Yield, be it denominated in Euro or US Dollar, has the potential to further provide attractive yields. To put it in perspective to the before mentioned rise in benchmark rates, the sensitivity towards rising yields is less pronounced. Especially at times when yields rose for "a good reason", that is the anticipation and reflection of a strong economic trajectory going forward, yields and spreads were usually negatively correlated. Negative total return contributions from the rates side hence were outmatched by falling credit risk spreads. So far we have no reason to believe it's different this time.

There is a caveat nonetheless. Looking at the average spread on US High Yield as an example, we see that we are at almost the tightest levels since 2007. However, we somewhat are in unchartered territory again, hence the road towards lower spreads might be uneven.

Development of the Credit Risk Spreads on Euro and US Dollar IG and HY Bonds
Source: Bloomberg, as of 03/31/2021; Illustration: Bergos



As long as the positive momentum and risk on sentiment prevails, there is still room to go. It will be crucial, however, not to completely ignore fundamentals factors. A positive general environment ultimately does not make careful and considerate credit selection redundant. A selective stance on High Yield is, to our understanding, key to achieve a positive return contribution on a risk adjusted basis. Especially the European High Yield market still offers potential on individual company level while maintain a higher average rating quality.

INVESTMENT GRADE CORPORATES FAIRLY PRICED BUT STILL OFFERING SOME GAINS

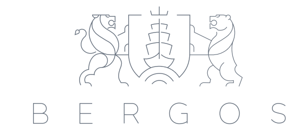
The factors mentioned before, this goes without saying, also impact the broad field of investment grade credit. Having seen already a strong recovery in credit spreads on US Dollar

and Euro denominated issues, we still expect a continuation in light of the described positive outlook, simply at a lower pace. The approach on achieving solid returns got hence a bit more difficult though.

Increasing the overall exposure is not the healing formula. In addition to the individual companies' fundamental quality, investors have also to carefully consider duration and the still somewhat lingering effects of the pandemic to compose a stable portfolio.

WILL THIS YEAR BE TRANSITIONAL FOR FIXED INCOME THEN?

To some extent it will be. The attractiveness of low yielding high quality assets, despite them offering some form of protection, will decrease due to constructive growth projections. Risk-bearing securities will benefit from the new cycle's early stage and hence continue to deliver positive returns. With this "more risk, more return" mindset, investors shall not get too complacent with regards to potential setbacks. Although it seems to be all clear for now, a careful and thorough analysis remains key to achieving attractive risk-adjusted returns.



BONDS
OUR EXPERT

RENÉ BOLHAR, CAIA
BOND STRATEGIST

René Bolhar joined the bank at the end of 2017 and is Deputy Head of our Asset Management. He is a member of the Investment Committee and leads the bank's fixed income strategy. He is also responsible for managing large institutional bond portfolios.

COMMODITIES

BY SOUMAILA TÉKÉTÉ

INDUSTRIAL METALS – STRONG FUNDAMENTALS AND POSITIVE OUTLOOK

Structural increases in demand through electronic vehicles and infrastructure spending may have a long-lasting positive impact on the demand for industrial metals

Limited supply & rising demand should set the stage for rising prices

Accelerating economic activity and a global trend towards electronic vehicles, decarbonization, green energy and the related infrastructure in particular, form a structural bull-case for industrial metals as demand should rise in tandem with the importance and magnitude of these trends.

Furthermore, the industrial metals bear market of the last decade has led to a reduction in capital expenditures (CapEx) of mining companies. This in turn has translated into reduced inventory levels and shrinking supply capacity over time, as mines usually face decreasing productivity in the course of their limited economic lifecycle. Therefore, drastic CapEx increases will likely be needed in some parts of the industrial metals market to keep global output at current levels and to keep

up with a potential rise in global demand. In the meantime, formerly oversupplied metals markets may potentially turn into deficit – which would increase price sensitivity of industrial metals.

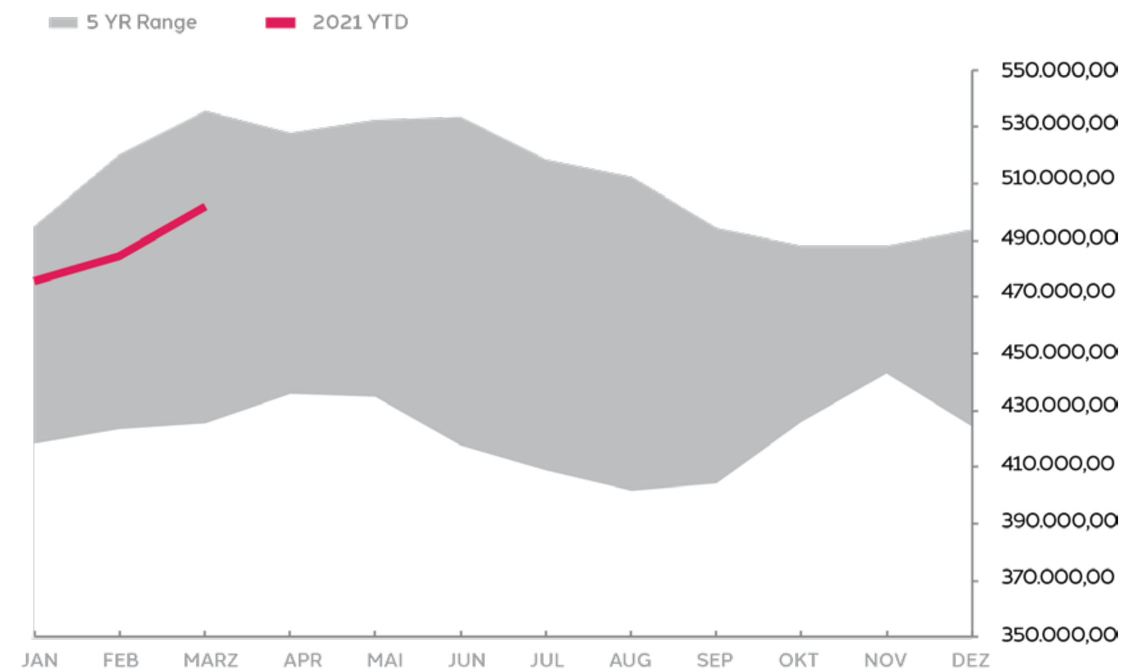
We believe, the long-term structural increase in demand in combination with the current short-term economic rebound and a somewhat limited supply will offer further price potential, despite the rally we have seen recently within the industrial metals complex.

CRUDE OIL – POSITIVE MOMENTUM

Oil prices are supported by improved fundamentals and microeconomic data

Structural overcapacity however should limit upside, and political event risks may lead to volatility and setbacks

As opposed to the terrible market crash at the same time last year, oil markets have started the year 2021 on a very positive note, as prices have gained ca. 20% year to date and are currently fluctuating around 60 USD per barrel. This positive momentum for crude oil as a cyclical asset is mainly attributable to the procyclical macro-economic environment and increased short-term demand, as well as to positive micro-economic evolvements such as ongoing discipline and support from OPEC+ countries which help keeping short-term supply in check. The improved fundamental picture is also reflected in the inventory data as today, one year after the big supply shock, inventory levels are back in their historical seasonal range



US Crude Oil Inventories in the context of their historical range
Period: April 2015 - April 2021
Source: Bloomberg; Illustration & calculation Bergos AG

Structural overcapacity however remains the limiting factor for oil prices – as ample global capacity from Non-OPEC (e.g. USA) as well as OPEC nations is available and could easily be reactivated. Therefore, political dependency of oil prices remains very high. Oil markets continuously rely on OPEC+ mutual consent and discipline to curb supply. Furthermore, other rather geopolitically caused outages may be questioned in the future. Even though an outright Iran deal seems rather unlikely for the time being, the indirect resumption of talks between the US and Iran may bear a certain event risks for oil prices, as Iran going back online after potentially successful negotiations would result in additional crude supply of ca. 2 million barrels per day.

As long as the OPEC support is kept in place and market fundamentals keep improving we see slightly more price potential for crude oil, albeit at a slower pace. The large overcapacity however should continue to cap any potential upside in the absence of supply shocks, and more volatility should be expected in the course of the year.

GOLD – WAITING FOR NEW DRIVERS

Gold remains an important part of a well-balanced multi-asset portfolio however, new catalysts are needed for higher gold prices

Rising inflation expectations eventually need to materialize

We consider gold to be an indispensable strategic element within any well-balanced multi-asset portfolio especially due to its diversification benefits and its safe haven function in times of stress. It may also offer a store of value for investors questioning the sustainability of ever rising global debt levels and the stability of fiat currencies given the unprecedented global monetary and fiscal stimulus we have witnessed recently.

From a tactical standpoint, however, we currently have a neutral stance on gold, as nominal rates adjusted for inflation, the single most important driver for the gold price in recent years

US Inflation Linked Bond Yields vs Gold Price
Period: January 2007 – April 2021
Source: Bloomberg; Illustration & calculation Bergos AG

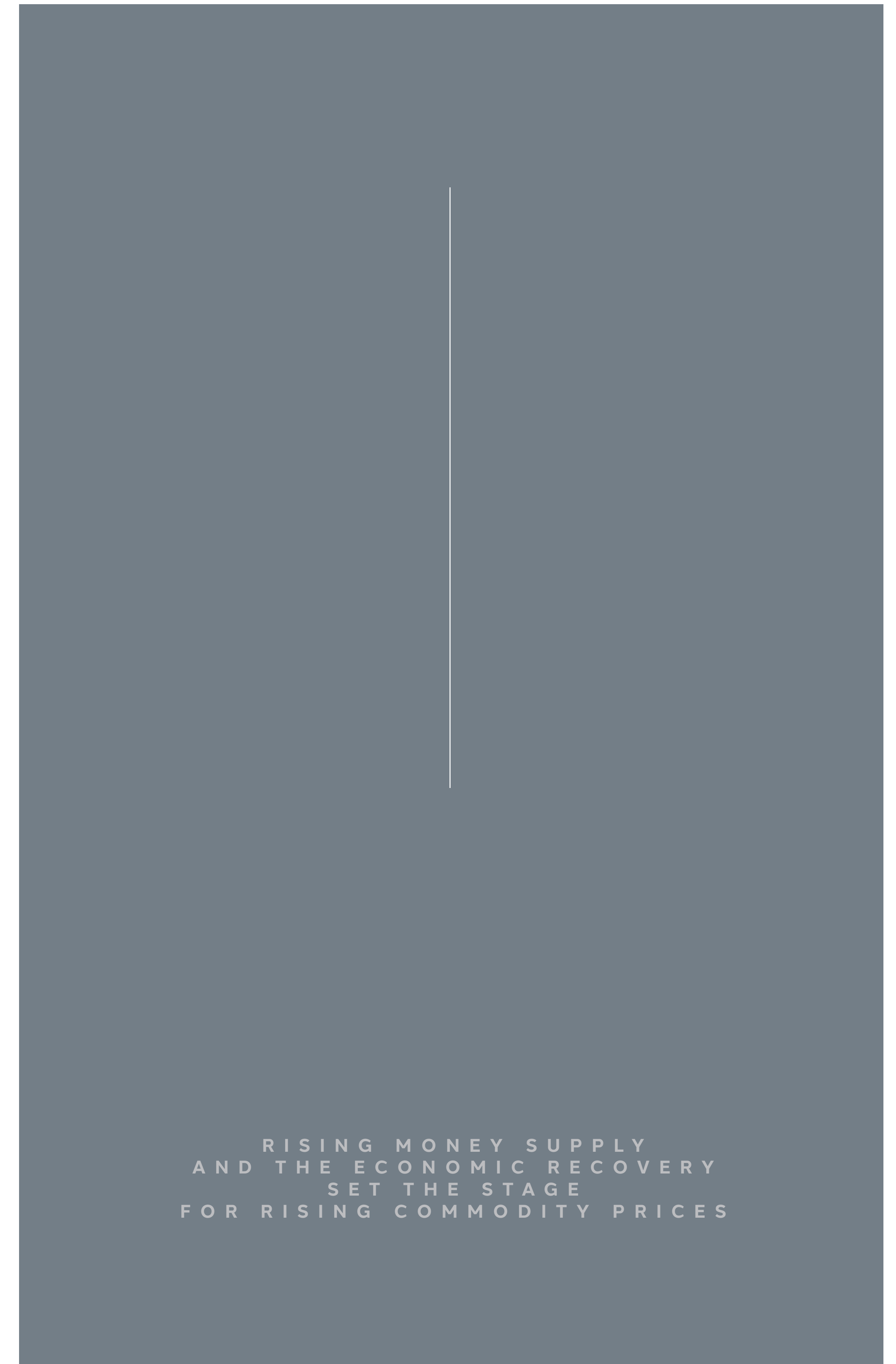
seem to have reached exhausted levels and have mostly lost their impact on the gold price since the beginning of this year. This decoupling is likely to be temporary in nature. However, we believe short-term risks for gold have increased, as the global macroeconomic picture indicates the previously built premium for safe haven assets like Gold is steadily being priced out and rising nominal interests are weighing on interest rate sensitive parts of the market. We believe this increased volatility is likely to stay in place until the anticipated potential inflation actually materializes and accelerates.

BERGOS

COMMODITIES
OUR EXPERT

SOUMAILA TÉKÉTÉ CAIA, CIIA
ALTERNATIVE INVESTMENTS STRATEGIST

Soumaila Tékété joined Bergos in 2016 as a cross-asset strategist and has since been responsible for various investment strategies. As a member of the investment committee, he is also responsible for strategy in the alternative investment area. Previously, he held various portfolio management positions at Union Investment and DZ Privatbank in Frankfurt and Zurich.



BERGOS

CURRENCIES

SMALL SURPRISES
BY DR. JÖRN QUITZAU, BERENBERG

CURRENCY MARKET ENVIRONMENT

The currency market experienced not one, but several small surprises in the first quarter of 2021. First, the European single currency began the year just as strong as it had been since May 2020, rising temporarily above USD 1.23 per Euro in early January. But then the upward trend was broken, rather surprisingly, and sentiment turned in favour of the US Dollar in the first quarter. The Euro also came under pressure against the Pound: The tailwinds boosting the British currency at the end of 2020 carried over into the new year, fuelling a mini-rally for the Pound in the first quarter. By contrast, the chronically overvalued Swiss Franc came under pressure, falling to its lowest level against the Euro in about one and a half years.

RECENT STRENGTH FOR THE US DOLLAR

Several factors have temporarily favoured the US Dollar against the Euro. In addition to the comparatively strong US economy, faster progress has been made in vaccinating the US population, holding out the promise of a faster return to economic normality. In addition, the extremely expansive policy of the US government and the US central bank have further stoked the economic euphoria. Higher US interest rates make Dollar zone investments seem more attractive. Although the Dollar's exchange rate is currently benefitting from these factors, we expect that the higher government debt resulting from the fiscal spending policy and the greater inflation tolerance of the US central bank will weaken the Dollar in the medium and long term.

By contrast, the Eurozone is suffering from the halting pace of vaccinations. In the meantime, it also had to digest the government crisis in Italy, although this issue has since been put to rest with the appointment of Mario Draghi as Prime Minister. The Eurozone is likely to get a grip on the coronavirus pandemic in the next few months, thanks to the "outdoor season" and vaccinations. We expect that the currency market will then take a closer look at monetary and fiscal policy, which will weaken the Dollar. Moreover, the US Dollar should be less in demand as a safe-haven currency as the general market sentiment improves. For this reason, capital will flow out of the Dollar zone. We see the Euro's exchange rate rising to USD 1.25 per Euro by the end of 2021.

U.S. Dollar is surprising strong against the Euro

USD per EUR, Source: Macrobond

Our positive Euro outlook is subject to two risks. First, the so-called EU Recovery Fund ("Next Generation EU"), which was largely responsible for the Euro's strength last year, has not yet been ratified by all national parliaments. In fact, the German Federal Constitutional Court has temporarily blocked the German Federal President from signing the law. The Federal Constitutional Court therefore gave itself time to review the constitutional challenge related to an emergency order. The Bundestag (lower house of the German parliament) and the Bundesrat (upper house) had previously approved the law. We assume this means that the law will only be delayed, not struck down. However, a residual risk remains given that we cannot definitively assess the legal details. If this residual risk materialises, the Euro's exchange rate would be adversely affected in a noticeable and lasting way.

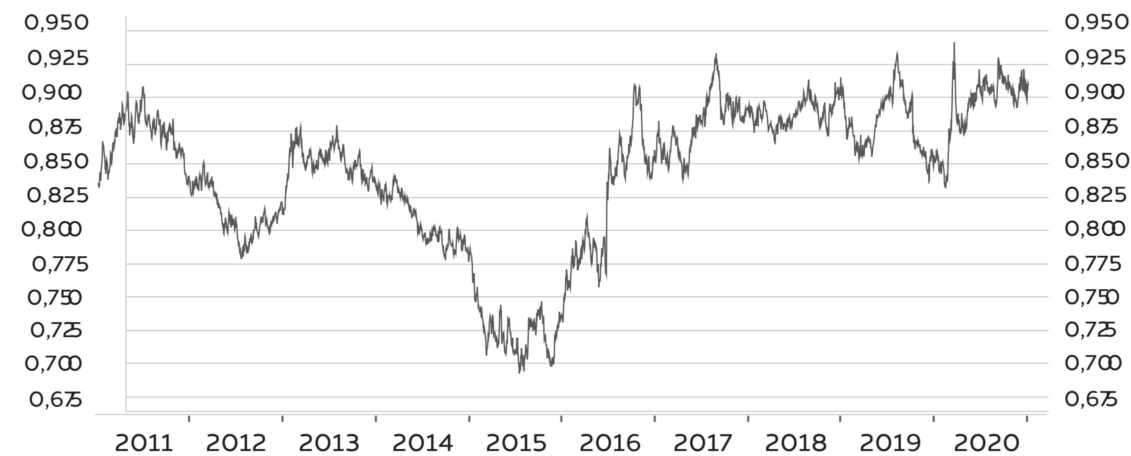
Second, the European Central Bank is currently reviewing its monetary policy strategy. If the ECB concludes that it can accept higher inflation rates than previously, that would probably put pressure on the exchange rate of the Euro. We consider it improbable that the ECB would communicate such a strategy change – if it implements it at all – so openly and explicitly. Nevertheless, it cannot be ruled out that the ECB could accept inflation rates above the ECB's target of slightly less than 2% after many years of "too low" inflation rates, as a kind of correction, so to speak. The degree to which such an approach would damage confidence in the Euro and drive down its exchange rate would largely depend on the nature of the ECB's statements on this subject.

UPWARD MOMENTUM FOR THE BRITISH POUND

Once the EU and the United Kingdom finally reached a Brexit follow-on deal at the end of 2020, the path was cleared for exchange rate gains for the Pound. The recovery in the first quarter of 2021 was quite dynamic. This upward momentum can be credited also to the quick progress of vaccinations: Whereas more than 46% of the UK population have already received at least one vaccine dose, only 13% of the EU population have received one (as of 5 April 2021). Therefore, both the sentiment in the country and the economic outlook for the United Kingdom is much more positive than for the Eurozone.

This favourable confluence of factors in the United Kingdom is appropriately reflected in the current exchange rate. Having now reached 0.86 Pounds per Euro, its upside potential is probably exhausted for the most part. The Bank of England is currently staying the course, awaiting further economic developments before taking its next step. This means that monetary policy could theoretically provide fresh impetus in the further course of the year. If, however, the Bank of England does not take any surprising measures, we see the exchange rate at 0.85 Pounds per Euro at the end of the year and beyond.

Vaccination problems are pushing the Euro down against the Pound



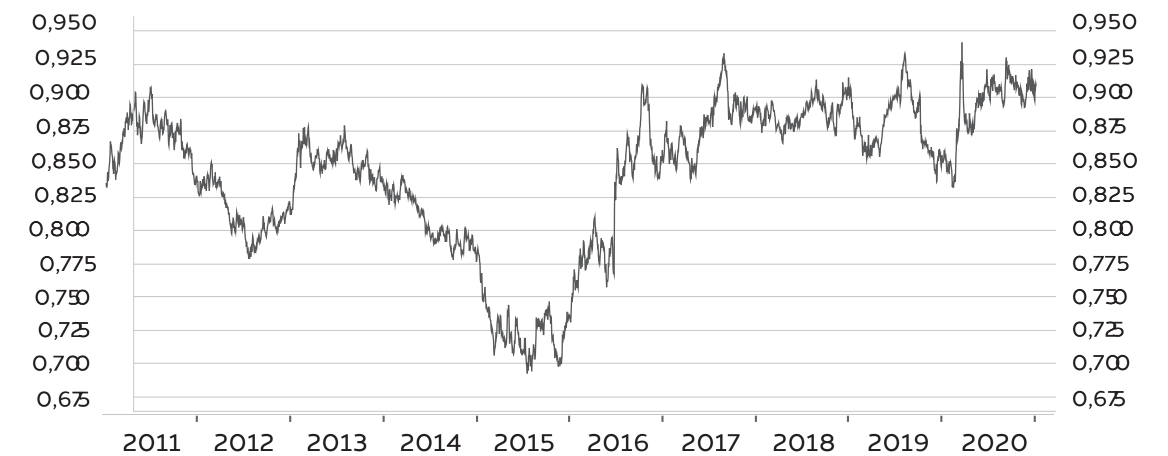
GBP per EUR, Source: Macrobond

Euro/British Pound Exchange Rate

SWISS FRANC

Due to the positive economic outlook and favourable sentiment in the financial markets, the Swiss Franc is no longer in as much demand as a safe haven. For this reason, the Euro made appreciable gains from mid-February to mid-March, rising above 1.10 for the first time since 2019. In the meantime, the exchange rate has settled in above this level and is trading in a sideways pattern. This is good news for the Swiss National Bank because it eliminates the necessity for currency market intervention at this level, even though it still considers the Franc to be highly valued. We believe that the overvaluation of the Franc is likely to persist for now.

Euro gains against the Swiss Franc



CHF per EUR, Source: Macrobond

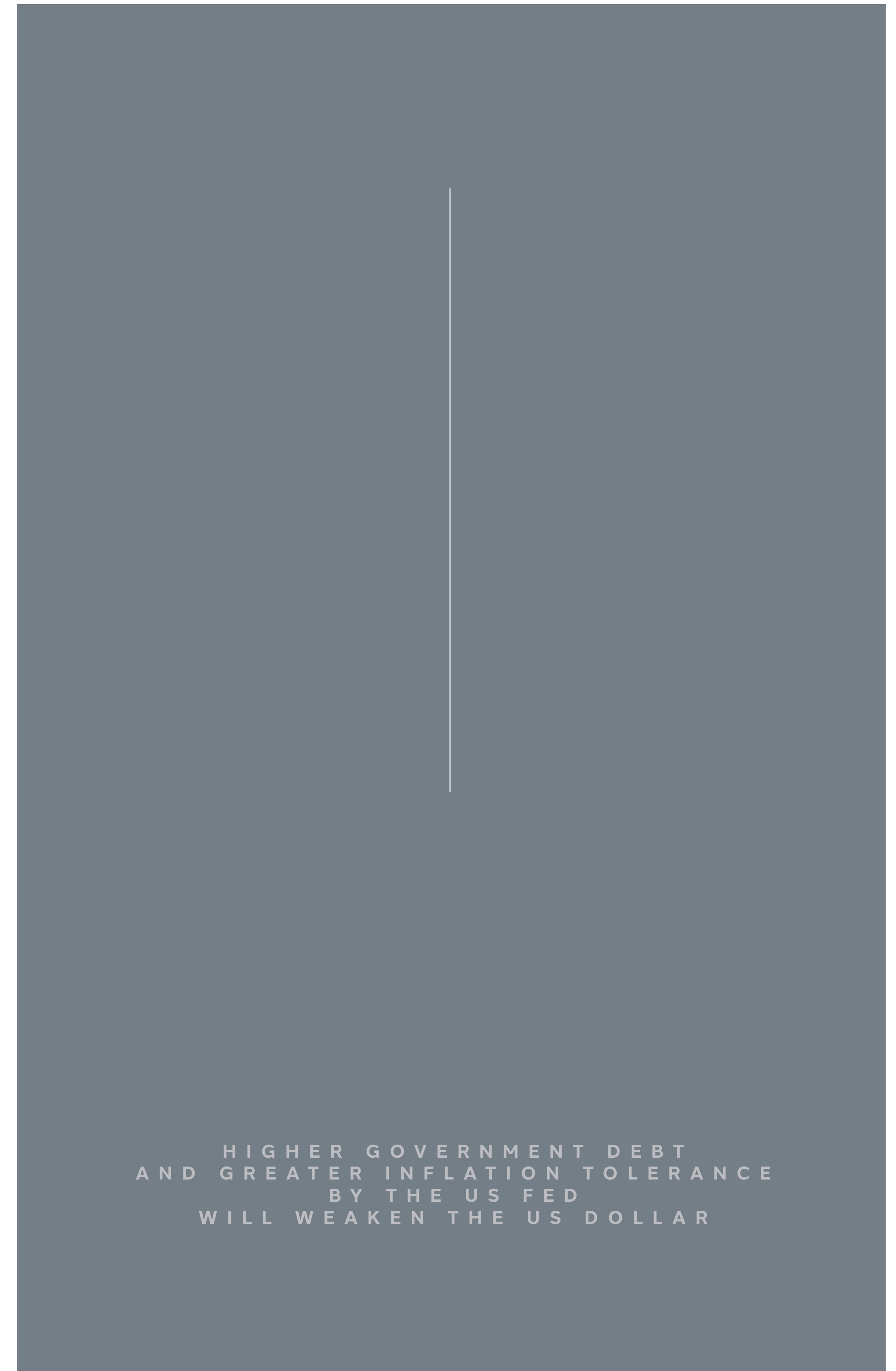
Euro/Swiss Exchange Rate

BERGOS

CURRENCIES
OUR EXPERT

DR. JÖRN QUITZAU
CURRENCY STRATEGIST,
BERENBERG

Dr. Jörn Quitzau has been with Berenberg since 2007, where he is Head of Economic Trends and responsible for currency analysis. Prior to that, he spent six years at Deutsche Bank Research in Frankfurt. Since 2014, he has been a Non-Resident Fellow at the American Institute for Contemporary Studies (AICGS), Washington D.C.

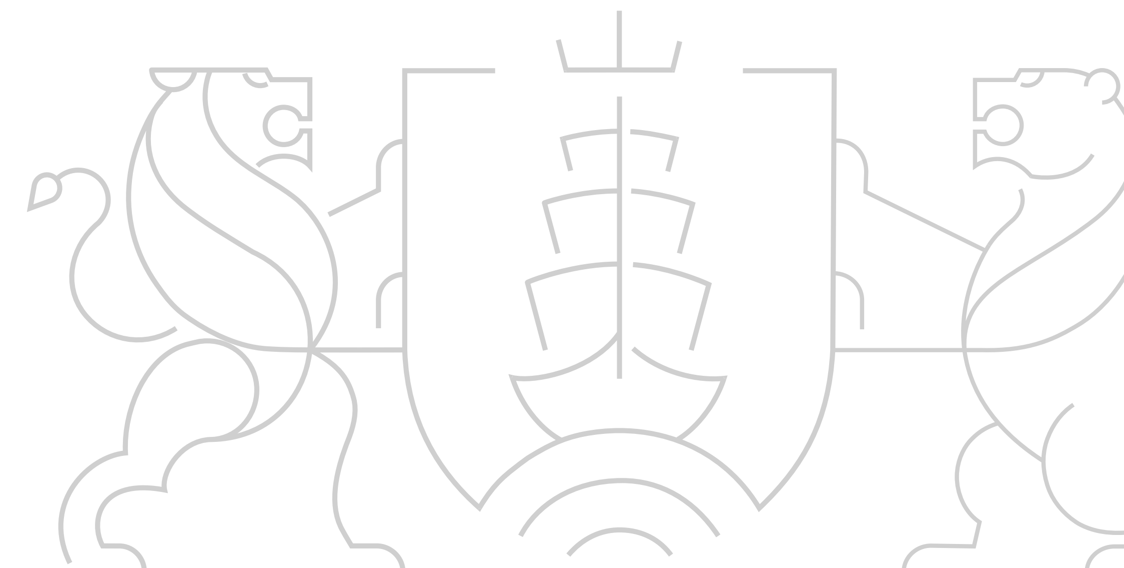


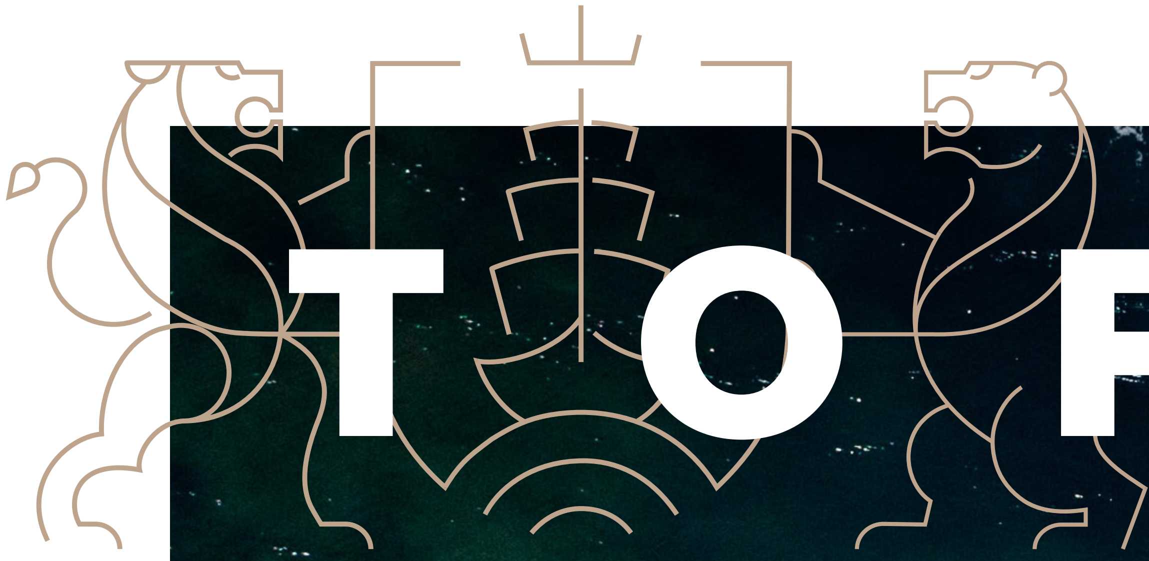
B E R G O S V I E W
M A T R I X

BANK VIEW	--	-	0	++	+
Equities	○	○	○	●	○
North America	○	○	○	●	○
Consumer Discretionary	○	○	●	○	○
Consumer Staples	○	●	○	○	○
Energy	○	○	●	○	○
Financials	○	○	●	○	○
Health Care	○	○	○	●	○
Industrials	○	○	●	○	○
Information Technology	○	○	○	●	○
Materials	○	○	○	●	○
Real Estate	○	○	●	○	○
Communication Services	○	○	○	●	○
Utilities	○	●	○	○	○
Europe	○	●	○	○	○
Consumer Discretionary	○	○	○	●	○
Consumer Staples	○	●	○	○	○
Energy	○	○	●	○	○
Financials	○	○	●	○	○
Health Care	○	○	●	○	○
Industrials	○	○	●	○	○
Information Technology	○	○	○	●	○
Materials	○	○	○	●	○
Real Estate	○	○	●	○	○
Communication Services	○	○	●	○	○
Utilities	○	○	●	○	○
Emerging Markets	○	○	○	●	○

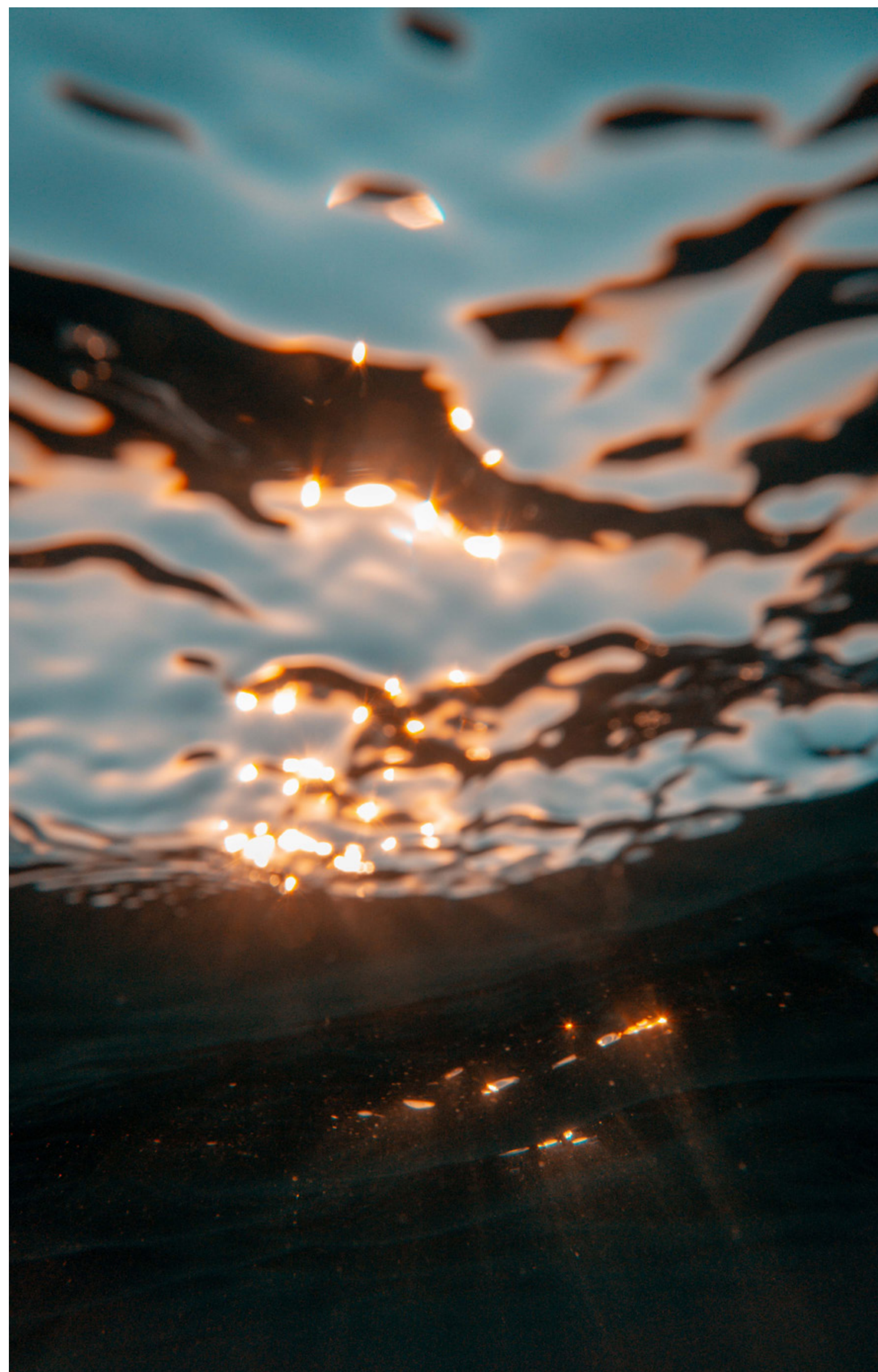
	--	-	0	++	+
Fixed Income	○	●	○	○	○
Denomination U.S. Dollar	○	○	●	○	○
Duration	○	○	●	○	○
Sovereigns	○	○	●	○	○
Corporates Non-Financial	○	○	○	●	○
Corporates Financial	○	○	○	●	○
Senior	○	○	○	●	○
Subordinated Debt	○	○	○	●	○
Corporate High Yield	○	○	●	○	○
Denomination Euro	○	●	○	○	○
Duration	○	●	○	○	○
Sovereigns	○	●	○	○	○
Core	○	●	○	○	○
Peripheral	○	○	●	○	○
Corporates Non-Financial	○	○	●	○	○
Corporates Financial	○	○	○	●	○
Senior	○	○	○	●	○
Subordinated Debt	○	○	○	●	○
Corporates High Yield	○	○	●	○	○
Emerging Markets	○	○	○	○	●
Hard Currency	○	○	●	○	○
Local Currency	○	○	●	○	○

	--	-	0	++	+
Alternative Investments	○	○	○	●	○
Commodities	○	○	○	●	○
Energy	○	○	●	○	○
Industrials Metals	○	○	○	●	○
Precious Metals	○	○	●	○	○
Hedge Fund Strategies	○	○	●	○	○
Long/Short	○	○	●	○	○
Relative Value	○	○	○	●	○
Macro	○	○	●	○	○
Event Driven	○	○	●	○	○
Convertibles	○	○	○	●	○
Real Estate	○	○	●	○	○





TOPIC



INFLATION

BY MAXIMILIAN HEFELE

LAST YEAR FEARED DEFLATION – TODAY FEARED INFLATION

Within the current dynamic recovery of the economy, last year's deflationary fears have vanished. Instead, inflationary fears have taken over and moved into the centre of attention. Excessive monetary and fiscal programs from central banks and governments are fuelling those worries and, therefore, it is worthwhile to take a closer look.

Short and mid-term we can identify different positive and negative inflationary factors. In both periods we expect moderately higher inflation rates compared to former years, both in Europe and the United States. This moderate rise in prices would increase the gap towards deflationary threats. We assess this as a positive development.

SHORT-TERM VIEW – TEMPORARY SPECIAL EFFECTS DOMINATE

In particular in the next months, inflation is likely to be driven by temporary base effects. The oil price is expected to be the primary driver. The average oil price of WTI Crude was trading below US-Dollar 17 per barrel in April last year and has increased to US-Dollar 61 today, 13 April 2021. Hence, the oil price has more than tripled on an annual comparison and is about to become a dominant factor for inflation. However, we think it is rather unlikely that this extreme development will repeat itself going forward but most likely will decline in the second half of this year.

Transportation costs for goods, in particular from Asia to western countries, are a second global driver for prices. Since November 2020, charter rates for 40-foot containers from Asia

to Europe rose from 2'200 to 7'400 US-Dollar (Freightos Baltic Index, 6 April 2021). This jump follows a shortage in container capacities in Asia. However, it is only a matter of time until container capacities will adjust to rising demand and, therefore, these effects will also decrease over time.

In addition, we are experiencing country-specific one-off effects which are also expected to push prices temporarily. For example, the subsequent increase of the German VAT as well as the start of the CO2 emissions trading will lead to higher energy costs.

In total, we expect a dynamic rise in inflation within the next months which might surpass the targets of the European Central Bank and the US Federal Reserve. The reasons for this development seem to temporary base effects rather than monetary and fiscal stimuli or an overheating economy. This conclusion is also supported by the still high US-unemployment rate of 6.2% currently. Furthermore, the US capacity utilization is only at 75% and therefore still at low levels in comparison to history. In case of rising consumer demand free capacities can still be exploited before prices start to rise significantly

MIDTERM PERSPECTIVE – THE DESIRED TIME AFTER LOCKDOWNS

If one looks into the future with optimism and expects the end of curfews, travel and economic restrictions, it seems very likely that additional demand impulses might arise. In the United States, this scenario seems within one's grasp already: according to CDC, more than 2.9 million US citizens are being vaccinated each day (7-day average as of 13 April 2021). So far, more than 120 million U.S. citizens have received one vaccination dose at least. For those over 65 years of age, even more than 62% have already received the second dose (CDC, as of 13 April 2021). We therefore can expect that the United States will end lockdowns much earlier than Europe.

Regardless of when the desired normalisation comes about, a dynamic spike in consumption can be expected. As a result of the ongoing pandemic, consumers' savings rates doubled in 2020 on both sides of the Atlantic. In the United States, the savings rate gained significantly also this January. On one hand, this is a result of omitted expenses, e.g. for air travel or entertainment events virtually impossible during lockdown, and, on the other hand, due to an increased safety need in the context of an imponderable pandemic.

A corresponding, quick increase in consumer demand as well as the associated labour-market and production effects might lead to increased inflationary pressure. The nature of such a demand-induced inflation would, however, fairly differ from a normalisation grounded on short-term base effects.

The US Fed seems open for a moderate increase in prices and might also tolerate inflation rates temporarily above the actual 2% target in the context of its Average Inflation Targeting (AIT). The AIT is directed at offsetting subdued inflation rates of past years. A significant spike of demand-induced inflation, however, would prompt the US Fed to leave the path of ultra-loose monetary policy. In our view, this would not represent a crisis scenario, but rather the manifestation of a normalising monetary-policy development. We, however, have not yet reached this point – we expect such a scenario in 2022 at the earliest.

INFLATION
OUR EXPERT

MAXIMILIAN HEFELE CFA
HEAD OF ASSET MANAGEMENT

Maximilian Hefele is Head of Asset Management at Bergos since 2003. He is responsible for all discretionary investments solutions offered by the bank. He is Managing Director and Chairman of the bank's Investment Committee.

BERGOS

This publication only serves information and marketing purposes. The information provided is not legally binding and does not constitute financial analysis, nor a sales prospectus, nor an offer for investment transactions, nor asset management, nor investment advice, and is not a substitute for legal, tax, or financial advice. Bergos AG (referred to hereinafter as »Bergos«) reserves the right to change the offering of services and products, as well as prices, at any time without prior notice. Bergos assumes no responsibility for the topicality, correctness, or completeness of the information. Bergos refuses any and all liability for the realisation of the forecasts or other statements concerning returns, price gains, or other asset appreciation contained in this publication.

BERGOS

This publication was not prepared in compliance with the Directives on the Independence of Financial Research and is also not subject to the prohibition of trading after the dissemination of financial research. The investment suggestions and investment ideas stated herein have not been tailored to your personal circumstances. Investment decisions should always be made on the basis of a given portfolio and consideration should always be given to your personal situation, risk appetite, and risk tolerance. Because investment suggestions and investment ideas can exhibit different risk characteristics, we ask that you read the specific product information and brochure entitled »Particular Risks in Trading Securities« and consult your client advisor if you have any questions. It is possible that Bergos itself or its directors or employees have invested, currently invest, or will invest in investment instruments concerning which this document contains information or opinions. It is also possible that Bergos has provided, currently provides, or will provide services to the issuers of such investment instruments. It can also not be ruled out that employees or directors of Bergos have worked, currently work, or will work for the issuers of such investment instruments. Therefore, Bergos itself or its directors or employees could have an interest in the future performance of investment instruments. This information is only intended for use by the recipient and may not be forwarded to third parties. The present information may not be copied in part or in full without the written consent of Bergos.

BERGOS

BERGOS

COPYRIGHT
BERGOS AG

ALL RIGHTS RESERVED
ZURICH, APRIL 2021

Editor
Maximilian Hefele, CFA
Head of Asset Management

Authors
René Bolhar, CAIA | Bond Strategist
Till Christian Budelmann | Chief Investment Officer
Maximilian Hefele, CFA | Head of Asset Management
Dr Jörn Quitzau | Currency Strategist, Berenberg
Dr Holger Schmieding | Chief Economist, Berenberg
Soumaila Tékété, CAIA, CIIA | Alternative Investments

Managing Editor
Aurelia Rauch | Head of Communications

BERGOS AG

HEADQUARTERS
Kreuzstrasse 5
8008 Zurich · Switzerland

phone +41 44 284 20 20
fax +41 44 284 20 22

OFFICES
29, Quai du Mont-Blanc
1201 Geneva · Switzerland

phone +41 22 308 59 00
fax +41 22 308 59 20

www.bergos.ch
info@bergos.ch