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BONHÔTE

'Inflation will be temporary,' so the story goes

Overview

Globally, growth is accelerating in most advanced economies. Vaccination drives have permitted some relaxation in the restrictions aimed at containing the virus, which in turn is boosting consumer spending. Meanwhile, industrial production is increasing, although the trend is patchy on a country-by-country basis. But then, it's important to understand that the current data take the previous year as their base, at a time when figures were plunging as a result of the pandemic.

Cross-border trade has been stricken by significant supply issues for several months. Shortages and bottlenecks are driving up prices, raising fears among investors of imminent tightening in monetary policies. In this setting, the bond market is doing the opposite of what it is ought to do. Rather, the downturn in long-term yields indicates that Fed chair Jerome Powell has succeeded in convincing most people that the current inflation spike will be temporary. Correspondingly, the yield on 10-year Treasury bonds has slipped to 1.45% – a level not seen since March. However, the lofty valuations enjoyed by equities are increasing the risk of a correction amid higher short-term volatility. Meanwhile, the S&P 500 last week set a new record and the Nasdaq finished above 14000 points. Tech stocks were picked up while industrials were dumped. Healthcare and utilities helped led global stockmarkets higher while financials, hurt by the ebbing yields, staged a retreat.

Impending tightening of monetary policies is spooking investors

The US consumer price index jumped by 5% year-on-year in May. Such a dramatic increase, not seen for nearly 13 years, is indicative of a strong recovery in the American economy. Inflation is riding higher on the back of dearer used cars and car rentals, demand for which is surging as many Americans take advantage of home-working arrangements to decamp from inner cities. Another reason is that the production of new cars has been severely hampered by the shortage of semiconductors.

Strong recovery in the US economy

At its meeting on Wednesday, the Fed (which is still buying USD 130 billion of assets per month) will probably leave its ultra-loose monetary policy unchanged. Unsurprisingly, the ECB has stuck to its guns, revising GDP growth for this year from 4% to 4.6% and inflation to 1.9%. According to Christine Lagarde, the latest data point to a rebound in services and continued momentum in manufacturing, suggesting faster GDP growth in the second quarter. The ECB will continue its asset purchase programme at a higher pace than at the beginning of the year. In any case, when tapering is eventually decided upon, it will be a very gradual.

The consolidation move towards 11270 did not take place, leaving the SMI free to soar to all-time highs. Its next target is 11992, but it will be difficult to break through this projected long-term resistance.

Key data

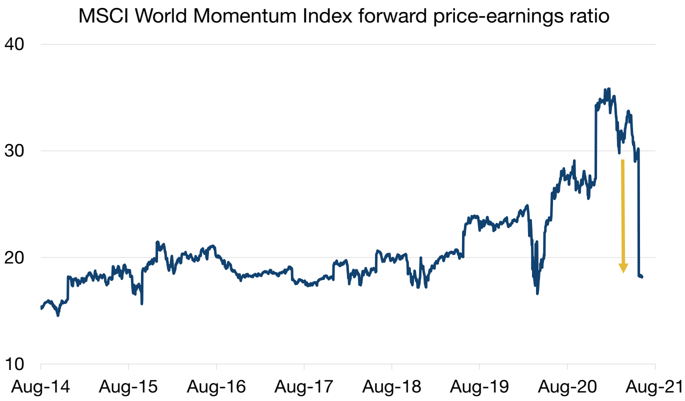
	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI Emerging Markets
Latest	0.90	1.09	11'841.30	4'126.70	15'693.27	6'600.66	7'134.06	4'247.44	14'069.42	28'948.73	1'381.99
Trend	➡	➡	⬆	⬆	⬆	⬆	⬆	⬆	⬆	➡	⬆
YTD	1.46%	0.53%	10.63%	16.16%	14.39%	18.90%	10.43%	13.08%	9.16%	5.48%	7.03%

(values from the Friday preceding publication)

Exposure to momentum suddenly gets cheaper

The end of the first half of the year usually marks some rebalancing in global indices. And the MSCI World Momentum has changed its composition, which has in turn depressed its valuation.

This index is made up of momentum stocks, i.e. stocks that have experienced price appreciation over the previous 6-12 months. As part of its semi-annual rebalance in early June, it shed technology-related momentum stocks (which had been the earlier gainers) and added financial and energy stocks.



Since these stocks are trading on much lower price-earnings multiples (P/E), the index valuation has tumbled by 39% to less than 20x forward earnings. This shift in the momentum index demonstrates the full impact of the pandemic, which finally undermined the long-lasting trends prevailing on equities. It now reflects the sector rotation that has taken place in the markets during the economic recovery.

Affordably priced value stocks have gained the momentum mantle in the place of tech stocks, today considered too expensive.

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