SARASIN
& PARTNERS

Six minute strategy

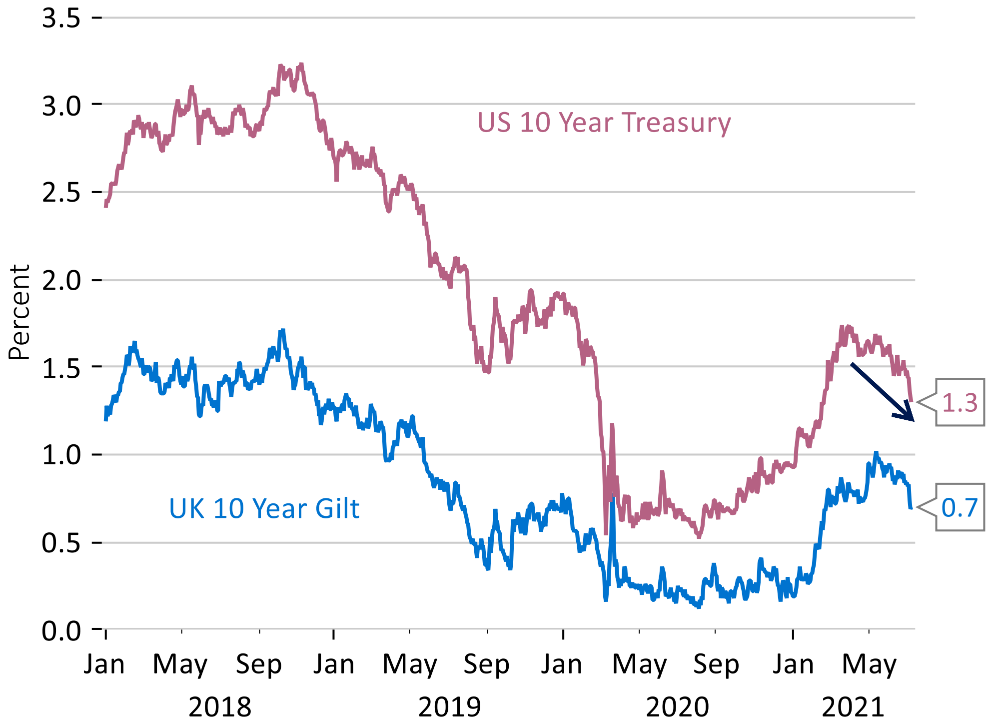
So why are bond markets rallying and should we be worried?

July 2021

Bonds: Global bond yields are falling even as economic growth accelerates & inflation pressures climb – why?

30 year bond yields well below current inflation rates

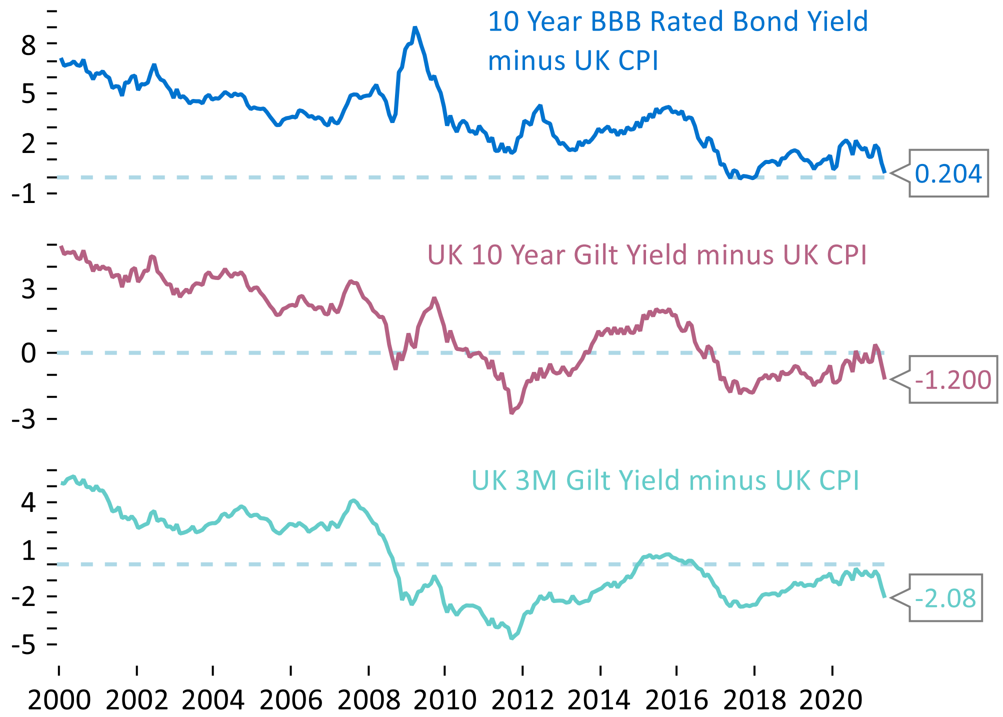
10 Year Government Bonds



Source: Macrobond, 09.07.21

UK real bond yields are extremely low

Real UK Bond Yields



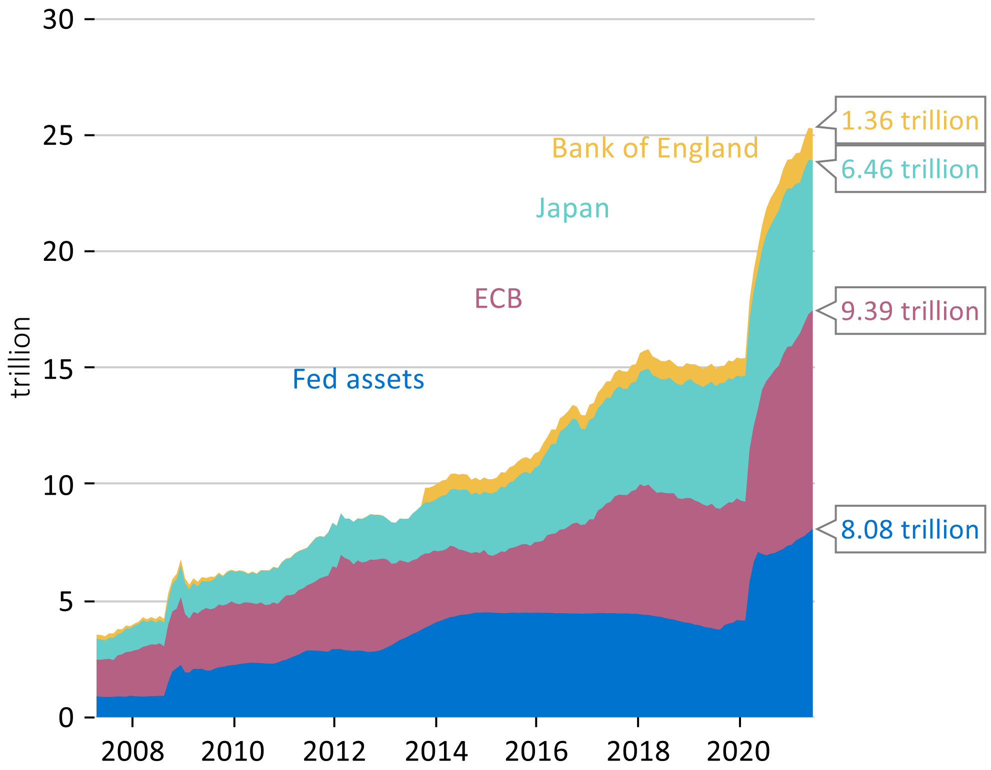
Source: Macrobond, 09.07.21

Why are bonds rallying?

1. Continued central bank buying & lower debt supply

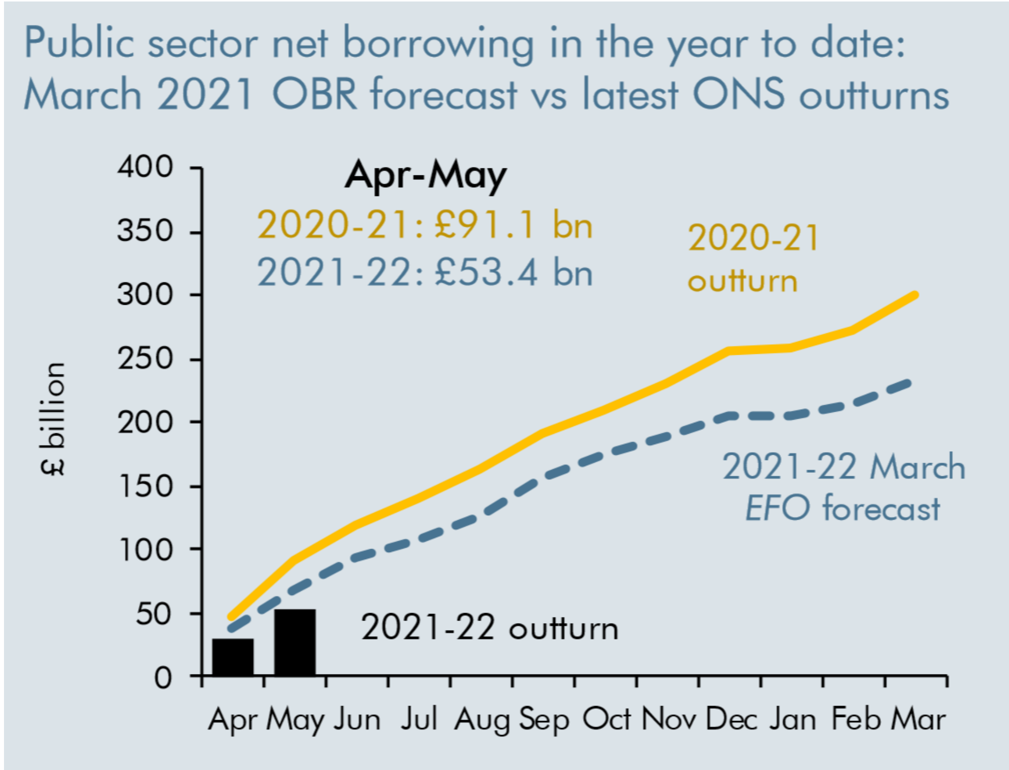
Fed & ECB will purchase 2 trillion of assets in next 12 months

Central bank balance sheet (USD, monthly)



Source: Macrobond, 09.07.21

Strong global growth means lower government bond issuance



Source: OBR June 2021

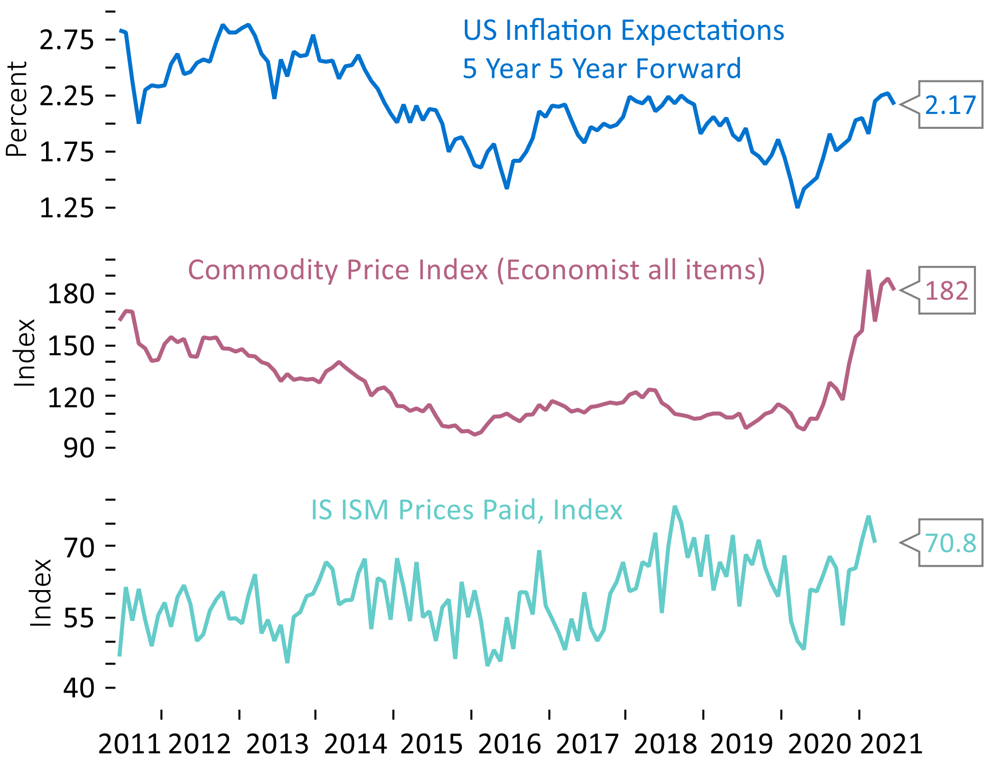
Monetary policy will remain highly accommodative for at least the next 18 months – even with taper in 2022, Fed purchases over the next 12 months will total $1.23trillion & ECB purchases will total €1.1trillion (Sarasin, July 2021)

Why are bonds rallying?

2. Global inflation: Some early signs of pricing pressures easing

Inflation expectations & commodity prices peaking?

Inflationary Indicators

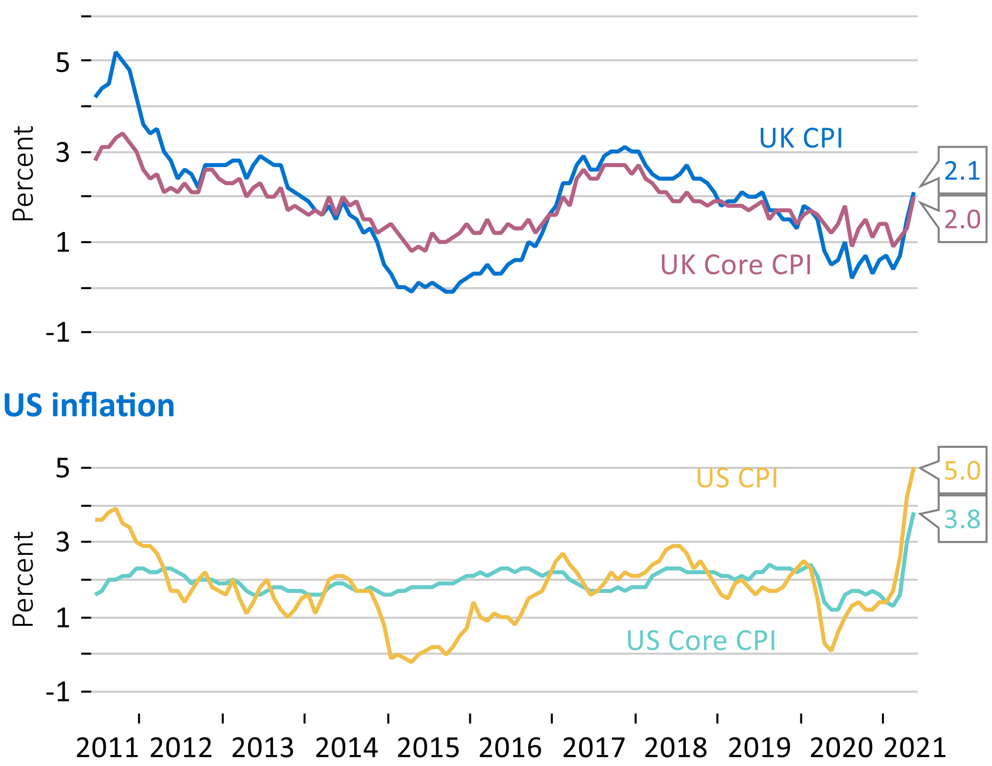


Source: Macrobond, 09.07.21

US headline and core inflation now rising sharply

UK inflation

US inflation

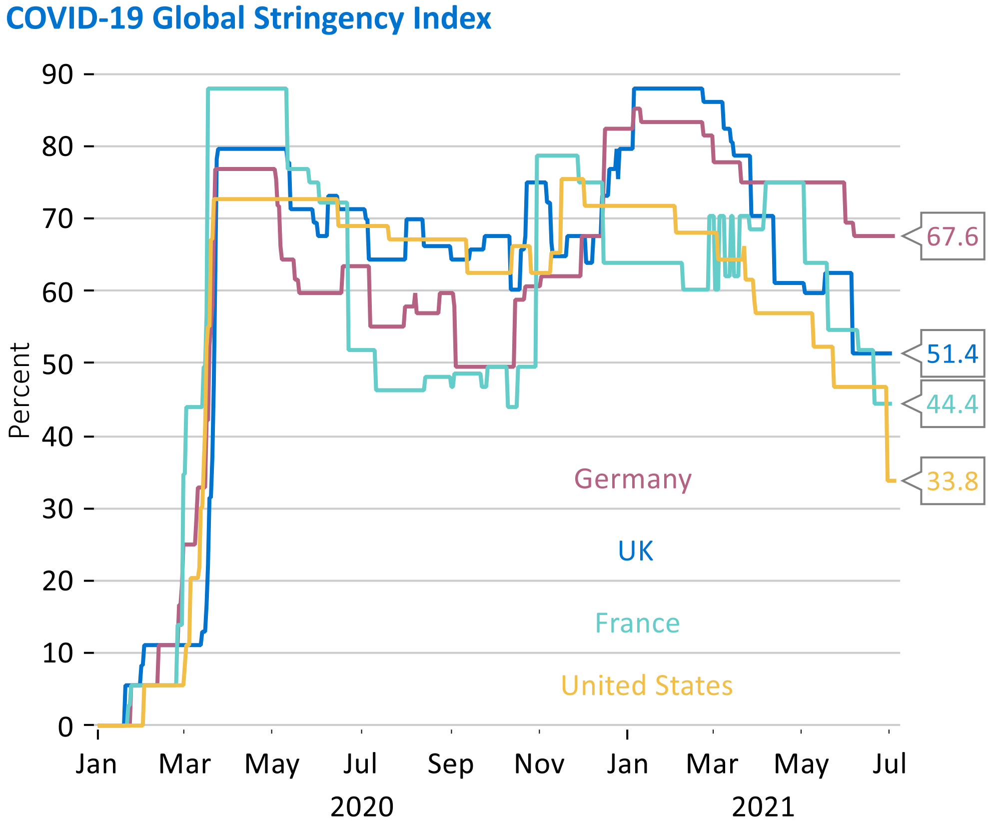


Source: Macrobond, 09.07.21

Why are bonds rallying?

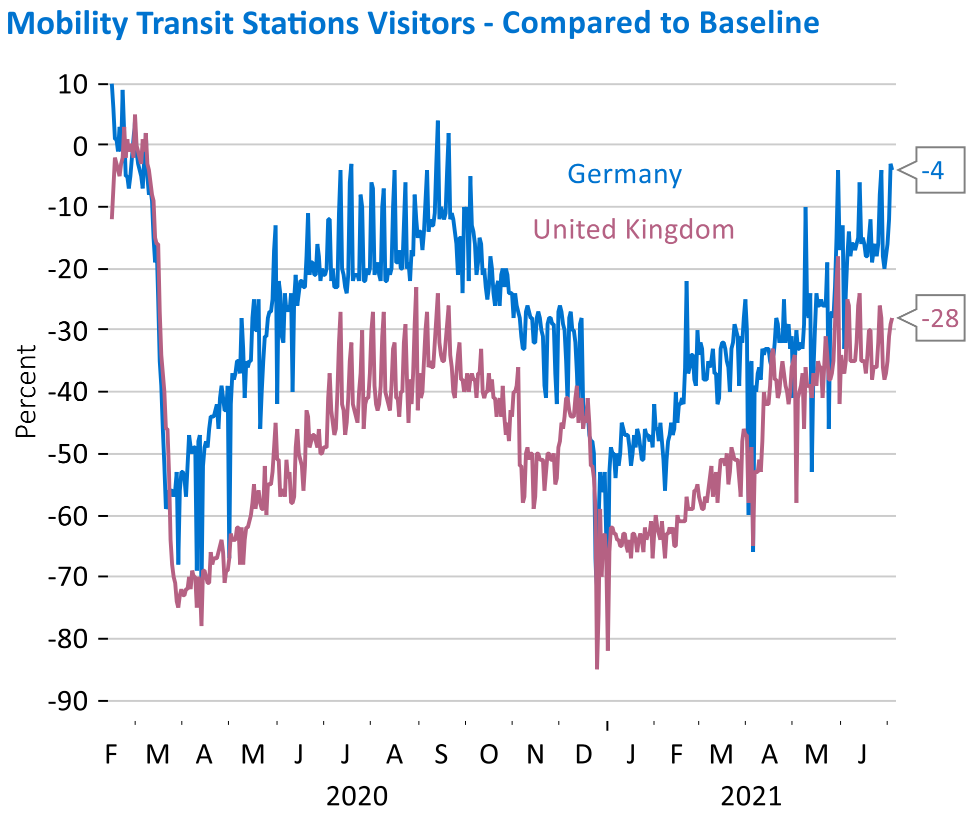
3. COVID update: Stringency slowly declining – US more ‘open’ than Europe – UK mobility weak

COVID Stringency Index – Delta variant?



Source: Macrobond, 09.07.21

Google mobility indices – UK lags



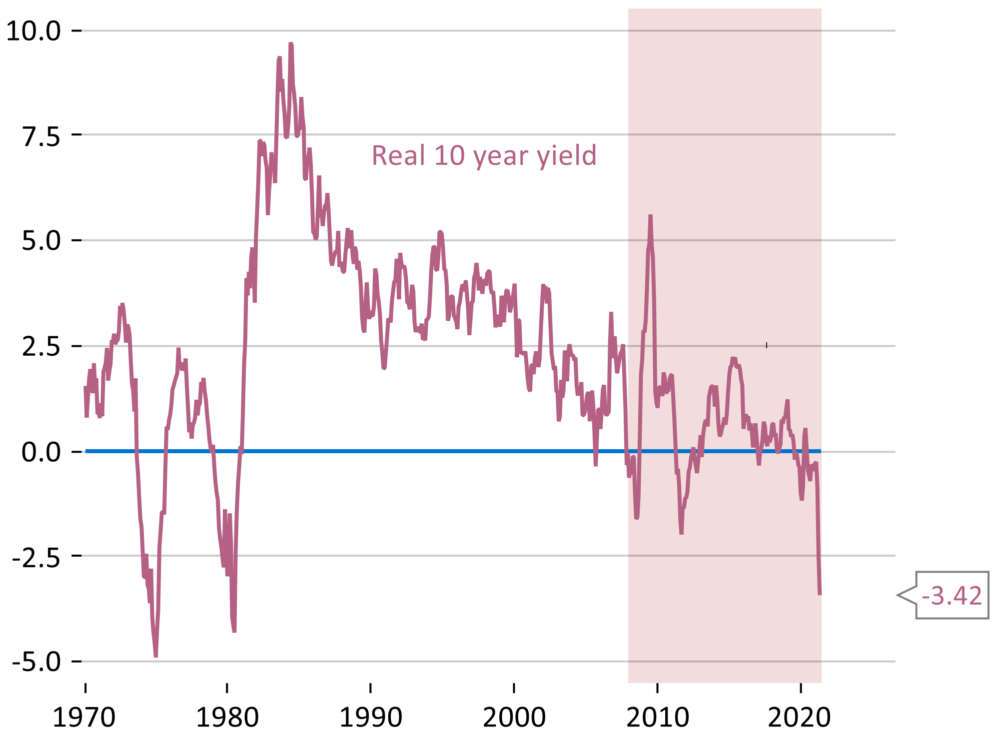
Source: Macrobond, 09.07.21

What are the consequences of lower yields?

Real interest rates that are negative provide support for higher equity valuations

Global equity markets still offer a yield premium to bonds

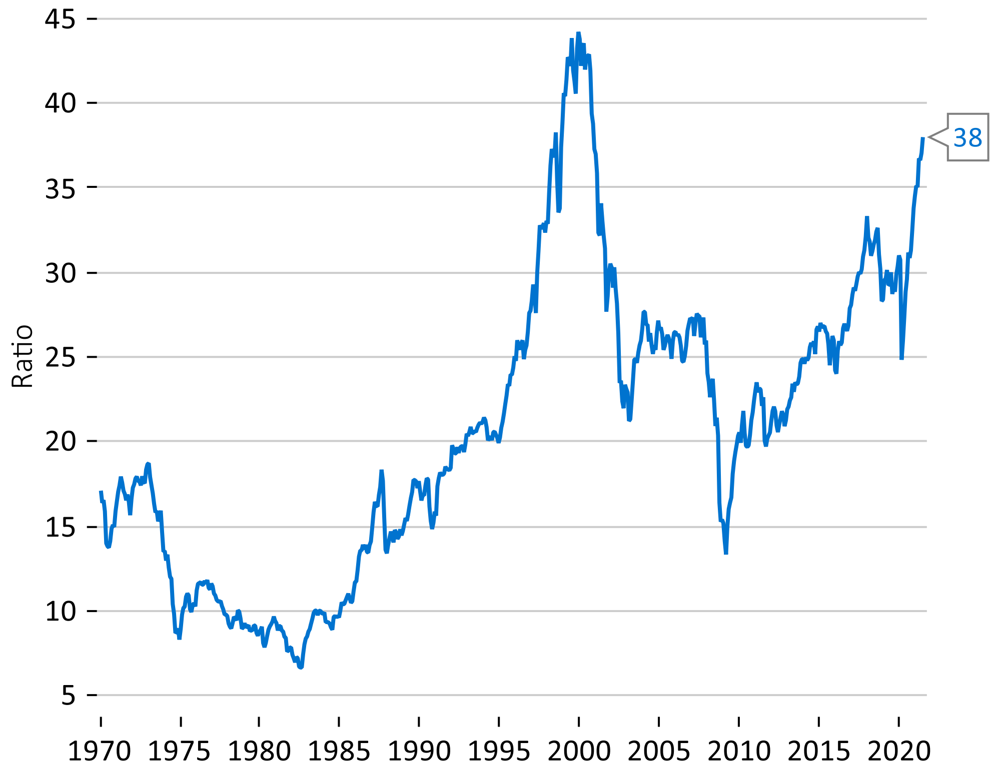
US 10 year Treasury yields less US inflation
Period since QE began shaded



Source: Macrobond, 09.07.21

Real interest rates remain negative after more than a decade

Cyclically Adjusted P/E Ratio (CAPE) S&P500



Source: Macrobond, 09.07.21

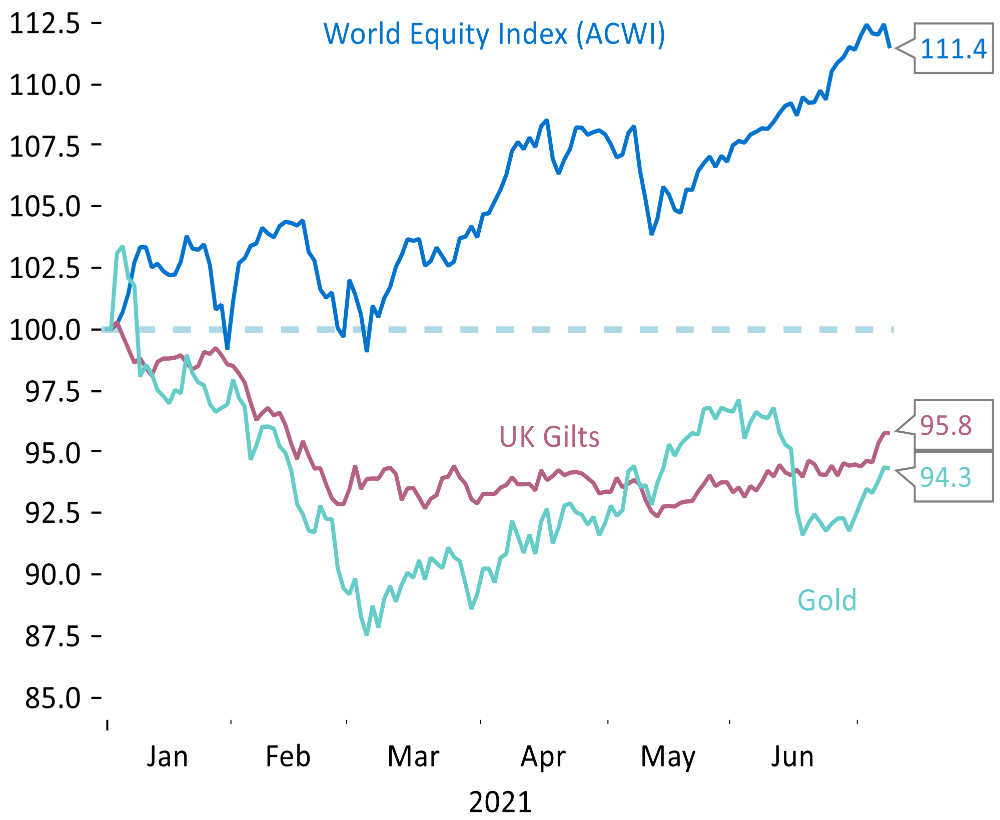
Inflationary pressures to remain high for the next 18 months on the back of disruptions to inputs and labour – from there on at a moderately higher pace of than the post GFC era of 2.25 – 2.5%.

Equities: Market performance 2021-to-date

Equities lead global asset returns – value style outperforms – volatility falls

Equities rally, bonds & gold decline

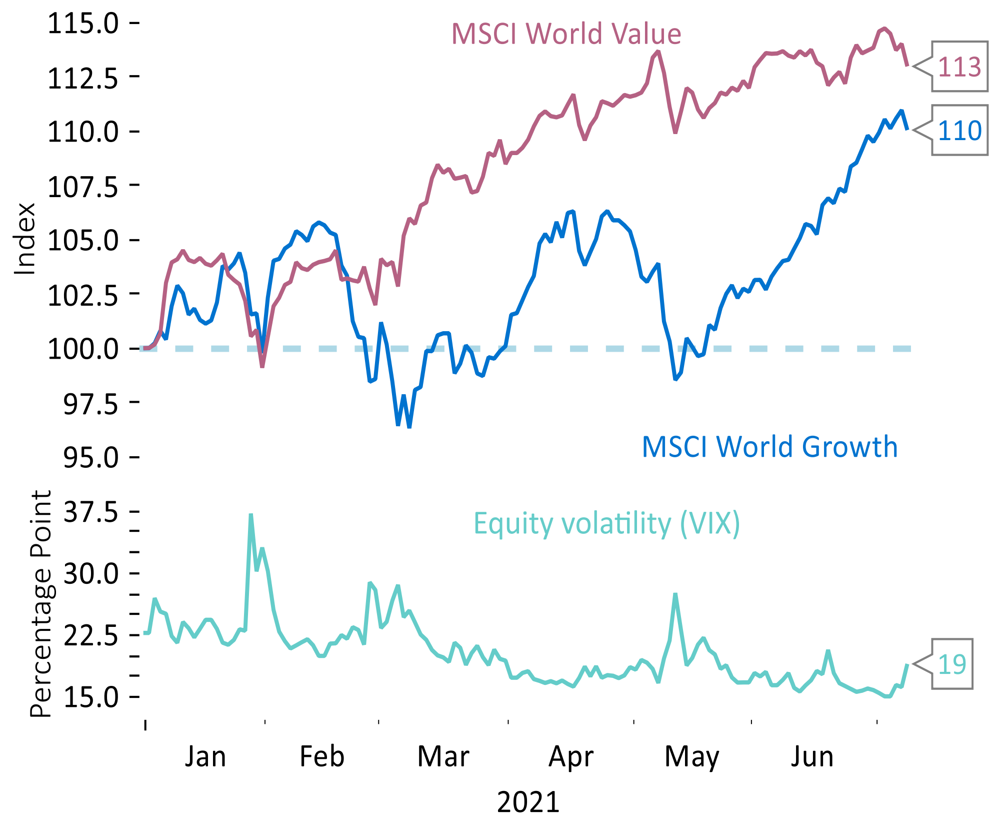
Global Asset Class Returns 2020 (£) to date



Source: Macrobond, 09.07.21

Value lead widens over growth – volatility falls

World Equity Style 2021



Source: Macrobond, 09.07.21

Strong economic momentum & generous financial conditions still favour risk assets

Global strategy update July 2021

Bonds	Strong Underweight • Strong UW Government Bonds – economies running 'hot' implies upside risks for yields • UW Investment Grade Credit – yield spreads narrow – UK charity & infrastructure issues offer social impact benefits
Equities	Overweight • OW Global – continued QE by central banks and negative real bond yields supports valuations • OW UK – dividend support attractive – fund flows return as Brexit deal settles • OW EM – global vaccine roll out accelerates – valuation attractive
Alternatives	Overweight • OW Other Alternatives – infrastructure and renewables beneficiaries of fiscal spend – liquidity issues remain • OW Uncorrelated Alternatives – gold positions as hedge against policy error
Cash	Overweight • Favour cash holdings rather than risk capital loss in bonds • No currency preference given similar macroeconomic policies/rates worldwide • Consider portfolio insurance
Risks	Current: Unequal distribution of vaccines, disorderly bond markets, valuations stretched Longer-term: Inflation pressures become entrenched, central bank policy error, China tensions with US/Taiwan

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If you are a private investor, you should not act or rely on this document but should contact your professional advisor.

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