

More volatility ahead?

Another month and another new high in US equity markets. Despite Hurricane Ida, the Delta variant, 5.3% inflation, ongoing pressure on Chinese stocks and the uncertainty over the outcome of the Fed's annual Jackson Hole retreat, equities, in August, kept on rallying.

Progress on US fiscal stimulus was slow and steady albeit the numbers now being discussed are dramatically lower than months ago. The bipartisan infrastructure deal of roughly USD 1 trillion passed in the Senate. The deal includes USD 550 billion in new federal investments in physical infrastructure, spread over five years. The infrastructure bill now moves to the House for approval.

The infrastructure bill may be passing in the nick of time. President Biden's approval rating is doing the opposite to the path of US stocks! It's plummeting and Vice President Harris's polling looks dramatically worse. One facet of this, for which they can thank Mr. Trump, is Afghanistan. Perhaps we will never know the details but the strategic mismanagement on the ground and internationally is clear. Does this mean Democratic party support is also lessening and what does this mean for next year's midterm elections? If further fiscal policy does not appear the Fed may need to step up QE.

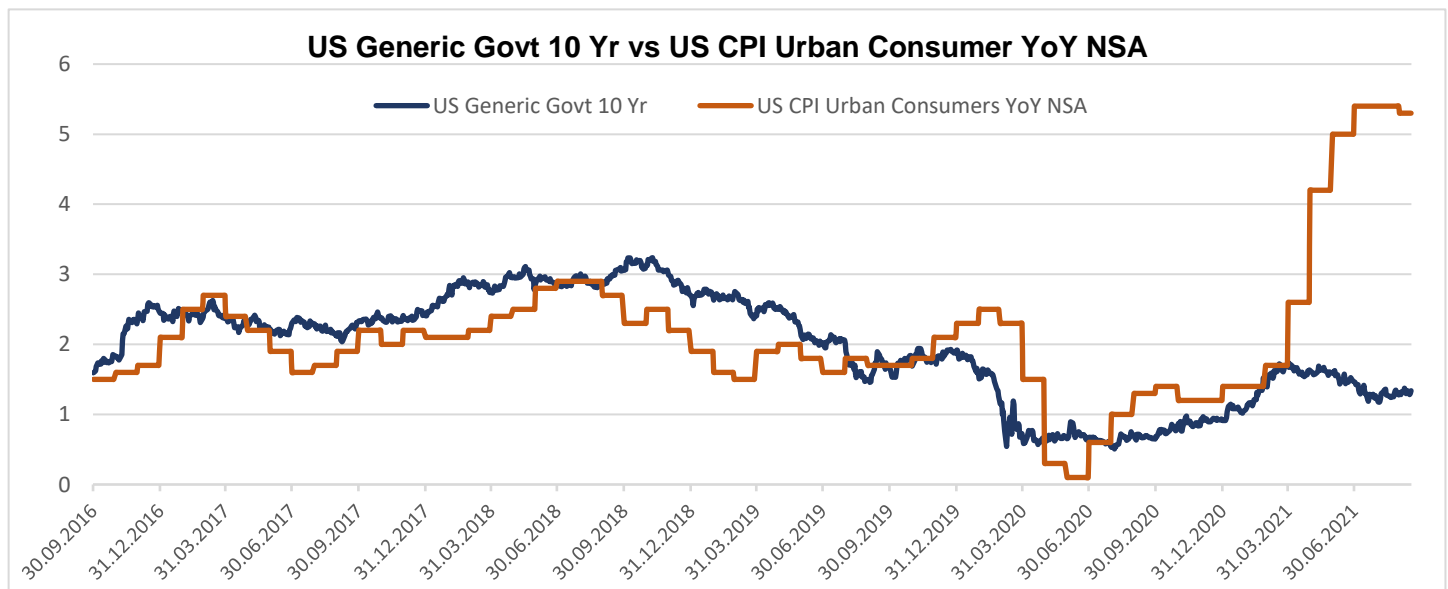
The annual Jackson Hole symposium didn't worry markets as Chairman Powell struck a cautious tone and put off any tapering announcement until Q4. He spoke

about requiring further progress in the labor market which means USD 120 billion of bond purchases per month continues.

European and Swiss equities had another good month rising over 2.5% in August. Continuing positive earnings releases saw Information Technology among the strongest performers with semiconductors continuing to benefit from high demand. Luxury goods came under pressure as Chinese political changes come to bear. The Chinese authorities want increased wealth distribution and along with bankruptcy concerns on some major property companies Chinese related securities came under pressure.

In other markets bond yields rose (prices fell), commodities and oil struggled with gold and the US dollar finishing the month unchanged.

US CPI inflation hit 5.3% in August with German EU-harmonized CPI hitting 3.1%. Yet markets don't care, in the same way that markets haven't cared about the threat of Covid since the vaccine announcement last November. For a bond investor inflation is public enemy number one. The fixed return you receive from a coupon each year is diluted by that inflation. But US government bond yields, on a 5-year maturity, remain at 80bps. Gold, too, is down this year with its inflation protection having deserted it.



Source: Bloomberg / Banque Heritage

Since the peak in bond yields back in 1980, we have been in a disinflationary environment and that has become engrained into our thinking. With a huge accumulation of debt on public and private balance sheets, the rapid speed of technology and the slow grind of demographics these three factors are strong systemic disinflationary forces.

Our view remains that inflation should slowly fall from current levels over the next 12 months. A higher average inflation rate going forward is likely as we return to 'normality' post last year's crisis. Supply chains could potentially take another year to get anywhere near 'normal'. Inflation is a notoriously impossible phenomenon to predict with inputs from commodities,

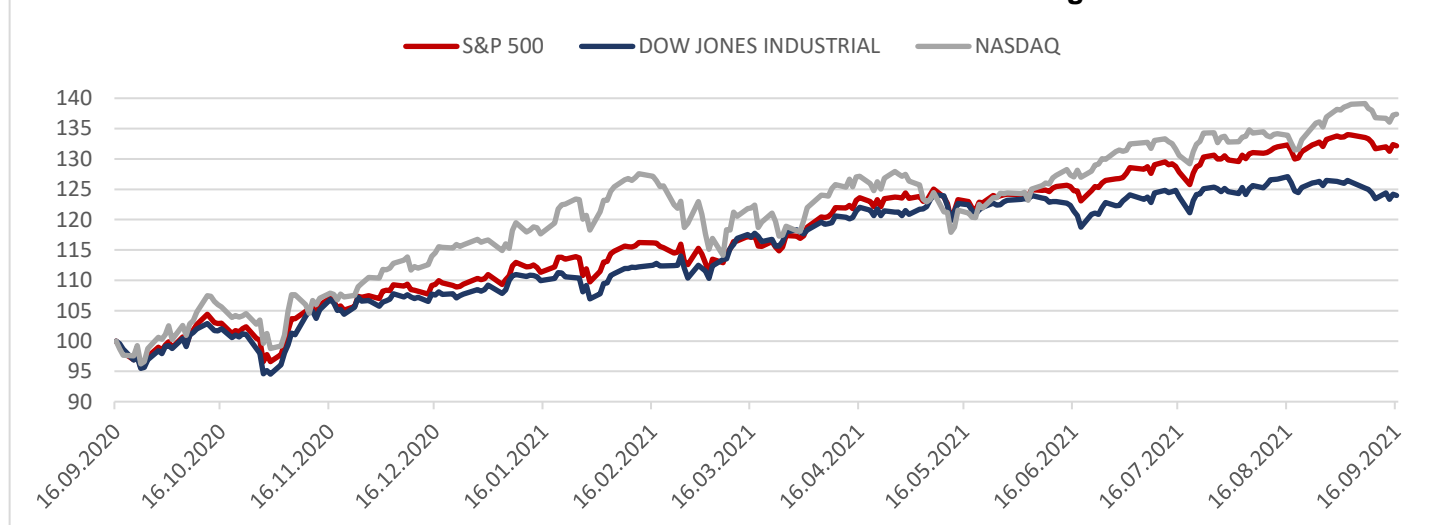
energy, currency, consumption, housing, transportation, food etc. The risk is a permanent change in psychology of the consumer. For the time the labor market remains distorted with enough job openings to satisfy the number unemployed but, yet no marriage between the two.

In Germany, who go to the polls this month, the political ire is rising in line with inflation. Whether Weimar fears do indeed live on is open to debate but with a low ownership of property or equities and a rising cost of living half the German population is being squeezed. Negative interest rates aren't helping in an environment where ECB buying

of Southern countries' debt is becoming very difficult to justify. German worries are being joined by Dutch and Austrian officials openly calling for tapering of bond purchases by the ECB. Nothing has really changed since the eurozone debt crisis; indeed, debt levels have increased. Italy's debt burden is 160% of GDP and rising. You can only kick the can down the road so far.

So, markets may not worry about current inflation levels but before long the impact socially, politically, or economically is sure to become a problem or level for change somewhere.

S&P500 vs NASDAQ vs Dow Jones Industrial Average



Source: Bloomberg / Banque Heritage

The investment committee has not made any changes for the beginning of the new school year in September. Our equity allocation remains neutral with a good diversification between cyclical and quality growth companies. Europe and the United States remain favored, while an underweighting is maintained on emerging markets. Uncertainty regarding the ongoing government's announcements in China and the health situation linked to COVID 19 in many emerging countries tempers indeed our current conviction

On the Fixed Income side, we remain mostly exposed to corporate credit. We maintain a balance between quality companies and high yield and favor the developed world regions.

Finally, we keep a significant portion of our alternative portfolio in uncorrelated assets as a source of diversification and downside protection.

Stay safe!

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