

## The risk of rising interest rates

Market update, May 2021

**W**hile current market expectations for US inflation are around 2%, several factors point a higher figure towards the end of the year. The deepening of the US twin deficit due to the economic rebound and continued money creation by the Fed may well ease the currency and trigger import-driven price increases. The observed capacity constraints in some sectors (e.g. chips) will take up to 2 years to resorb. In addition, the country may want to repatriate some key supply chains. These two factors will put pressure on end-consumer prices. Also, the last stimulus package includes direct payments to individuals, which will push spending higher.

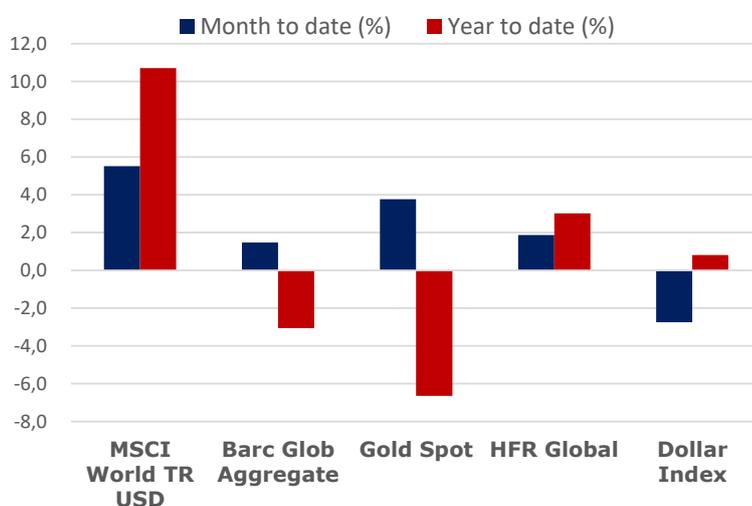
Irrespective of effective or expected inflation, the absolute level of yields is still very low by historical comparison and a simple “normalization” of the curve - if not too sharp and abrupt – is possible and would even be positive for the economy at large. In this scenario - which equates to an increase of real yields - fixed income securities would suffer losses, but more dangerous would be the event of a strong uptrend move. Massive bond issuances at ultra-low rates may prove difficult to digest by market participants, as recently seen in some auctions. Market chartists also point at different levels between 1,5% and 2,5% on the 10y T-bond where CTA managers may trigger huge momentum trades. On the other hand, strong arguments can also be made against a higher yield curve. Regarding inflation, there are still reasons to believe that the deflationary forces of the last decades (globalization and technology) are still at work, particularly the latter.

The saving glut - which has been further boosted during the pandemic - will continue to pour capital into T-Bonds, as they remain the ultimate safe haven for all market participants. At around 1,5%, 10y T-Bonds equals the S&P500 dividend yield, which makes bonds relatively attractive to some.

Then the Fed has made it clear it will not lift rates prior to 2023 and is ready to tolerate an inflation temporarily in excess of 2%, consistent with the “2% average inflation” concept. We also believe that the Central Bank - which continues its massive QE program - must have some critical interest level in mind, where it would intervene to contain the increase (yield control).

We expect the US 10-year yields to range between 1,80% to 2% at year end. Nevertheless, given the unfavorable risk/return profile of US bonds, we believe a protection at current levels could be sought through duration reduction.

## MARKET PERFORMANCES



## GMG VIEWS

<b>Equities</b>	US	→
	Europe	→
	Emerging Markets	↑
<b>Fixed Income</b>	Sovereign	↓
	Investment Grade Corporate	→
	High Yield Corporate Bond	↑
	Emerging Market Debt Local	↑
<b>Real Assets</b>	Precious Metals	→
	Real Estate commercial	↓
	Real Estate residential	↑
<b>Currency</b>	US Dollar	↓

## US 10-Year Treasury Historical yield (%)



source: Bloomberg

## Disclaimer to Market Update

### **What is the Market Update?**

The Market Update is a document prepared and published by GMG Investment Solutions (Switzerland) SA (“GMG”), a Swiss financial intermediary member of Swiss Association of Asset Managers (SAAM), a Self-Regulatory Organisation (“SRO”) authorized by FINMA, or its affiliates (the “Document”).

The Document is for information purposes only and is intended to provide general comments and notes on select aspects of the preceding month’s or stated period’s economic environment, challenges and events. Nothing contained in the Document constitutes a solicitation, offer, recommendation, or investment advice to *inter alia* buy or sell any investment instrument, give effect to any transaction, or to conclude any legal act of any kind whatsoever. This Document alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision. For further important information about this document, please refer to point 4.

### **Restrictions to access**

The Document is for distribution only under such circumstances as may be permitted by applicable law. In particular, this Document is not intended and shall not be distributed to:

- US persons and must not be distributed in the USA, or
- In any jurisdiction where its distribution may be restricted by laws applicable to this or similar types of documents.

Persons who receive this Document should make themselves aware of and adhere to any such restrictions.

### **Figures and data**

This Document contains figures and data obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. GMG cannot assume responsibility for the quality, correctness, timeliness or completeness of the information contained in this document.

### **Important information**

**No independent financial analysis:** This Document is not considered as an independent financial research product under Swiss laws and regulations, in particular the directives on the Independence of Financial Research issued by the Swiss Bankers Association (SBA) (the “Directives”) and consequently this Document is not governed by the Directives to the publication and distribution of independent financial research reports, including relevant restrictions or required disclosures.

**No investment recommendation:** This Document does not constitute and does not contain information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers, including any opinion as to the present or future value or price of such instruments. This Document does not contain recommendations to the general public about financial instruments nor should it be considered as a preparatory act to the provision of an investment service or carrying out of an investment activity

**No investment advice and no personal recommendation:** This document is not and does not contain investment advice and/or personal recommendations. In particular, nothing contained in this Document may be considered as a recommendation that is made to a person in his capacity as an investor or potential investor, or in his capacity as an agent for an investor or potential investor, that is suitable or appropriate to a recipient’s individual circumstances. Nothing contained in this document may be considered as an invitation, or suggestion, or recommendation or equivalent to:

- Buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument; or
- Exercise or not to exercise any right conferred by a particular financial instrument to buy, sell, subscribe for, exchange, or redeem a financial instrument.

**No offer and/or placement of financial instruments:** The opinions expressed in this document are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as an invitation, solicitation or offer to buy, sell or place financial instruments.

### **Copyright**

This document may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of GMG.