A POSITIVE, BUT NUANCED, VIEW OF THE ROAD AHEAD

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We have a generally positive, but nuanced view of the direction of the global economy. Following China, we believe that growth momentum may gradually wane in the US, followed slightly later by Europe. At the same time, slowing growth data looks likely to give impetus to new forms of economic stimulus, including infrastructure spending in the US.

At the same time, we recognise that ambitious infrastructure plans in the US face numerous political hurdles. We also are aware that tax hikes are moving up the agenda for corporates and higher earners. Yet we remain confident that consumers in the US will continue to spend, helped by accumulated savings and a steadily improving jobs picture. **Consumer resilience, complemented by even relatively modest net new spending on infrastructure, should help US GDP, which we see growing by 6.1% in 2021** and 3.9% in 2022. Strong growth and advanced plans for Fed tapering could continue to prop up an already quite strong US dollar in the short term (despite jitters over the debt ceiling).

We have a generally favourable view of Europe given high vaccination rates and broad economic support, as symbolised by the Next Generation EU (NGEU) and dovishness of the European Central Bank. While not denying protracted global supply issues, our internal scorecard—which looks at vaccination rates, success in bringing the pandemic under control, policy support and industrial edge—supports our positive view of Europe from a macro point of view. We recently revised up our GDP growth forecast for the euro area to 5.0% (from a previous 4.3%) and forecast growth of 4.5% in 2022.

The direction of NGEU as well as of the green hue of recovery programmes in other regions of the world mean that the **'Green Marshall Plan'** has been one of our leading investment ideas this year. Italy, which is one of the biggest recipients of NGEU funds, is turning out to be a particularly interesting case study of the ability of the EU to foster a greener (and more digital) recovery. Thanks to policy support, we believe Italian GDP will spring back to its pre-pandemic level in 2022. We will also be keeping a close eye on the outcome of the German federal elections at the end of this month, which could well determine the extent of further European integration and tolerance for deficit spending.

In both Europe and the US, **inflation**—largely brought about by supply problems and rising commodity prices. Some of the drivers of higher prices could wane, but cyclical inflation issues could persist for longer than foreseen.That said, we believe the Fed and ECB will remain dovish and relatively tolerant of inflation spikes—with the Fed pointing to its 'average inflation target' and the ECB to its symmetric price target of 2% over the medium term. As for investments, high input prices, together with rising wage pressure, could challenge corporate margins—thus ensuring **our preference for companies with pricing power.**

Investment decisions regarding China have become more delicate recently in view of the regulatory crackdown on many leading sectors of the economy and the pressure on offshore equity listings. From a macroeconomic point of view, the slowdown in economic momentum should lead to greater fiscal support, likely to be targeted to align with the Communist regime's new 'common prosperity' goals. While an increased focus on governance and on supporting key economic sectors could provide long-term benefits, and while China's middle class continues to grow, the short-term impact of regulatory changes could be negative for corporate profits.

Other emerging markets like Brazil are trailing in their vaccination drives and also are especially vulnerable to surges in inflation. While such countries have benefited from big increases in commodity prices, more normalised growth in developed markets may mean commodity growth slows. As for Japan, the change of prime minister in Japan may be a trigger for extra policy support in Japan, where economic recovery has been lacklustre. We have a positive stance on Japanese equities.

While generally upbeat on **equities** in general in the medium term, we believe there is a risk of disappointment in the short term as the pace of earnings growth slows, supply bottlenecks keep inflation aloft and tax increases are increasingly discussed.

Despite low spreads, we still see carry opportunities in what we call the **credit trilogy.** This involves investing in so-called 'rising stars' (credits recently downgraded to high yield status but on the cusp of regaining their investment-grade status) as ratings upgrades outstrip downgrades. While adamant about the need to avoid the lower depths of the rating scale, we also see scope for going carefully down the capital structure to invest in the subordinated debt of financial companies and hybrid structures—the second part of our credit trilogy. Our conviction that one can take advantage of volatility in the credit curve to pick up yield from duration plays forms the third part of the trilogy.

Finally, we would like to point to the scope for **real assets** to provide diversification to an asset allocation. Areas of interest include REITS and private-equity real estate, which should benefit from a post-pandemic reset of commercial property markets. ■