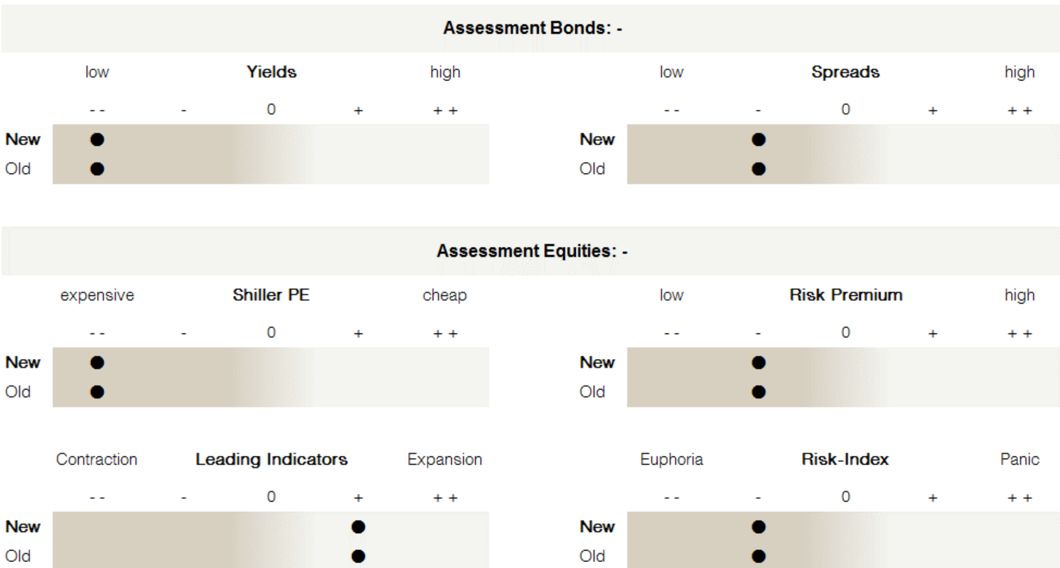
Transitory interest rate bump?

March 2021

- Nasdaq halfway back from correction lows
- Risk appetite remains high
- Temporary interest rate bump in long-term US-rates?
- Defensive sectors increasingly attractive

Increasingly defensive sector orientation

There is a German proverb that says: “Life punishes those who come too late, the moment punishes those who come too early”. When we look at some of the current market developments, we find similarities. That is why we deliberately refrain from participating in various developments that we do not believe to be sustainable. This might temporarily be a bit painful, since we seem to miss one or the other opportunity. However, applying our quantitative model, we are now finding real opportunities that are very different from prevailing market views and fit in with our generally defensive bias: we have decided to overweight the relatively attractively valued consumer staples, healthcare and commodities sectors. With regards to the macroeconomic environment, we are also rather skeptical of the market consensus that assumes the economy will reflate "no ifs, no buts”. In our view, it is more likely that the rise in U.S. long-term interest rates is a temporary interest rate bump. As soon as long-term interest rates sufficiently reflect long-term inflation expectations, rates will likely peak. Given this assumption, the yield on 10-year U.S. government bonds could rise towards 2%. Under these conditions, the cyclical sectors are still likely to post further gains. However, the very positive outlook for these sectors seems to be priced into current valuations to a large extent. Furthermore, a too strong and uncontrolled rise in U.S. interest rates is definitely not on the agenda of the U.S. Federal Reserve and would presumably lead to the so-called yield curve control and long-term interest rates would ultimately become capped by the central bank.



Sound Capital AG
Claridenstrasse 19
P.O. Box
CH-8022 Zürich

Tel +41 44 206 25 25
Fax +41 44 206 25 00

welcome@sound-cap.com
www.sound-cap.com

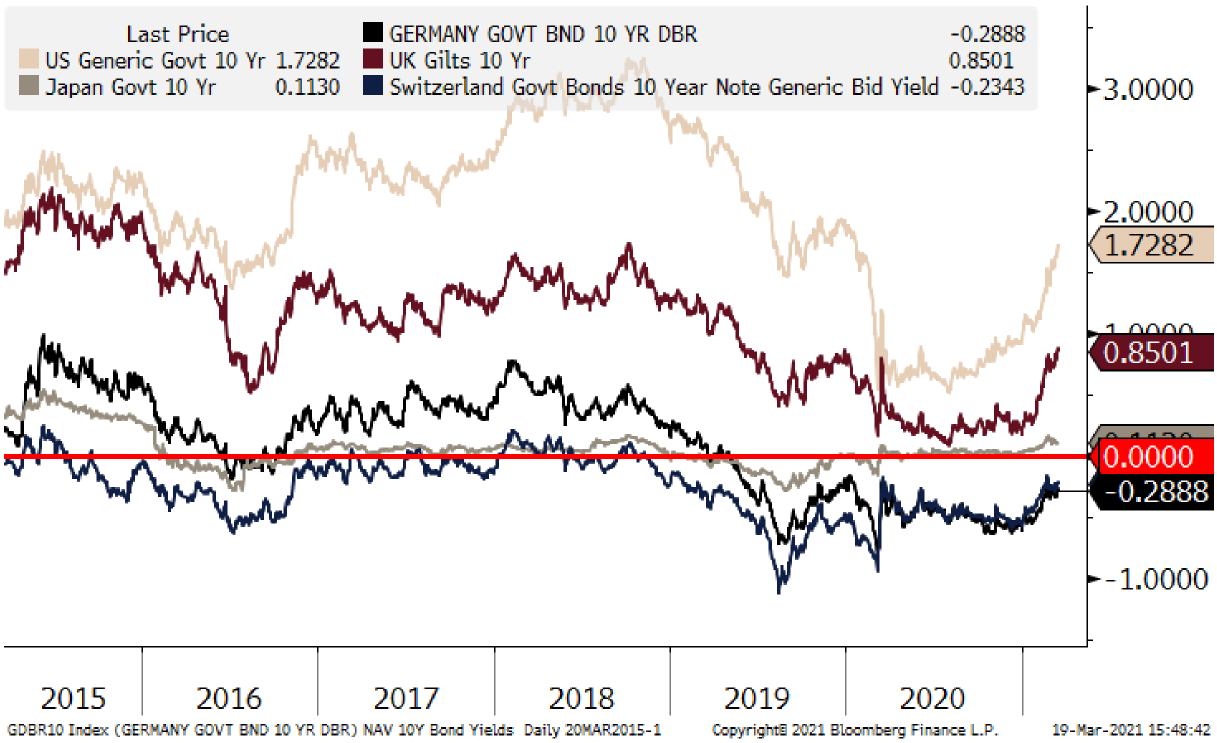
Since our last publication, we have made no changes to either the asset classes or the investment categories.

Within the asset classes, there were major movements in the cyclical sectors, especially in equities. According to our model, the strong price gains are only partially justified by fundamental data. In the current environment, we favor consumer staples, healthcare and the commodities sector.

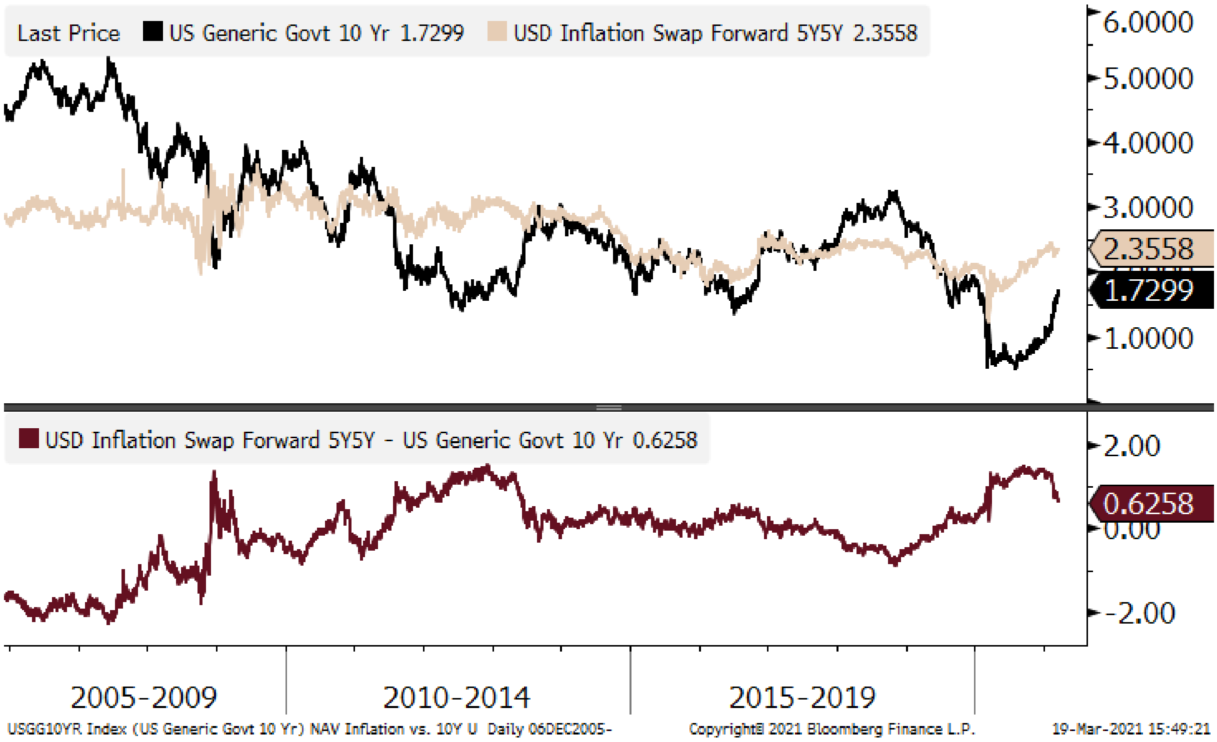
Interest rate level (indicator --) / Spreads (indicator -)

Assessment unchanged / Assessment unchanged

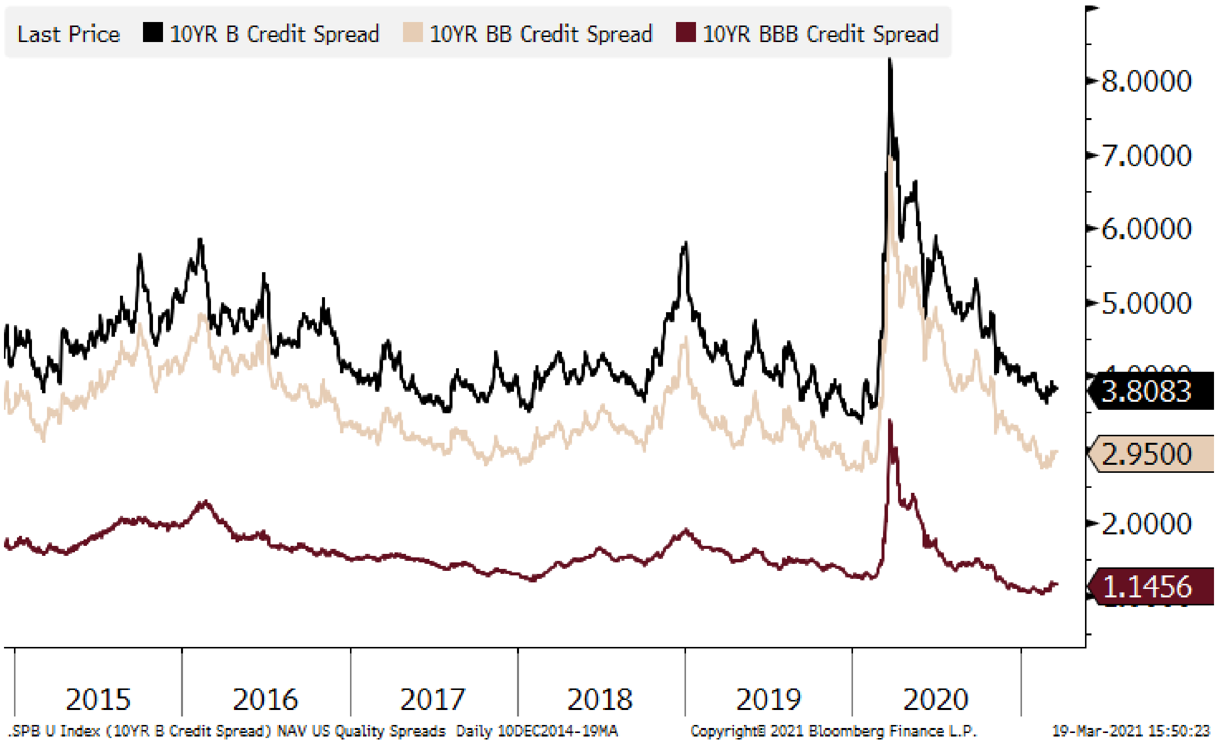
The sharp rise in interest rates is particularly visible in the US and the UK, while interest rates have risen to a lesser extent in Europe. Despite plenty of media coverage, it is worth noting that the current increase has only brought 10-year US-rates back to pre-pandemic levels.



The gap between expected inflation and long-term U.S. interest rates is narrowing as a result of the rise in interest rates. The gap is still relatively high by historical means, which is why a further rise in U.S. interest rates cannot be ruled out.



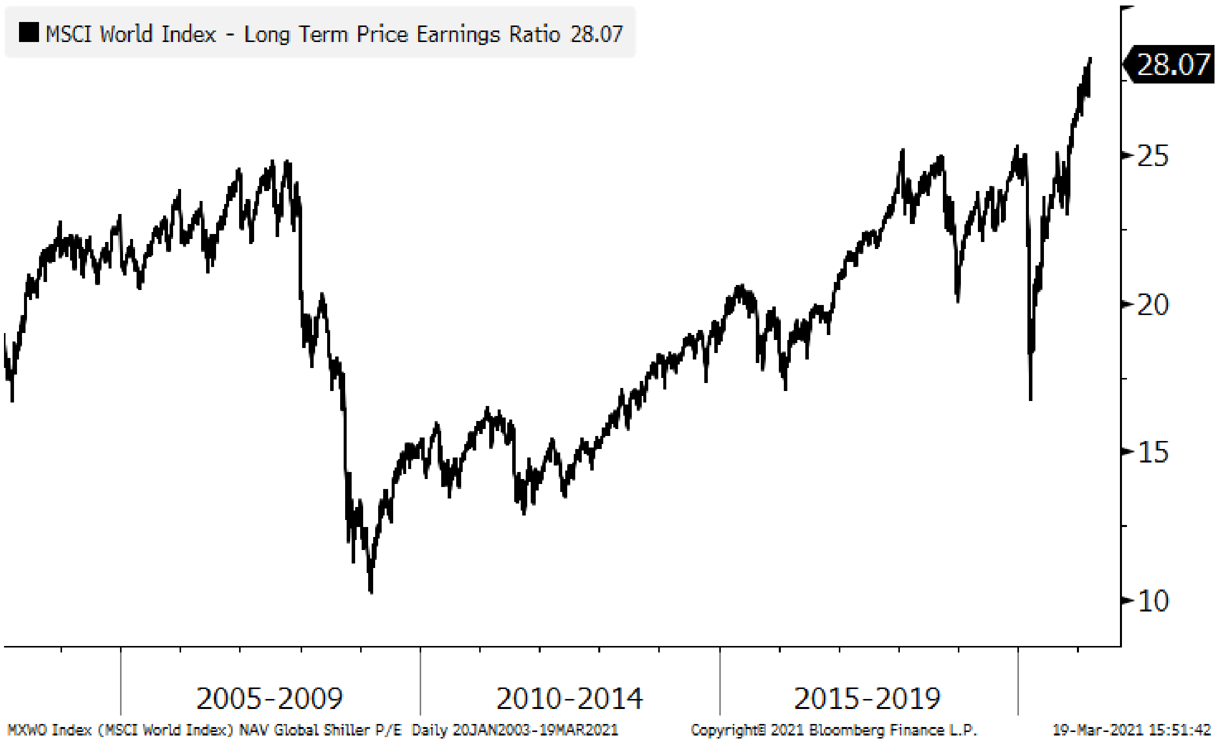
Spreads for all corporate grades have increased slightly since our last publication. Nevertheless, they are still at very unattractive levels.

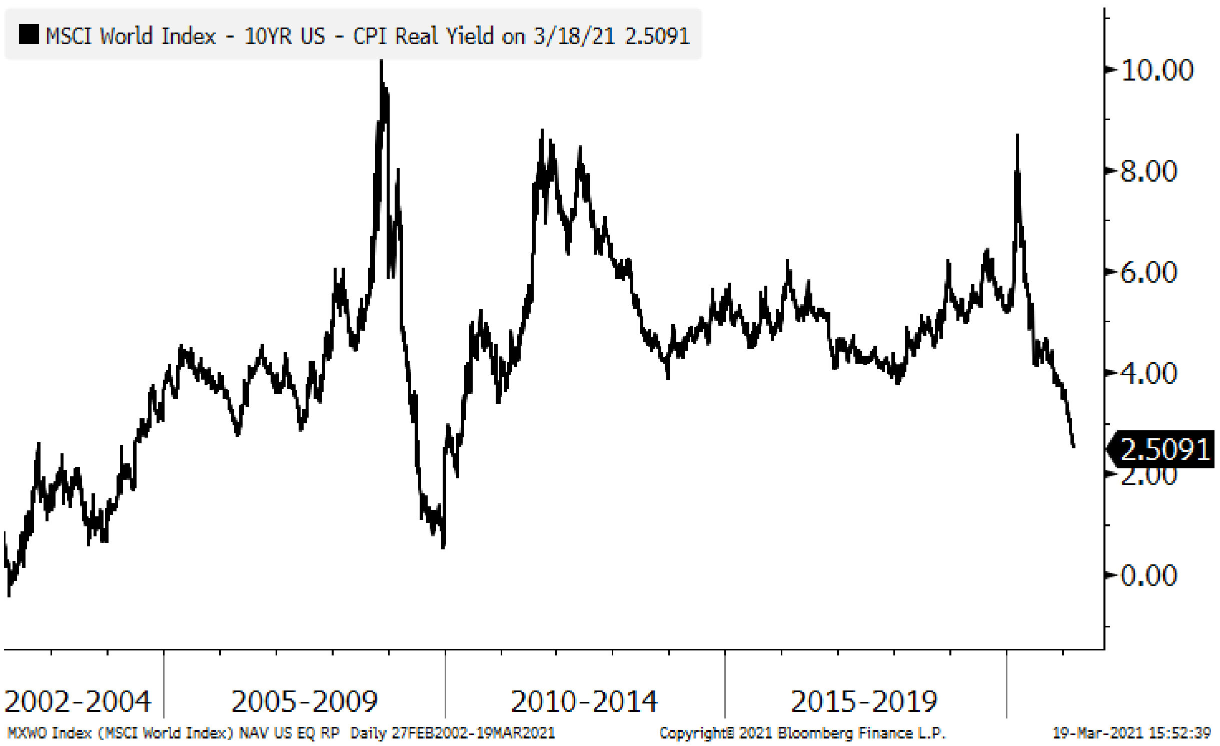


Shiller P/E ratio (indicator --) / Risk premium (indicator -)

Assessment unchanged / Assessment unchanged

The rise in global equities has pushed the Shiller price/earnings ratio up further. The absolute valuation remains unattractive. Furthermore, the rise in interest rates has led to clearly lower risk premiums, especially in the US, and makes the market look unattractive in relative terms as well.

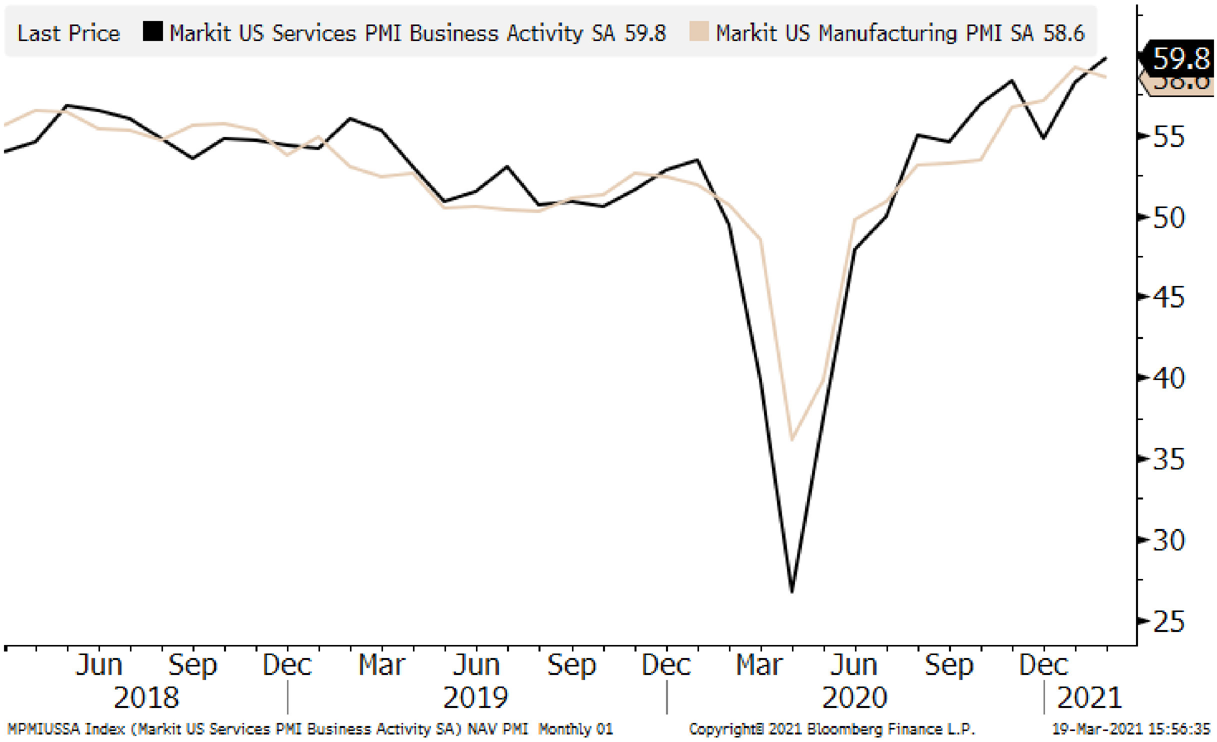




Macro leading indicators (indicator +)

Assessment unchanged

Leading indicators are developing encouragingly, particularly in the US, and show positive signs of a successful vaccination campaign and a reopening of the economy.



Risk index (indicator -)

Assessment unchanged

Further inflows into the equity market, coupled with an increased risk appetite for cyclical sectors, have caused the countercyclical risk index to rise slightly. On an annualized basis, 2021 holds the largest equity inflows on record. The risk index thus remains negative.

Appendix:

The Navigator is the central tool for our investment allocation. We use it to systematically and consistently assess the aspects that are relevant to the development of the financial markets. As a result, our clients can rely on a rational and anti-cyclical implementation of our investment decisions.

- Focusing on the essentials: Interest rate level, risk premium, valuation, economic development, investor sentiment and positioning. These are the decisive factors for success on the financial markets, especially in turbulent times when the temptation to react irrationally to the headlines is particularly strong.
- Comparability over time and place: The factors mentioned above are equally relevant for all markets and at all times. This is the result of a strict «backtesting» process that continues into the future.
- Cumulating our investment experience: Our strength lies in the many years of experience of our partners and principals. It is precisely this experience that we summarize and make applicable with our Navigator.
- Transparency: Thanks to our monthly publication, our clients always know where we stand in the investment cycle and where the financial markets are headed.

Datasource: Bloomberg