Letter from the CIO

BANQUE HERITAGE

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Outrunning Delta

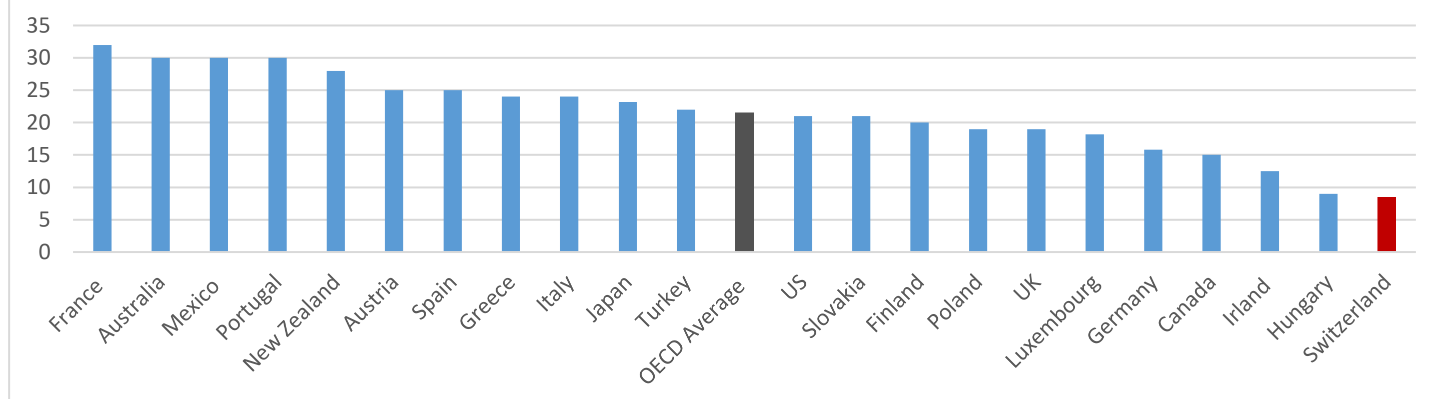
The month of June was marked by the exponential increase in cases of COVID 19 linked to the Delta variant, first discovered in India in October 2020. This new-found freedom, which we mentioned in our last newsletter, seems to be restricted again, the appearance of a 4th wave being only a matter of time. Fortunately, vaccination campaigns are well underway, and proving that vaccines work. In Israel, for example, where nearly 60% of the population is fully vaccinated against the virus, the figures are promising. While the vaccine's efficacy in terms of contamination and the development of Delta variant symptoms is estimated at 64%, the efficacy in preventing severe cases remains above 90%. Vaccines therefore make it possible to control the pressure on the hospital system and avoid overly restrictive containment measures. However, the rate of vaccination is showing signs of slowing down in all countries, and governments have understood that if they want to avoid closing economies, they will have to encourage the rest of the population to get vaccinated. As an example, France has just surprised everyone this week, by announcing a compulsory vaccination for healthcare workers as well as the implementation of the "health pass" for access to cafes, restaurants and even means of transport. And it is a safe bet that other countries will follow suit, as no government wants to go backwards. Despite these latest developments, the markets continued to advance during the month of June, some reaching new records.

In Switzerland, the SMI Index posted an increase of more than 5% over the month, fueled by the good performance of its pharmaceutical sector (Lonza: + 13%, Roche: + 11% and Novartis: + 7%). The US market also outperformed the World equity index, thanks to technology stocks which benefited from the fall in long-term interest rates in the United States. The Nasdaq thus closed with a performance of 5.5%, while financials, whose business model benefited from steepening yield curves, ended in negative territory. On other asset classes, we note the significant fall in long term rates in the United States, the market fearing an economic slowdown. The dollar also appreciated strongly (DXY: + 3%), while gold tumbled 7% over the month.

With global stock market indices closing the first half of 2021 at record levels, and the Fed preparing the ground for the deployment of more restrictive monetary measures, should we fear the near end of the current economic cycle? We do not think so. Admittedly, macroeconomic dynamics seem to have reached a peak, particularly in the United States, where the ISM manufacturing index has shown signs of slowing down since March. Certain signals are also appearing at the company level where the dynamic of upward revisions to results shows a deceleration in profit growth from the end of 2021. However, these levels are still historically high, thus demonstrating the strength of recovery. We remain convinced that after an economic recovery of unprecedented magnitude, the growth potential remains significant, supported by the abundance and maintenance of liquidity, by the reopening of borders, and by the recovery of certain sectors of the economy (catering, tourism, culture). Household consumption continues to grow strongly, and investment in businesses is picking up massively. While it is true that sovereign long rates have shown mistrust of the sustainability of the cycle in recent weeks, it is highly likely that this sentiment is only temporary. The newly started Q2 earnings season should give us a clearer picture of both the strength of the cycle and its length, and we expect it to be pretty good. The start of the sectoral rotation of pro-cyclical stocks towards more defensive companies should therefore wait a few more months!

Source: Bloomberg / Banque Heritage

From a political point of view, following the G7's acceptance of the implementation of a 15% minimum tax rate for companies worldwide, the G20 in turn approved this text last weekend during its meeting in Venice. In search for new revenue to pay off the abysmal debts contracted by countries to deal with the COVID crisis, this text, initiated by the OECD and supported by the US Treasury, aims to put an end to tax competition between countries. It will certainly take a lot of energy to get it adopted, especially in the American Congress, or within the European Union where countries like Ireland and Hungary still apply rates of 12.5% and 9% respectively. This text is definitely a major step forward in terms of fiscal harmony, as it could concern up to 10'000 multinationals and generate additional revenue of around 150 billion per year according to the OECD. Subsequently, the agreement also provides for the reallocation of a share of the income tax paid by multinationals to so-called "market" countries, i.e., those where they carry out their activities. The direct target is obviously the GAFAs which have experienced exceptional growth during the pandemic and paid relatively low taxes. The next few months should be decisive and negotiations between now and the next G20 summit in Rome in October should go well!



Source: OECD / Banque Heritage

Our Investment Committee decided at the beginning of July to take some profits on certain pro-cyclical securities within the portfolios, thus reducing our overweight in equities maintained since the beginning of the year to neutral. As explained above, we do not believe that the economic cycle is in a reversal phase, and we remain in favor of a significant exposure to risky assets. However, the market uncertainties reflected by the flattening of the yield curves, combined with the summer period generally characterized by low volumes, make us fear an increase in volatility over the next few months.

In other asset classes, bonds remain strongly underweighted in our allocation, favoring corporate credit over sovereign debt. The strength of the recovery and refinancing conditions should help prevent defaults in the medium term.

Finally, we maintain a significant weight in strategies with a low correlation to traditional assets, such as hedge funds and gold, although the latter currently seems very dependent on the evolution of the dollar.

Have a nice summer.

Jean-Christophe Rochat, CIIA
Chief Investment Officer

BANQUE HERITAGE

BANQUE HERITAGE SA
Route de Chêne 61
Case Postale 6600
1211 Geneva 6
Switzerland

www.heritage.ch