

Vontobel

# Investors' Outlook

Anything for Christmas  
but coal

December 2021 /  
January 2022



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Bank Vontobel AG  
Gotthardstrasse 43  
8022 Zurich

### **Editor**

Martin Gelnar

### **Authors\***

#### **Reto Cueni, PhD**

Chief Economist,  
Vontobel

#### **Stefan Eppenberger**

Equity & Commodity Strategist,  
Vontobel

#### **Frank Häusler**

Chief Investment Strategist,  
Vontobel

#### **Michaela Huber**

Economist,  
Vontobel

#### **Daniel Maier, CFA**

Head Thematic Investing,  
Vontobel

#### **Mario Montagnani**

Senior Investment Strategist,  
Vontobel

#### **Sandrine Perret**

Senior Economist,  
Fixed Income Strategist,  
Vontobel

#### **Sven Schubert, PhD**

Senior Investment Strategist,  
Head of Strategy Currencies,  
Vontobel

#### **Dan Scott**

Chief Investment Officer,  
Head of Investments & Thematics,  
Vontobel

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# Anything for Christmas but coal

Dear readers,

What gift does Santa have in store for us this time? Will his sleigh be brimming with plastic toys and fast fashion from far-off places? Will Rudolph and his fellow reindeer have a lighter load to lift because the North Pole-bound container ships are still stuck at port? Anyway, we can be pretty sure the red-clad gentleman's sack won't contain an increasingly toxic item: coal. The same holds true for **Befana**, Santa's broom-wielding female counterpart, who will hardly distribute lumps of **carbone** in Italy.

The black stuff, originally useful as heating material around Christmas, has long become a signifier of naughty behavior when stuffed in a kid's stocking near the fireplace. Today, with the memory of the wrangling over coal at the United Nations' climate change conference COP26 in Glasgow still fresh, it is even less in favor.

## The alternatives: renewables or even nuclear energy

"Never touch coal" may be one of our New Year's resolutions, but we know what happens to those. We all agree on the direction of travel: the world must cut greenhouse gas emissions quickly. Just like many New Year's resolutions, however, achieving carbon neutrality by 2050 (or even earlier) may be too ambitious. Our power grids may have weaned themselves off coal but currently still rely heavily on gas (around 60%) with renewables accounting for just under 30%.

This is a big step in the right direction. Nevertheless, we know how vulnerable our power grids are when the sun doesn't shine or wind doesn't blow—remember, for instance, last year's exceptionally cold winter in Texas that kept the windmills from turning. We cannot afford to ramp up our dependence on renewable power without



—  
**Dan Scott**  
Chief Investment Officer,  
Head of Impact & Thematics,  
Vontobel

innovation in power storage. At the moment, battery technology isn't sufficiently developed to store enough renewable power. There are, of course, other technologies, like pumped-storage hydroelectricity (often used in Switzerland's system of hydroelectric dams), or energy storage by way of flywheels or compressed air. Even so, none of them are as efficient as traditional (pollutive) forms of power generation. If we really want to get to net zero by 2050, we may need to reassess our view on nuclear energy—a controversial proposal but one that many countries are increasingly considering in light of our war on fossil fuels.

## Will we take up the "decarb" diet?

Let's hope we will, for the sake of the planet and our children, embrace a much-needed decarb diet after the pudding-heavy Christmas of the industrial revolution. At the same time, we should take care not to be too ambitious with our New Year's resolutions. Failing that, we may find ourselves in the midst of an energy crisis with significant parts of the population unable to afford heating for their homes. In such a case, power-hungry consumers would probably start wishing for Befana and her sacks of coal again.

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## → Webcast

To view our webcast on recent market developments, click:  
**[vonto.be/macro-en-dec21](https://vonto.be/macro-en-dec21)**

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## 4 Investment strategy



**Frank Häusler**  
Chief Investment Strategist,  
Vontobel



**Mario Montagnani**  
Senior Investment Strategist,  
Vontobel

# Inflation and energy worry us but we retain our positioning

Things usually calm down around Christmas, and many of us would welcome some respite after a couple of hectic months. But the financial markets aren't exactly at ease going into 2022. Inflation still is the talk of the town, except in Switzerland, where there is hardly any price pressure to speak of. This is to a large part due to the strengthening tendency in the Swiss franc. Stagflation is another concern, albeit not part of our scenario. We believe that economic growth will be strong enough to avoid stagflation, and expect inflation to moderate in 2022. More on those topics on the following pages.

The nervousness on financial markets contrasts with our steady hand when it comes to allocation. After upgrading the subsegment of US stocks in October, we are reaffirming our moderate equity overweight. One of the advantages of this asset class is that it can digest higher inflation rates better than fixed income. Regarding the latter, our longstanding underweight remains in place as well. On the alternatives side, commodities would seem like a good opportunity but the entry point after a recent rally is hardly optimal. Gold remains a valuable cushion against unexpected negative developments. For details, see the overview page 5 or read the asset class-focused items on pages 16 to 19.

	UNDERWEIGHT		NEUTRAL	OVERWEIGHT		
	significantly	slightly		slightly	significantly	
<b>1</b> <b>Liquidity</b>				→		Our small cash overweight remains in place. While we don't recommend holding much liquidity in an environment of low or negative interest rates, a certain amount is warranted to seize "buy-the-dip" opportunities.
<b>2</b> <b>Bonds</b>		→				We stand by our slightly negative stance. The current interest rate environment isn't bond-supportive, and prospects of a slower-than-expected drop in inflation readings bode ill for bonds' fixed interest payments. This, combined with low spreads and our expectation of slightly higher key rates over the next 12 months, suggests a cautious approach. Our views on the sub-segments remain unchanged. While emerging markets debt still offers some solid returns, government bonds hardly do (but we still have a neutral rating on those). Investment grade (IG) corporate bonds remain uninspiring, in our opinion. Our neutral rating on high yield bonds remains in place.
<b>3</b> <b>Equities</b>				→		We are comfortable with our current positioning. A "post-peak" growth environment doesn't mean there will be negative equity returns. It simply increases the likelihood of lower, but still positive, returns. Also, we believe that equities can rise some more despite recent rallies and prospects of central banks reducing their extraordinary liquidity injections. Moreover, recent earnings reports have demonstrated the ability of many companies to protect their margins. Finally, there are expectations of high dividend payments and significant share buybacks, particularly in the growth-oriented US corporate sector. Within equities, we retain our double overweight on US stocks. The American equity market has an appealing sector mix and a clearer "growth" focus than that of the euro zone, which is more geared towards so-called "old economy" or value sectors. We retain a neutral rating for Swiss, Japanese, as well as emerging market equities, and a negative one for euro zone stocks.
<b>4</b> <b>Gold</b>				→		We reiterate our slightly positive view on gold. While we acknowledge that the yellow metal is facing some headwinds in the form of potentially higher interest rates, particularly real rates, we like it for its diversification and hedging qualities. Gold would be a safe haven in the event of armed conflicts or unfavorable developments on the inflation front. A stagflation scenario, however unlikely, would also benefit the metal.
<b>5</b> <b>Commodities</b>			→			An unchanged neutral stance seems reasonable here. The asset class has gained tremendously on the back of the cyclical reopening of the economy, but prices have gone up too far and too fast. The longer-term outlook remains favorable with commodities likely to draw strength from huge investment plans under various decarbonization schemes, as well as supply/demand imbalances.
<b>6</b> <b>Alternative strategies</b>			→			Our moderate underweight in hedge funds remains in place. We maintain our neutral view on other types of alternative investments, such as insurance-linked securities. This leaves us with an overall neutral—and unchanged—view on alternative investments.



**Next year will be  
harder, better,  
tougher, “greener”**



Inspired by the Daft Punk’s “Harder, Better, Faster, Stronger”, we have adapted the song title to our needs. Next year will be harder, as China’s need for structural adjustments in several areas is likely to become more challenging. It will be better as we expect Covid-19 uncertainty and supply-chain confusion to fade, inflation to normalize and growth rates to slow but stay decent. It will be tougher given nagging questions about who will pay for the Covid-19 legacy of massively higher sovereign debt. It will be “greener” with climate change, and efforts to mitigate it, possibly replacing the pandemic as main talking point.



—  
**Reto Cueni, PhD**  
Chief Economist,  
Vontobel



—  
**Michaela Huber**  
Economist,  
Vontobel



—  
**Sandrine Perret**  
Senior Economist,  
Fixed Income Strategist,  
Vontobel



—  
**Sven Schubert, PhD**  
Senior Investment Strategist,  
Head of Strategy Currencies,  
Vontobel

Will economic growth be good or bad in 2022? That depends on the reference year. If you have last year’s average growth rates in mind, you will most likely be disappointed. But set against the averages in the decade before the start of the pandemic, next year’s increase will still be pleasing. Consumption should continue to be among the main drivers of the recovery, triggering further strong investment by companies. Overall demand, while not grinding much higher, will probably stay strong given that households have accumulated extra savings and profited from higher asset prices. We don’t expect governments to swiftly reduce their fiscal support, so the economy shouldn’t fall off a “fiscal cliff” in 2022. Lower overall public spending should keep second-round effects like lay-offs and sectoral restructuring (including bankruptcies) manageable. Important political events in 2022, such as the French presidential elections in April and the US mid-term elections in November, will hardly change this, in our opinion (for an overview of our baseline macroeconomic scenario, see the table on page 9).

Either way, we expect the currently still solid momentum to slow towards pre-Covid levels by the end of next year. The closer growth levels come to pre-pandemic trend growth (see chart 1), the tougher it will be for the economy to excel. Yet a return to more “normal” growth rates is important to calm down supply chain stress and ease price pressure.

Inflation should generally recede again, also because several price-driving base effects will reverse over the course of the first half of 2022<sup>1</sup>. This should bring inflation rates to close to or below the usual 2% target of the biggest central banks (see chart 2), diminishing the probability of sudden and faster-than-announced moves to tighten policy. That said, the monetary authorities are likely to decisively scale down their stimulus over the quarters to come.

1 Inflation rates soared this year, partly due to a base effect tied to energy prices. These fell massively after February 2020 and stayed low throughout 2020, pushing inflation down. So this year after February, the year-on-year price comparison has a very low reference point (i.e. a low “base” from 2020), which increases inflation mechanically throughout the current year 2021. This effect will reverse again and ease inflation pressure from energy prices in 2022, unless they would increase much further from here.



# 8 Macro highlights

What are the biggest risks to our baseline scenario? Given the seasonal pattern of the pandemic, new containment measures could again result in weaker growth in winter and a snap-back in summer (see euro zone part below). Also, tighter restrictions, among other triggers, could lead to new supply or energy shortages that would push prices higher, which, in turn, may lower demand (if wages don't rise fast enough) or start a so-called "wage-price spiral" (if wages keep pace with inflation), setting the scene for a period of persistently high inflation. Such a development could then prompt quick tightening action by central banks (see US part below). In addition, China's real-estate issues and other growth challenges will hardly disappear, and the government's success, or failure, to tackle the problems will bear on the global economy (see emerging market part below).

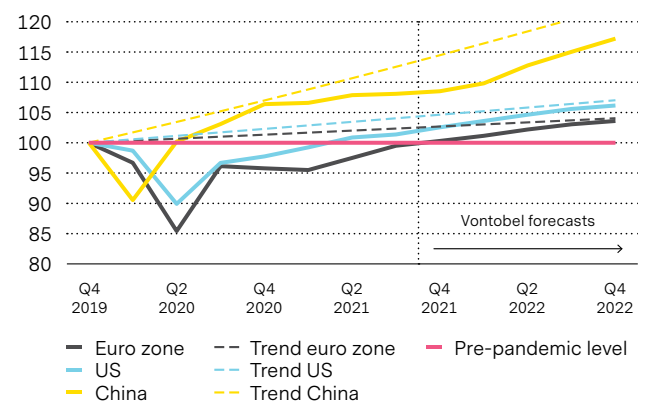
### Euro zone 2022: The year of the unsettled normalization

A new round of pandemic-induced restrictions in several European countries could once again keep consumers from spending. This should lead to a growth slowdown during the winter months but then trigger another rebound during summer, assuming a recurring seasonal pattern of Covid-19 restrictions. The economic outlook will depend on governments' management of the restriction and the re-opening, the ability of companies to invest and plan ahead based on such policies, as well as their effects on household consumption. We currently haven't penciled in a shift in consumer behavior in our euro zone outlook, still expecting private consumption to perk up, restrictions permitting. We also expect 2022 public spending, while below the 2021 level, to be still ample enough to support the economic recovery (particularly due to the European Union's recovery fund money for the peripheral EU countries), even in the event of temporary tight restrictions. This leaves us with a forecast of a still favorable annual growth rate of 4.4% in 2022 versus an estimated 5% for 2021.

Expecting the euro zone's inflation measure to drop below the European Central Bank's (ECB) inflation target in the second half of 2022, we don't foresee any fast monetary policy tightening (first rate hike not before 2023). The ECB's overall asset purchases will still amount to 20–40 billion euros per month next summer, down from above 80 billion euros at present. French elections are unlikely to produce any surprises. If we believe current polls, Emmanuel Macron, or a pro-business candidate of the rival French Republican party, will win in the second round.

**Chart 1: US and euro zone seen reaching pre-pandemic growth path 2022, China struggles to catch up**

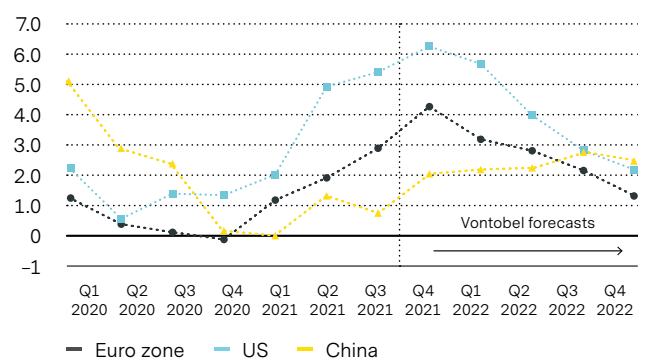
GDP indexed to 100 at pre-pandemic level (end of 2019)



Source: Eurostat, BEA, NBS, Refinitiv Datastream, Vontobel

**Chart 2: Inflation rates seen dropping back to central bank targets in the euro zone and the US**

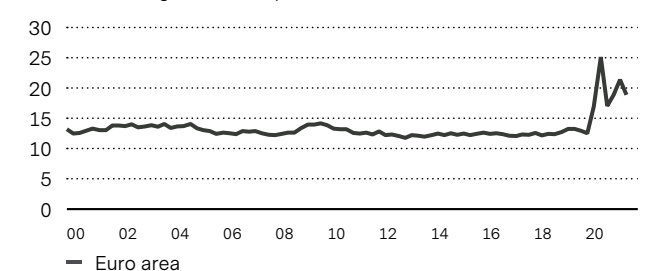
Quarterly inflation in % (year-on-year comparison)



Source: Eurostat, BLS, NBS, Refinitiv Datastream, Vontobel

**Chart 3: Consumers have some spending power left after high pandemic-era savings rates**

Household savings in % of disposable income



Source: Eurostat, Refinitiv Datastream, Vontobel, data per second quarter 2021



**Our economic baseline scenario for 2022:  
Harder, better, tougher, “greener” – and what could derail it**

**Baseline scenario:  
Harder, better, tougher,  
“greener”**

- **Global:** Still good growth after peak, inflation to normalize over H1, strong but less ample fiscal support
- **US:** Growth slows to pre-pandemic levels, inflation normalizes towards summer, much fiscal support
- **Euro zone:** Slowing growth rates but above pre-crisis levels, inflation abates in H1, recovery fund works
- **China:** Growth rates weak at the start of the year, fiscal and monetary policy become supportive in spring
- **Central banks:** Stepwise reduction of monetary policy stimulus, faster in the US than in the euro zone

**Important risks  
that could derail  
our baseline scenario**

**All these risks have the potential to significantly affect our baseline scenario – they could trigger a more positive or negative development:**

- Supply bottlenecks could intensify, pushing prices up, lowering demand if wage growth doesn't keep pace
- More fiscal stimulus and faster implementation could increase demand and spur inflation
- Covid uncertainty could remain high, keeping service consumption low and escalating second-round effects
- Escalation of property crisis in China, unfortunate monetary and fiscal policies could trigger economic turmoil
- Central banks could lose patience with elevated inflation, fast monetary policy tightening lowers growth

**Macro themes  
for 2022**

**Macro themes we consider important for 2022:**

- **Harder:** China's need for structural adjustment in its property sector, slowing growth and testing diplomatic ties
- **Better:** Supply-demand mismatches that caused inflation surge and energy crisis starting to fade in 2022
- **Tougher:** The long Covid-19 legacy of fading fiscal support, higher debt, and taxation, will surface
- **“Greener”:** Awareness of climate change is rising, as is the urgency for drastic (re-)action and policies

Source: Datastream, Vontobel

# 10 Macro highlights

## **US 2022: Fading inflation, rising rates**

The US will enter 2022 on a stronger footing with the economy expected to accelerate again in the last quarter of the current year from a weaker third-quarter expansion of 2.1% in annualized terms. An expected rate of 4% for the whole year of 2022 would see growth remaining higher than pre-Covid. We expect a further pick-up in services spending, and demand for goods remaining decent, albeit slowing. Weaker consumer uptake should be offset by the need to rebuild inventories of finished goods, leaving manufacturing production sustained over the year.

At a year-over-year rate of 6.2% in October, US headline inflation has never been higher in the past 30 years. The price pressure will remain elevated until at least the second quarter of 2022, when both negative base effects and easing supply-side constraints will help to dampen inflation gradually. While inflation may prove more tenacious than expected, we don't expect prices to spiral higher or consumer expectations to worsen. Meanwhile, the US Federal Reserve looks set to terminate asset purchases by mid-2022 and start raising the fed funds rate during the second half of 2022. President Joe Biden's nomination of Jerome Powell for a second term as Fed chairman and Lael Brainard as vice chair will ensure continuity at the central bank's helm, and a smooth exit from the current accommodative monetary policy. That said, upside inflation risks also imply that the central bank could adopt a more restrictive stance quickly if need be. This would imply earlier-than-thought and more pronounced rate increases—perhaps already at the end of the second quarter. In our view, this would occur only if the labor market recovers more rapidly towards full employment and wage growth becomes broad-based.

In the mid-term elections due in November 2022, Biden's Democrats could lose their slim majority in one or both chambers of the US Congress. This could be another headache for the president, who currently faces low approval ratings despite a first legislative victory of Congress passing his infrastructure bill worth 1.2 trillion US dollars. Regarding his popularity, much will depend on whether or not he will be able to see through another proposal, the USD 1.75 trillion-strong social and climate spending "Build Back Better" bill this year or early next.

## **Japan 2022: Recovery first, normalization later**

Covid-19 and a set of emergency measures have made Japan a latecomer to the global "recovery party". We believe the recently announced fiscal stimulus package bodes well for consumer sentiment and helps to revive domestic consumption. Apart from that, many of the supply-side constraints weighing on the country's manufacturers should abate in the months ahead.

What could derail our baseline scenario? On the one hand, an economic slowdown in the US or China, for example, could hurt export-dependent Japan. On the other hand, newly elected Prime Minister Fumio Kishida has yet to prove he can win over the public. If he fails, his tenure may be as short as that of his predecessor. Another development to watch is the bigger-than-expected fiscal package, which could lead to an overheating of the economy. Another Japan-specific risk is the possibility of natural disasters such as earthquakes.

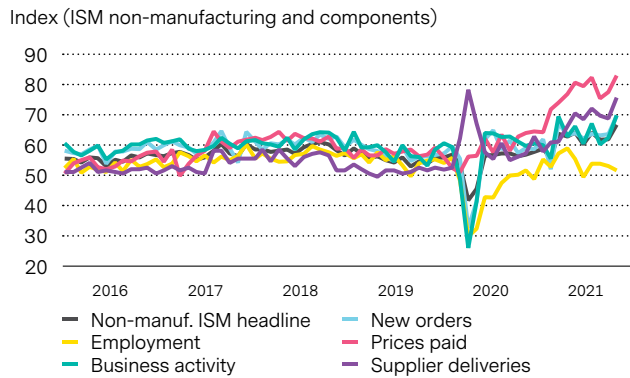
## **Emerging markets/China 2022: From less to more stimulus**

Emerging market growth is likely to slow in 2022 after an expected stellar advance of 6.6% in 2021. The tightening of monetary policy in many countries that began in the first half of 2021 is likely to claim its dues next year. Moreover, the likelihood of rising key rates in developed markets may limit the attractiveness of some emerging market assets to investors and hamper economic activity in the region. Even so, we expect emerging economies to post a solid growth rate of at least 4.4% in 2022. Inflation should peak in next year's spring with warmer weather keeping commodity prices in check because of the reduced need for fuel-intense heating. Moreover, supply-chain bottlenecks (containers and semiconductor products) should ease as well.

The risks potentially undermining our forecast are tied to "the usual suspect" China. Debt-laden Chinese real estate developers could still send ripples through the financial sector and burden households, with such a development affecting emerging markets and beyond. However, Chinese authorities have already reacted, and more steps to stabilize the housing market could follow. The Chinese central bank, for its part, already switched from policy normalization and de-leveraging to moderate easing earlier this year. More such measures are probably needed to bring a Chinese 2022 growth rate of 5.5% within reach as per our forecast, but we remain optimistic.

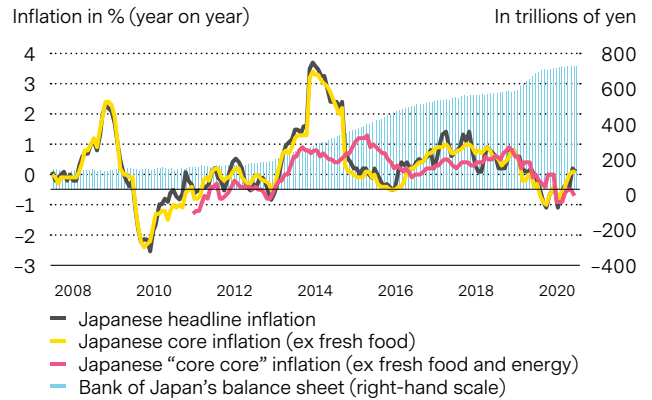
Depending on the size of the stimulus, things could start looking better fast, possibly presenting a buying opportunity for emerging market assets following a gloomy year of 2021. Another factor that may surprise investors and economists next year is the easing of pandemic restrictions, reflecting extensive vaccination efforts in many emerging economies. This could make southeast Asia and Latin America attractive destinations for the important tourism sector. It will also be interesting to see whether China will abandon its zero Covid strategy after the winter Olympic Games in Beijing.

**Chart 4: Services sector activity seen strong at the start of 2022, later normalizing**



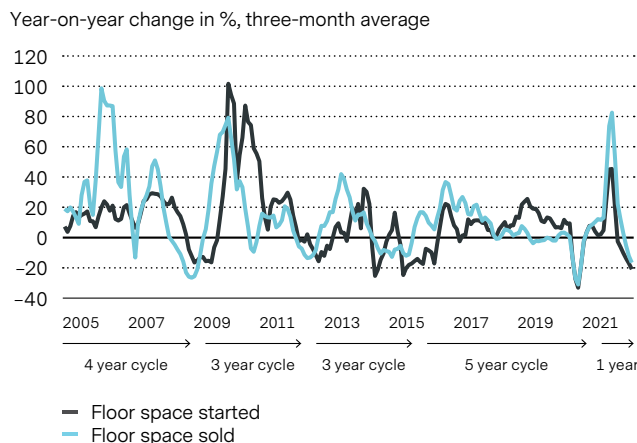
Source: Refinitiv Datastream, Institute for Supply Management (ISM), Vontobel

**Chart 5: Japanese central bank has little choice but to remain accommodative amid sub-target inflation**



Source: Refinitiv Datastream, Vontobel

**Chart 6: Chinese housing market faces a severe correction**

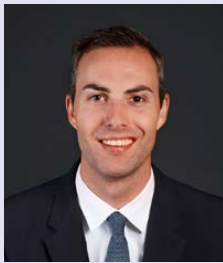


Source: Refinitiv Datastream, Vontobel



# Thematic (mega)trends, like friendships, can last a lifetime

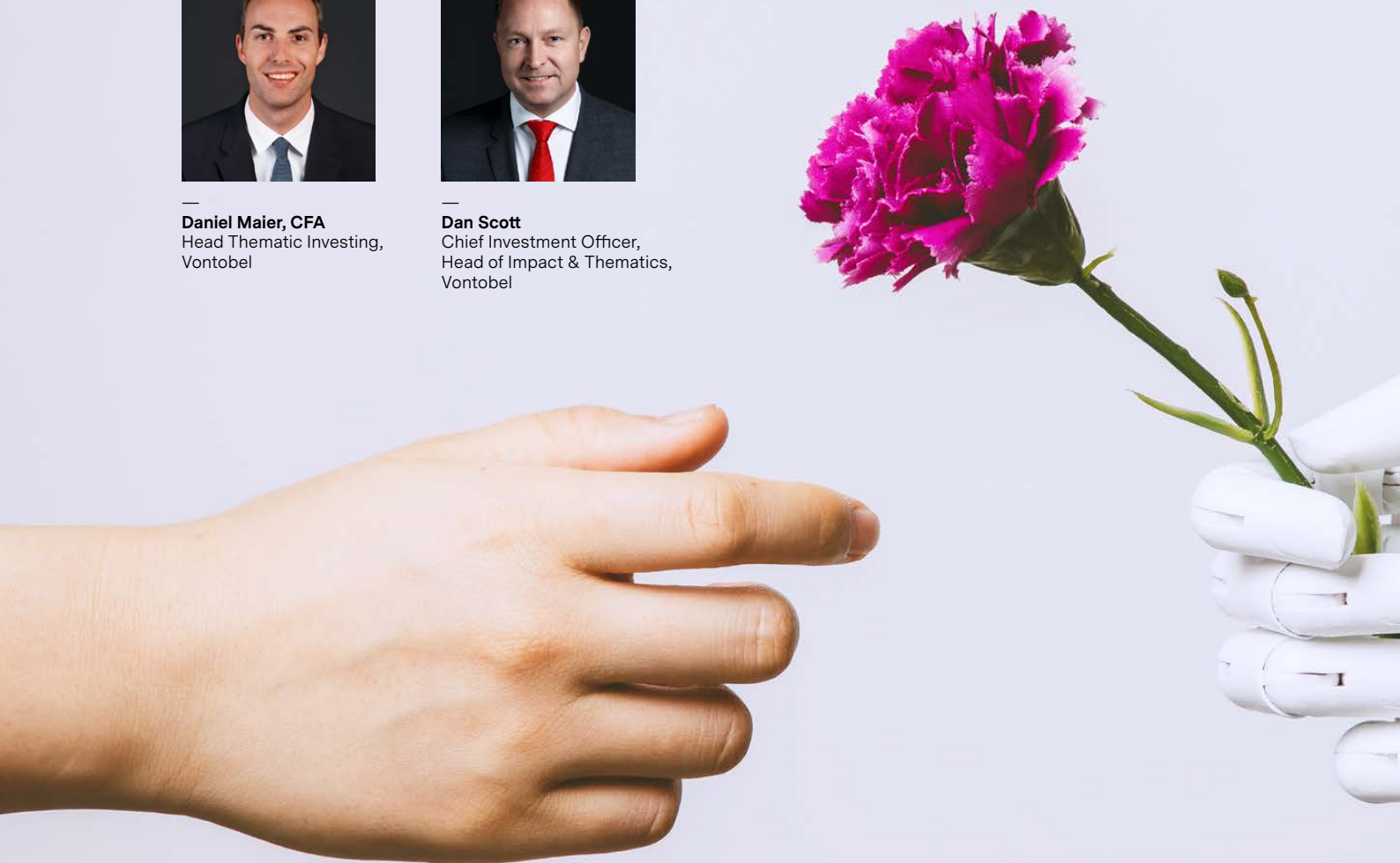
The trend is your friend, the saying goes. But how can you as an investor tell short-term trends from those that will last for decades? We believe that our “megatrends”-based investment approach offers an answer. Just like inner values that are essential to a friendship, it is the themes embedded in the megatrends that hold out the promise of investment opportunities.



—  
**Daniel Maier, CFA**  
Head Thematic Investing,  
Vontobel



—  
**Dan Scott**  
Chief Investment Officer,  
Head of Impact & Thematics,  
Vontobel





In our understanding, megatrends combine powerful steadiness—think of the working of tectonic plates—with the flexibility to incorporate transformative change. They remain relevant for decades and have the potential to affect our daily lives. An example of such a fundamental shift is the transition from the industrial era to the information age, anticipated by the author and futurist John Naisbitt<sup>1</sup> in the 1980s, and the technological advances in its wake, such as personal computer, the internet, or the mobile phone. As asset managers offering a megatrend strategy, we aim to anticipate such potentially life-changing megatrends, and our list comprises four of them:

– **Sustainable value creation**

Investor demand for companies with high environmental, social and governance standards is growing. These can be found in areas such as energy generation, mobility, and recycling.

– **A multipolar world**

The rise of China and other emerging markets has turned the economic world order upside down. With new competitors and consumers entering the global stage, computer networks, data availability and security become ever more important.

– **Demographics and urbanization**

More people live in cities than ever before, adopting new consumer habits and forms of entertainment such as e-sports. At the same time, societies in advanced economies are ageing rapidly, resulting in a shrinking labor force and mounting pressure on healthcare.

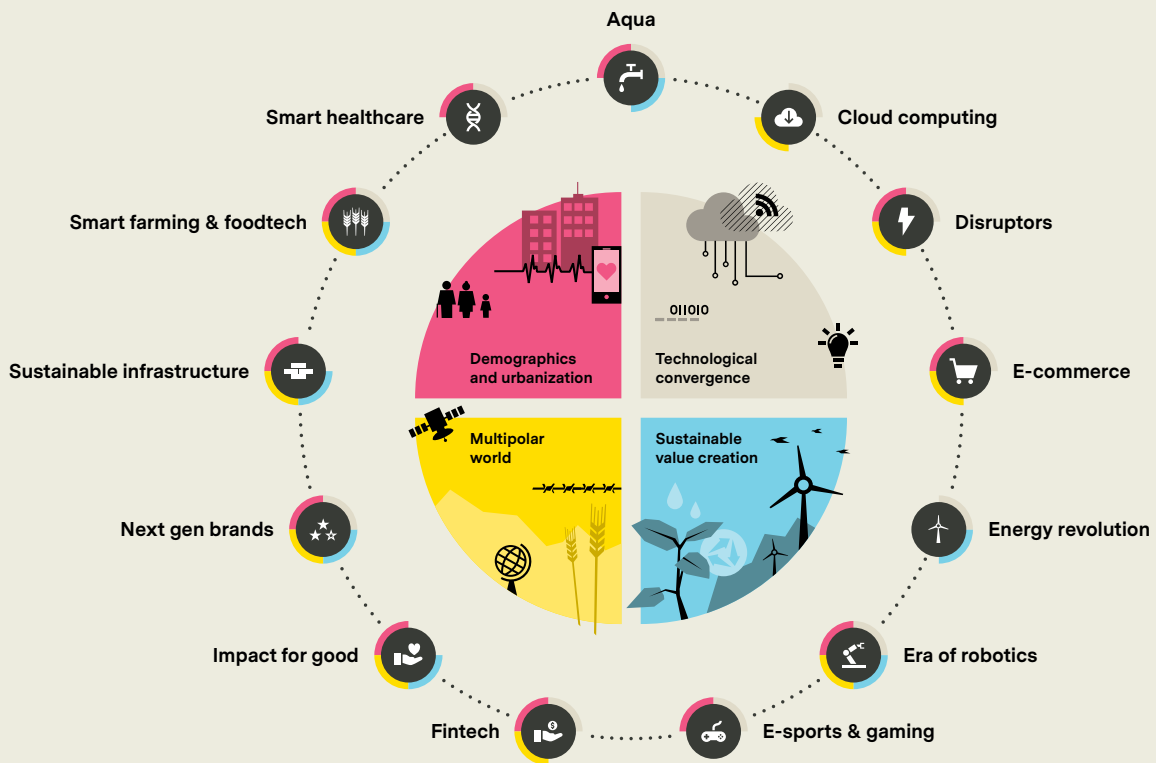
– **Technological convergence**

With digitalization increasingly challenging the analogue world, the way we do business or make payments is changing fast. E-commerce, self-driving cars, robotics come to mind, and there are many more areas relying on connectivity and artificial intelligence.

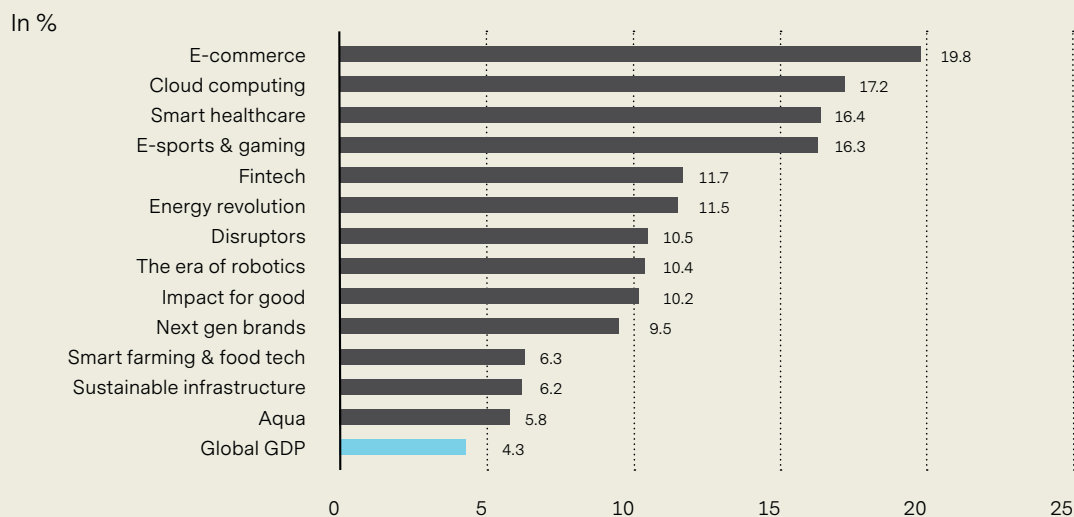
<sup>1</sup> “Megatrends: Ten New Directions Transforming our Lives”, published by John Naisbitt in 1982 after nearly a decade of research, became an international success.

# 14 Viewpoint

## Themes arising from megatrends ...



## ... and the pertaining growth rates



\* Expected compound annual sales growth rate (CAGR) of companies within the thematic universe vs. global GDP growth estimates (CAGR 2021 – 2023 for all metrics, GDP data provided by the IMF as of November 19, 2021)

Source: Bloomberg, MSCI, International Monetary Fund, Vontobel



In an environment where the global economy is slowing, a keen eye for corporate niches with high growth potential seems to be a reasonable approach. Many companies active in these areas are eligible for our megatrends portfolio, and the themes they represent are waiting to be harnessed (see figure).

#### **The power of intersections**

This thematic diagram reflects the high degree of diversification of our megatrends strategy where risks in some themes during certain market phases are offset, and ideally more than offset, by opportunities in others. Thus, risk mitigation goes hand in hand with the aim to increase returns. Often, real gems can be found where several megatrends intersect. One such example is “smart farming” and “food technology”. This theme represents an intersection of all four megatrends we have identified. The challenges here are the scarcity of arable land and natural resources to feed a growing global population. New technologies help us to sustainably increase production efficiency and reduce food waste.

As an investor, you can, of course, concentrate on one or several themes we have highlighted, and pick your own stocks for thematic portfolios. However, we believe our multi-theme solution provides access to a broad range of cutting-edge industries and disruptive companies benefiting from structural growth drivers and thematic purity. The portfolio offers a healthy mix of established names and little-known newcomers, resulting in both a high active share and diversification to navigate challenging market environments.

According to Wayne Gretzky, the Canadian legend of the ice rink, a good ice hockey player plays where the puck is, but a great player “plays where the puck is going to be”. In our view, this also makes the difference in investing.

#### **Thematic investing can, but doesn't have to, tick the sustainability box**

Investing along thematic lines is an ever-growing trend that's closely related to the popularity of “sustainable” investments. It's important to understand, however, that thematic investing isn't always sustainable. Plenty of themes, like cloud computing, robotics, or e-sports and mobile gaming, have little to do with promoting a positive environmental or social change. By contrast, so-called impact investing, another increasingly popular investment approach, falls squarely in the sustainability category. So what is the difference between thematic and sustainable, or impact, investing? In a nutshell, thematic offerings concentrate on opportunities related to a specific theme, or a range of themes, tied to global megatrends. Sustainable strategies, meanwhile, focus on sustainability principles, i.e. a portfolio of companies that adhere to certain environmental, social and governance (ESG) standards. Impact investing goes further than that, pursuing specific environmental and/or social objectives. Impact investors not only expect solid returns, but also want to see a detailed account of how the investee companies' positive contributions are measured and reported on.

Due to the absence of naming conventions, it's sometimes hard to establish whether a financial product qualifies as thematic, sustainable, or impact. Efforts to make the sustainable investing industry more transparent are underway, particularly in the European Union, which has become a trailblazer in the codification of “green” products. The “article 9” products that meet the most stringent EU requirements are marked with two dark-green leaves for easy identification. Asset managers with such an offering, typically tied to clean technology, renewable energy, or other impact objectives, must show how their products meet these claims, and demonstrate their alignment with the so-called EU Taxonomy, a term the EU coined for this specific initiative. For asset managers, this involves in-depth research and active engagement with the investee companies.

# The seas could remain choppy amid a normalizing economy



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**Sandrine Perret**  
Senior Economist,  
Fixed Income Strategist,  
Vontobel

**The year of 2021 was mixed for fixed income, with high yield categories posting the most solid returns amid overshooting inflation and normalizing yields. With inflation seen coming down in 2022, yields look set to normalize further. Easy financial conditions will persist, helping bonds to remain resilient in an environment of reduced monetary policy support.**

A month before the end of 2021, high-yielding assets register the best returns in the fixed income space while both government bonds and emerging market government debt look set to finish in the red (see chart 1). Markets are nervous with volatility remaining elevated—judging by the ICE BofAML Move index’s mid-November level of 80 points, the highest since the beginning of the pandemic—amid plans by some central banks to slowly reduce the extraordinary measures originally designed to fight the effects of the pandemic. Moreover, there is a growing risk that higher inflation readings may prompt some premature tightening action by the US Federal Reserve, for instance. However, our general bond market outlook remains broadly unchanged, and we confirm a

negative overall stance. Within the asset class, a relative preference for emerging market debt versus investment grade corporate bonds is still warranted.

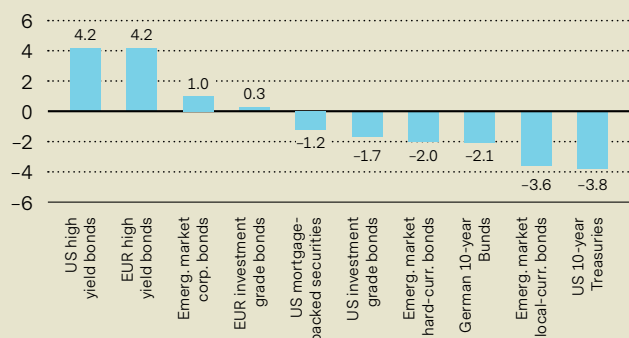
## Low or negative real returns expected in 2022

Like in 2021, the prospect of diminishing monetary policy support is likely to be a drag for bonds next year. Combined with still very high inflation levels at the start of 2022, expected real returns will stay negative for most low-yielding debt securities. We anticipate rising real yields on government bonds over the course of 2022, as inflation expectations start to drift lower from record highs. Nominal yields will also continue their modest upward trend—our three-month and 12-month forecasts for US ten-year yields stand at 1.7% and 1.9%, respectively (see chart 2).

As modest rate hikes are starting in some industrialized countries, yield curves are likely to flatten during most of 2022. But given that the market is pricing in a more pronounced tightening cycle than flagged by some central banks, we believe that bond markets should be able to manage rate hikes quite well. In the US, the appointment of Jerome Powell for a second term at the Fed’s helm should also contribute to calming nerves (see our Macro highlight article on page 6). In the corporate bond segment, yield spreads are likely to widen modestly in 2022 given the current tight levels and high valuations of such issues. Easy financial conditions should, however, mitigate the impact on this part of the market and keep default rates low, as real yields will remain at levels historically close to record lows.

**Chart 1: High yield and emerging market corporate bonds post the highest returns in 2021**

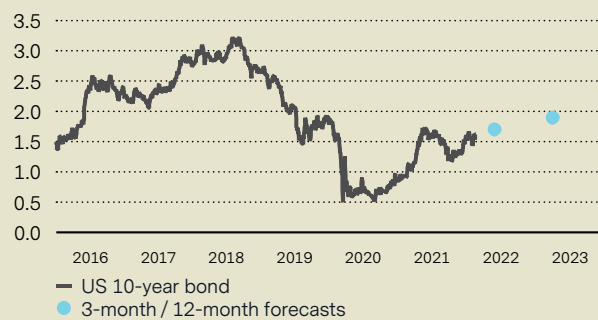
Total return in local currencies, in %



Source: Refinitiv Datastream, Bloomberg Barclays, JP Morgan, Vontobel  
Data as of November 22, 2021

**Chart 2: US 10-year government bond yield expected to rise towards 2% by the end of 2022**

Yield in %



Source: Refinitiv Datastream, Vontobel

# Why equity investors needn't fear high valuations



—  
**Stefan Eppenberger**  
 Equity & Commodity Strategist,  
 Vontobel

**In the eyes of many investors, stocks are currently either too expensive in absolute terms, or so richly valued they are crash-prone, or both. By contrast, our overweight position in equities reflects the view that strong corporate earnings will outweigh the downside of slightly expensive valuations.**

Regarding valuation, which puts per-share profits in relation to the current share price, we follow two rules of thumb: First, the higher the valuations, the lower the return potential in the longer term, and second, the higher the key interest rates, the more valuations tend to come down. Consequently, views on valuation should reflect longer-term return expectations.

To determine whether a stock is too pricey, many investors track the Warren Buffet indicator, named after one of the most successful equity investors of all time. This metric compares the total value of all global stocks in the MSCI World index—i.e. the so-called market capitalization—with the global gross domestic product. The idea behind it: The value of all companies should be tied relatively closely to economic output.

Worryingly, the Warren Buffet Indicator has hit a new all-time high recently (see chart 1), even surpassing the level from 2000 shortly before the bursting of the “dot-com bubble”. However, it’s worth noting that the indicator disregards interest rates. They are currently so low that risky asset classes such as equities appear to be one of the few places offering solid returns.

Investors shouldn't be fixated on any one important indicator like the Warren Buffet. In our case, we look at a number of different metrics tracking simple price/earnings (P/E) ratios, cyclically adjusted P/Es, and equity risk premiums. Currently, five out of ten indicators (including the Warren Buffet index) suggest exceedingly high equity prices, with the remainder pointing to fair value. This relates to our first rule of thumb: Longer-term return expectations should indeed be adjusted downwards somewhat compared to past years.

## Some metrics have moved lower

Interestingly, despite stock markets reaching new highs, three ratios have come down significantly in the past six months, for example the simple P/E ratio (see chart 2). The reason is that companies have not only met but even exceeded the high market expectations of future earnings. However, the downward move is also a reflection of changed expectation regarding the big central bank's next steps, and the second rule of thumb we have mentioned above. That said, we continue to believe that the headwinds for equities from tighter monetary policy should be offset by solid earnings growth next year.

**Chart 1: Warren Buffet indicator's recent high worries some investors**



Source: Refinitiv Datastream, Vontobel

**Chart 2: Stocks are fairly valued according to the price / earnings ratio**



Source: Refinitiv Datastream, Vontobel



# Low inventories may signal future price increases



—  
**Stefan Eppenberger**  
Equity & Commodity Strategist,  
Vontobel

**The growth slowdown in China bodes ill for commodities, which is why we don't overweight this asset class despite soaring prices. However, the record-low inventory level for many commodities, while leaving the market vulnerable to external shocks, is also one of the reasons why we keep a modest commodity exposure in our portfolios.**

In the first half, we benefited from our overweight in commodities, but subsequently gave up this positioning too soon. However, our increased equity focus later made up for what we missed on the commodity side.

Going back to a commodity overweight currently wouldn't make sense, in our opinion. Global demand is growing at a slower pace than in early 2021 and the slow-down of the commodity-dependent Chinese economy, particularly the country's real-estate sector, is a bad omen for metal prices. Meanwhile, oil demand is likely to suffer somewhat from the renewed Covid-19 lockdown going into winter. Moreover, the Organization of the Petroleum Exporting Countries (OPEC) is currently increasing its production by 400,000 barrels per day every month.

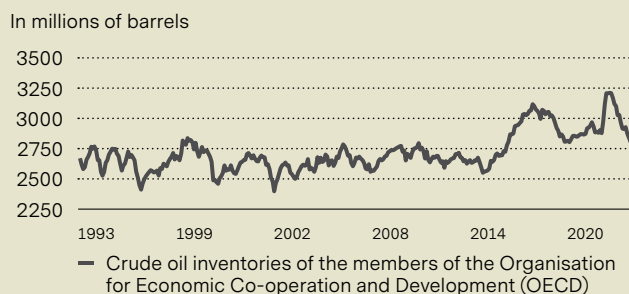
It's worth noting that oil inventories currently hover around 2015 lows (see chart 1), leading to speculation that the US may release part of its strategic petroleum reserves—as indeed did happen in late November. Stocks of copper and other metals are even smaller than they were before the financial crisis levels (see chart 2). While low inventories don't necessarily lead to higher prices, they could be a precondition for a spike in commodity prices in the event of a positive demand shock (e.g. more fiscal stimulus in China) or a negative supply shock (e.g. tensions in the Middle East), similar to the current situation in the area of computer chips, or coal and gas prices (see Investors' Outlook November issue). Therefore, holding a commodity position seems like a good idea.

Generally, we believe that the outlook for this asset class remains favorable in the short and longer term. While demand for commodities will remain elevated, the supply situation looks shakier due to years of underinvestment, a consequence of previously low prices. Moreover, many investors, rather than putting their money into smoke-stack industries, have started funding sustainability-linked projects.

## Decarbonization will drive commodity prices

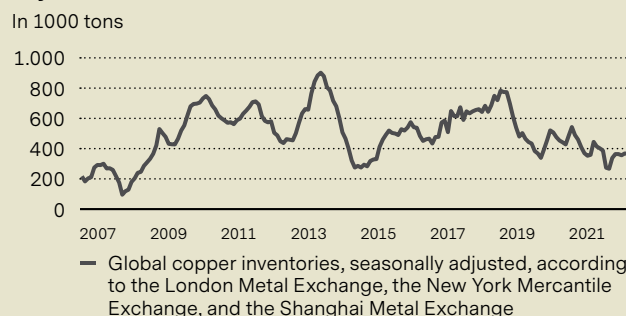
The trend towards a decarbonized world brings new demand, but perhaps for other parts of the commodity spectrum. As such, we don't think that prices will collapse from here. However, we will wait for the economic cycle to look more promising before we start thinking about an increased commodity allocation.

**Chart 1: The world's oil tanks are emptying fast**



Source: Energy Information Administration, Refinitiv Datastream, Vontobel

**Chart 2: Copper stocks are currently at lows unseen in years**



Source: Refinitiv Datastream, Vontobel

# Two safe-haven champions defy risk-on stance



—  
**Sven Schubert, PhD**  
 Senior Investment Strategist,  
 Head of Strategy Currencies,  
 Vontobel

**Rising risk appetite aside, two safe-haven currencies have been among the darlings on foreign exchange markets lately. The US dollar could face some short-term weakness, but may rally later in 2022 on the back of a tighter US monetary policy. The Swiss franc should hold up well, supported by low domestic inflation rates.**

The franc's rugged health, watched by an uneasy Swiss National Bank (SNB), is a consequence of Switzerland's longstanding current-account surplus and only moderate inflation pressure. The latter factor translates into the country's relative gain of competitiveness (via increased Swiss purchasing power) against the US and Europe, where inflation runs high(er). Our business cycle model "Wave" has for some time pointed to a strengthening of the Swiss franc given that Switzerland has the strongest growth momentum among the 50 countries we cover.

Rising interest rates outside Switzerland may fail to lure investors away from franc assets. True, nominal yields in countries like the US and even the core euro zone are up, but so is inflation, with those developments offsetting each other (see chart 1). While the Swiss currency is

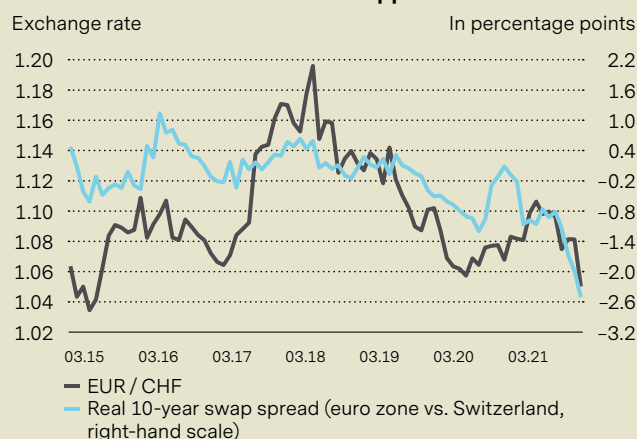
unlikely to reach parity versus the euro anytime soon—the SNB isn't likely to allow that—it may well do so in the next few years.

The euro, meanwhile, is held back by renewed lockdowns in some European countries, which hampers the economy. By contrast, the US growth momentum seems to be improving amid an easing Covid-19 regime (see chart 2) and the huge infrastructure bill approved by the US Congress. This raised expectations of an earlier-than-expected tightening of US monetary policy, which is another reason for the recent strong dollar rally against the euro. But with markets already pricing in three US rate hikes next year, the dollar's potential for further gains versus the euro seems limited in the near term. Moreover, should the pandemic wave reach America, possibly through increased tourist travel from Europe, the euro may see a short-term bounce before the US Fed's tightening cycle pushes it lower versus the dollar again—to our long-held 12-month target of 1.12.

## Are yuan assets worth watching?

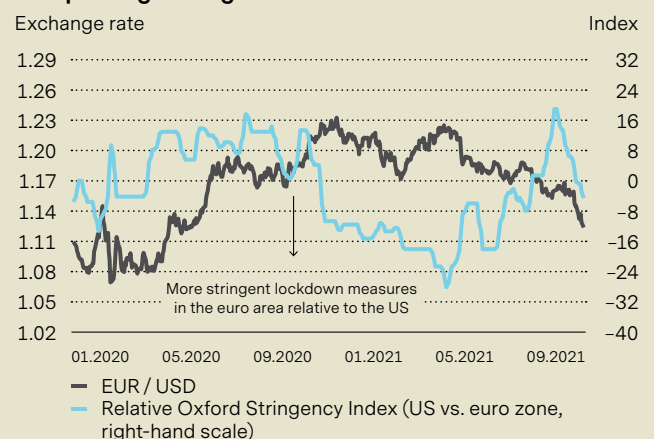
Emerging economies are on a much firmer footing than before the previous US tightening cycle in 2015. For example, many of them boast record-high current-account surpluses. However, a year of policy normalization in the US—rising US yields—and slowing growth rates in many emerging markets don't suggest a sustained upward trend in the respective currencies, so investors need to be selective. Yuan-denominated assets may be worth a look once China overcomes its growth issues, possibly in the first half of 2022.

**Chart 1: Historically low yield spreads between the euro zone and Switzerland support the Swiss franc**



Source: Refinitiv Datastream, Vontobel

**Chart 2: The US is easing lockdown measures, Europe is tightening them**



Source: Refinitiv Datastream, Oxford Economics, Vontobel

# Economy and financial markets 2019 – 2022

The following list shows the actual values, exchange rates and prices from 2019 to 2020 and our forecasts for 2021 and 2022 for gross domestic product (GDP), inflation/inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates and commodities.

<b>GDP (IN %)</b>	<b>2019</b>	<b>2020</b>	<b>CURRENT</b>	<b>FORECAST 2021</b>	<b>FORECAST 2022</b>
Euro zone	1.6	-6.5	3.7	5.0	4.4
US	2.3	-3.4	4.9	5.5	4.0
Japan	0.0	-4.7	7.7	2.3	2.5
United Kingdom	1.7	-9.7	6.6	6.7	5.2
Switzerland	1.3	-2.5	7.7	3.5	2.8
China	6.0	2.3	4.9	7.7	5.5
<b>INFLATION (IN %)</b>					
Euro zone	1.2	0.3	4.1	2.5	2.2
US	1.8	1.2	6.2	4.5	3.6
Japan	0.5	0.0	0.2	-0.1	0.4
United Kingdom	1.8	0.9	3.1	2.4	3.1
Switzerland	0.4	-0.7	1.2	0.6	0.7
China	2.9	2.5	1.5	1.0	1.8
<b>KEY INTEREST RATES (IN %)</b>					
EUR	-0.50	-0.50	-0.50	-0.50	-0.50
USD	1.75	0.25	0.25	0.25	0.50
JPY	-0.10	-0.10	-0.10	-0.10	-0.10
GBP	0.75	0.10	0.10	0.25	0.75
CHF	-0.69	-0.76	-0.75	-0.75	-0.75
CNY	4.35	4.35	4.35	4.35	4.35
<b>10-YEAR GOVERNMENT-BOND YIELD (IN %)</b>					
EUR (Germany)	-0.2	-0.6	-0.3	-0.2	0.0
USD	1.9	0.9	1.6	1.7	1.9
JPY	0.0	0.0	0.1	0.1	0.1
GBP	0.8	0.2	0.9	1.1	1.3
CHF	-0.5	-0.5	-0.1	-0.1	0.1
<b>EXCHANGE RATES</b>					
CHF per EUR	1.09	1.08	1.05	1.07	1.05
CHF per USD	0.97	0.88	0.92	0.92	0.94
CHF per 100 JPY	0.89	0.86	0.81	0.84	0.87
CHF per GBP	1.28	1.21	1.23	1.24	1.21
CHF per AUD	0.68	0.68	0.67	0.67	0.66
USD per EUR	1.12	1.22	1.14	1.16	1.12
JPY per USD	109	103	114	110	108
USD per AUD	0.70	0.77	0.73	0.73	0.70
CNY per USD	6.95	6.51	6.86	6.45	6.50
<b>COMMODITIES</b>					
Crude oil (Brent, USD/barrel)	66	52	83	80	80
Gold (USD/troy ounce)	1,521	1,898	1,862	1,800	1,800
Copper (USD/metric ton)	6,149	7,749	9,841	11,000	12,000

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8022 Zurich  
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