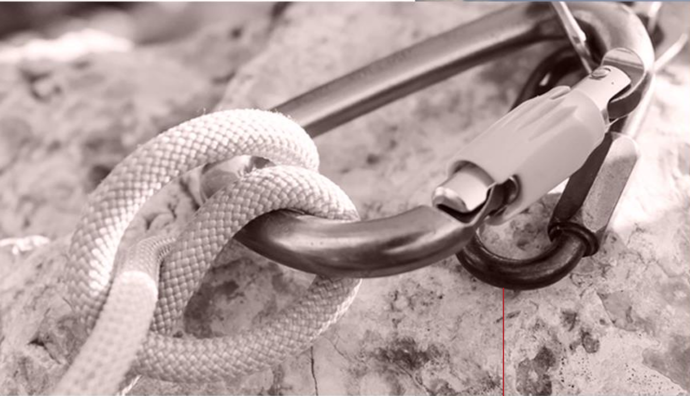
THE ESSENCE



1. Macro, Fixed Income and Rates
2. Equity
3. FX and Commodities

Key Take-Aways

- The general environment continues to be one of abundant liquidity and low interest rates. Investors are therefore «forced» to migrate to risk and «relative growth prospects»
- Expensive assets are expensive because of the above-mentioned factors. Stretched valuations in equities can stay that way for longer than one expects
- We therefore recommend staying invested in equities with a neutral positioning. We think it's difficult to time the sectorial rotations and consequently recommend a balanced approach with exposure to both value via Europe (e.g. UK, Germany) and growth (e.g. large cap US tech)
- The Fed is in a difficult situation with no easy exit from its current policy of loose money. It is therefore expected to remain the money printer of last resort for the foreseeable future
- Signs of higher inflation are appearing. Is it transitory or will it stay for some time with us – difficult to say
- Speculating on tapering, however, could well appear to be a costly strategy
- Nevertheless, we think that current signs of inflation will haunt markets and investors. Temporary rises in yields are possible and will lead to opportunities and stress in equity markets
- Treasuries and investment grade bonds are extremely expensive. Unfortunately, cash is not really an option where negative interest rates apply
- The Swiss franc will retain its haven status thanks to a prudent budget and fiscal approach in Switzerland
- We foresee the USD, EUR and JPY to remain stable against each other. EM currencies do not appear to be attractive in this environment

Macro, Fixed Income and Rates : Transitory inflation

Three key themes as we head into the heart of Summer: the recovery, the transitory nature of inflation and the consequences of government stimulus.

The pandemic-induced panic, anxiety, and despair endured by humanity is diminishing. The intensity of our emotions and the angst in our memories will also recede.

However, the consequences of the government pandemic-response will remain with us well beyond our generation. The impact and resonance of these events are monumental, and they have no historical precedence. They are tectonic, they are accelerating, and they come with great permanence. We must battle through the shifting dynamics of finance and economics to discern truth.

As lockdowns are lifted in the rich world, the effects of stimulus and vaccines are becoming more obvious. The post-pandemic transformation of the economy promises to evolve at a staggering pace and scale.

The Treasury bond market has been range-bound for two months. This is remarkable considering the most recent economic data: Q-1 GDP rose at 6.4%, Personal Consumption is rising at 11.3%, Import Prices are rising at 10.6%, Producer Prices are rising at 6.2%, and Consumer prices are rising at 4.2%. These numbers are epic. It is a faulty assumption however, to surmise that they can be studied in isolation.

Global central bank activism is focused on financial stability and this requires extremely, and permanently, low interest rates. The Fed will remain a supportive influence on interest rates for the foreseeable future.

Look no further than Japan. The BOJ has been trying for 30 years to inflate the economy. Despite astonishing stimulus, and almost a complete ownership of the JGB market, and an enormous, and rising, percentage ownership of the Japanese equity market, Their agenda can only be viewed as an abject failure. The economy is slowing, and prices continue to fall.

Is Mr. Powell correct when he says that inflationary pressures are transitory?

The disinflationary macro trends which have been in place since 1980 are not only still with us…they are accelerating. Superficial comparisons to the real structural inflation we saw in the 70's does not stand-up to rigorous scrutiny.

For most in support of the disinflationary, slow-growth argument are the prospects for employment. Improvement in the U.S. employment conundrum is the clear and stated objective of the Fed.

Furthermore, it will also be impossible for the Fed to reduce its balance sheet. The economy requires more leverage. We are currently witnessing the greatest redistribution of debt in history. Debt is rising at the federal level and falling at the household and corporate levels. This is by design. The multiplier of debt-to-output is decelerating at a worrisome rate. The Fed knows this too. Reduction of stimulus presents a problematic outcome. That being a financial crisis and a probable recession.

The Fed is willing to live with distortions, and income inequality for, what they perceive is, the greater good. We are not sure that is true. What is certainly true is that we can expect very stable and very low short-term borrowing rates for the foreseeable future. In the short-term, episodes of slightly higher inflation are therefore possible.

Nevertheless, expect the Fed to buy more bonds, and provide more stimulus if the market panics. Any abbreviated, misinterpreted spike in yields will be bought by savvy investors.

We believe there is no value in credit. Risk/Reward metrics imply the owner is the high probability loser.

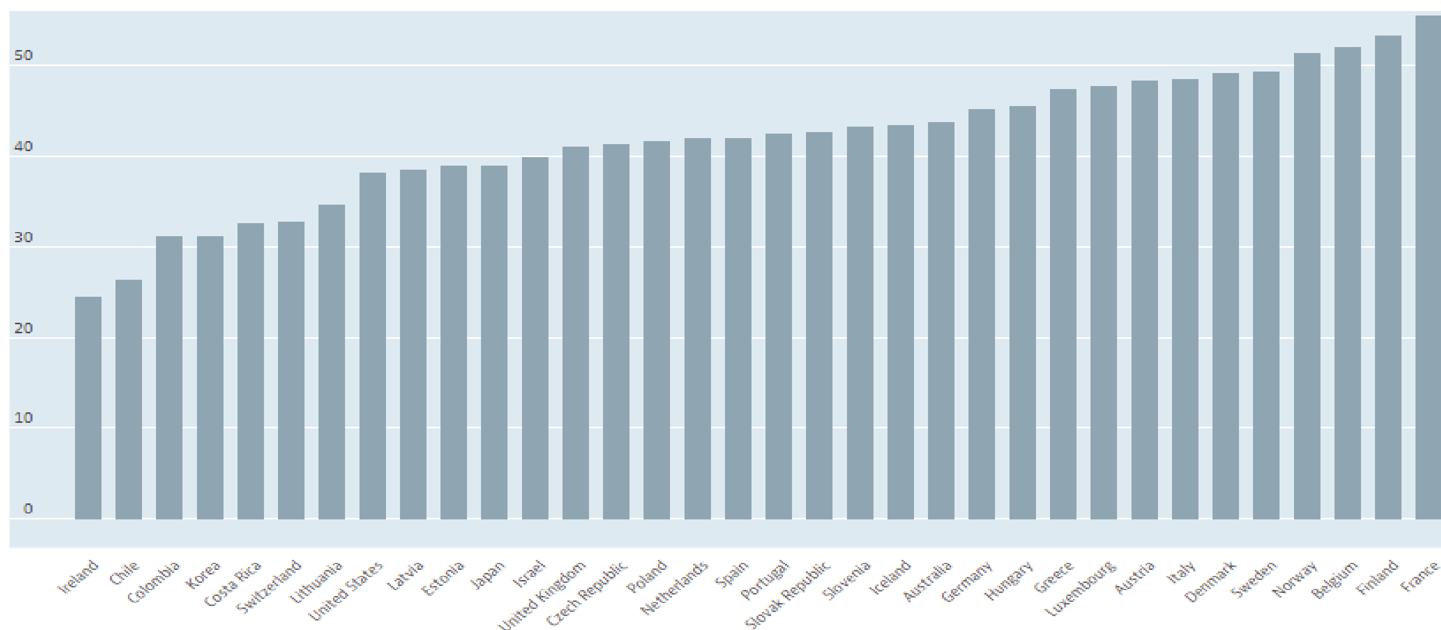
Equity : Goldilocks with Risks

The equity market has been range-bound for three months. This is remarkable in light of profits and profit-margins of corporate America being higher than ever.

The mitigating factors are the anticipated disinflationary slow-down and the drag on output as a result of higher taxes. The higher prices of food and energy for the majority of households results in a reduction of disposable income. The fiscal spending bill, if it becomes law, must be paid for with higher taxes, and will clearly result in the government's larger, and much less productive, contribution to the overall output of the U.S. economy. A reversion to below trend growth is the calculated outcome.

Many feel the new administration's progressive agenda is just and politically appealing. This is, at least, partially true. Elsewhere, we see what such policies have done for example to Europe. Once an economic powerhouse, the EU is becoming a global economic bystander. Europeans are quick to point-out that only 35% of government revenues in the U.S. come from taxes and thus should rise. In Europe, the total government take of economic output is close to 50%. It will be difficult for government to demand much more.

General Government Spending (Total, % of GDP, 2020 or latest available)



Source: OECD

Business in the U.S. is unique. American businessmen are collectively huge risk-takers because risk means a "justifiable" reward. American businessmen swing for the fences and are not afraid to fail.

The European model of governance, which mandates higher income taxes, corporate taxes, capital gains taxes, and estate taxes, would crush the American version of free market capitalism.

Beyond destroying employment prospects, bigger government in the U.S. will greatly reduce disposable income, smother innovation, and discourage entrepreneurial initiative. The quest for shareholders, financing partners, and a more competitive tax regime would require businesses to seek opportunity abroad.

This progressive administrative agenda to redistribute wealth is understood, by at least half of the population, as a pervasive assault on freedom. The non-economic, progressive agenda being promoted by the new administration will lower investment and employment opportunities. This will reduce state and municipal tax revenues. Vital public services will be much more difficult to fund in core cities. This can only result in diminished public services, more crime, an even-greater exodus of taxpayers from cities, and more societal hardship on those who need it most.

On another interesting note, the National Bureau of Economic Research reported this week that 30% of work in the post-pandemic U.S. economy will be performed remotely. Remoteness is transforming, reconstructing, and revolutionizing the U.S. economy. This is as negative to downtown commercial real estate and small business, as it is positive for disruptive innovations and transformation technologies.

As we look at equity markets it seems that we need to look beyond the headlines and consider how new economic, technological, and societal forces impact a company's ability to extract, capture, and originate value.

One such example is Amazon which is paying $8.5bn to purchase the film studios of MGM. Why would they do that? Amazon will now be able to offer its 200m Prime subscribers a library of 4,000 films and 17,000 TV episodes at an investment of less than $50 per Prime subscriber. Amazon is enhancing its ability to capture value. They will be doing to entertainment what they did to retail. "Put the other guys out of business.".

Growth stocks could move back into the limelight provided that interest rates remain calm.

In Europe, the German DAX is our favored index but it is trading at the upper end of the trading range. Spain and the UK are still lagging.

While investors need to remain invested, falling volatility points to increasing complacency and risks.

Main positions of the «Direxion Work From Home» ETF and their estimated P/E and adjusted EV/EBITDA. The green positions are recommended at Cité Gestion SA

	P/E	EV/EBITDA
Proofpoint Inc	81.4	198.2
Box Inc	31.7	34.5
Fortinet Inc	58.0	38.7
Facebook	22.0	17.8
NetApp Inc	17.7	12.9
Oracle Corp	17.8	11.1
IBM	13.3	8.9
Cisco	16.3	11.0
Alphabet	24.8	18.8
America Movil	13.4	n.a.
Nutanix Inc Class A	n.a.	n.a.
VMware Inc	23.9	17.5
Adobe Inc	42.1	44.4
Hewlett Packard	8.8	5.4
Microsoft Corp	31.3	21.8
Slack Technologies	701.9	n.a.
Progress Software Corp	13.8	11.6
Amazon.com Inc	46.7	31.1
Marvell Technology Inc	35.8	51.4
DocuSign Inc	139.7	n.a.
Palo Alto Networks Inc	54.4	197.1
Broadcom Inc	16.3	15.4
Vonage Holdings Corp	54.9	32.7
Ping Identity Holding Corp	170.4	142.2
Inseego Corp	n.a.	260.5
Atlassian Corp PLC Class A	176.3	394.6
Zscaler Inc	379.0	n.a.
Zoom	77.2	147.5
Crowdstrike Holdings Inc	495.4	n.a.
FireEye Inc	47.2	n.a.
Avaya Holdings Corp	8.7	5.9
Xerox Holdings Corp	11.4	8.8
Workday Inc	77.2	148.7
Alibaba Group Holding Ltd	21.7	37.9
Plantronics Inc	10.9	13.7
Okta Inc Class A	n.a.	n.a.
Upland Software Inc	21.4	29.5
RingCentral Inc Class A	189.5	n.a.
8x8 Inc	408.7	n.a.
Aurora Mobile Ltd	n.a.	n.a.

Source: Bloomberg

FX and Commodities: The Swiss Franc is King

The Swiss Franc is a haven currency in a maelstrom of central bank profligacy. It can come as no surprise to observe that the currency is up by almost 400% since Nixon took the dollar off the gold standard in 1971.

The shocking reality of Modern Monetary Theory and the advent of exorbitant fiscal spending initiatives will be difficult to roll back. It is much more of a "Non-fiat currency" than the tradeable "Majors". Swiss regulation, compliance and governance procedure can be relied upon to a degree not found in most places.

As the Swiss Franc outperformed the dollar in March of 2020, we would expect CHF to outperform any other currencies should a volatility chapter emerge.

We believe the Dollar, the Euro and the Yen will remain reasonably stable against each other. The G-3 un-holy alliance of central bank balance expansionism and excessive indebtedness binds them together in weakness.

Emerging market currencies broadly speaking will underperform as their economies are under performing and money is flowing away from their countries.

The US dollar weakness against the yuan has captured our attention.

This is significant as the yuan has appreciated by 11% against USD in the last 12 months. Of course, interest rate differentials play a significant role in currency valuations. The PBOC raised rates this month by 2% to 7%. U.S. rates have been anchored at 0 % for 18 months. Few investors will choose to put cash on deposit in China instead of the U.S., but some Chinese may very well opt for a crypto instead of a dollar.

The strong yuan trend vs USD raises some concerns: instead of exporting deflation as it has done for decades, the Chinese actually could begin to export inflation. This must be monitored closely in the years ahead as it would be a game-changer.

Swiss franc: 50 years of appreciation against USD.

Source: Cité Gestion

As far as commodities are concerned, we believe that food and energy are measured outside of headline inflation figures for a reason.

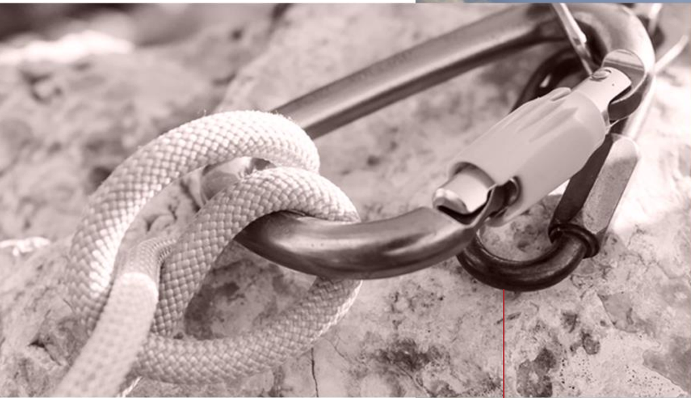
These commodities, along with many other raw input materials, are routinely subject to supply disruptions. This time is no different. The markets will adjust.

There is a saying which maintains that the best way to combat high prices, is with higher prices.

It may take longer than some would like, but the supply chain chokehold hampering delivery of goods (that people want in a hurry) will revert to average.

Total demand for goods and services, will remain well-below pre-pandemic levels. The same is true for aggregate wages, and for the overall demand for money (which was trickling feebly out of the banking system -to the economy- well before the onset of the pandemic.)

GDP will not match pre-pandemic levels for years.



By choosing Cité Gestion, you will benefit from our unique business model which sets us apart from most traditional wealth managers. Learn more on our website : www.cité-gestion.com

And follow us on LinkedIn to stay connected to all market news and perspectives.

Disclaimer and important information

This document has been published in Switzerland by Cité Gestion SA, Geneva, a custodian and securities dealer subject to regulation and supervision by the Swiss Financial Market Supervisory Authority (FINMA). It is not intended for distribution, publication or use in any jurisdiction where such distribution, publication or use would be prohibited, and is not directed to persons or entities to whom it would be unlawful to send such a document. All information provided in this document, in particular opinions and analyses, is for information purposes only and should not be construed as an offer, advice or recommendation to buy or sell any particular security or to enter into any transaction. Nor does this publication constitute - and should not be construed as - an advertisement for a particular financial instrument. The risks associated with some investments are not suitable for all investors and a precise assessment of the risk profile must be made. Nor should this document be construed as legal, accounting or tax advice. Although Cité Gestion SA makes every reasonable effort to use reliable and complete information, Cité Gestion SA makes no representation or warranty of any kind that the information contained in this document is accurate, complete or up to date. Any decision based on this information must be made at the investor's risk and Cité Gestion SA declines all responsibility for any loss or damage that may result directly or indirectly from the use of this information. United States: Neither this document nor any copies thereof may be sent, taken or distributed in the United States or given to a US-Person. This document may not be reproduced (in whole or in part), transmitted, modified or used for public or commercial purposes without the prior written consent of Cité Gestion SA.