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Spectre of inflation waning

Overview

Equity markets gained ground last week, particularly in Europe, on the back of better macroeconomic data across the board. The services sector improved its showing as lockdowns and other restrictions were eased. Sector wise, energy – helped by the 4.5% increase in crude prices on confirmation of OPEC production cuts – and automotive were particularly firm. Financials and tech were moreover helped by a downswing in bond yields, with the US 10-year yield dipping to 1.57%. We believe that the stronger recovery in European equity markets is set to continue, underpinned by the estimate for 50% earnings growth this year, indices' highly cyclical compositions and more attractive valuations compared with US equities.

The stronger recovery in European equity markets is set to continue

Despite firmer macroeconomic indicators than expected, in turn boosting the prospect for higher interest rates, the spectre of inflation has been waning of late. It looks like central banks have succeeded in reassuring the markets of their willingness to keep policy nice and lose for the foreseeable future. The US employment report for May showed 559,000 new jobs, which in other circumstances might have caused an upset given that the forecast was for 671,000 (the unemployment rate fell to 5.8%). Yet the lower-than-expected data has cooled expectations of imminent monetary policy tightening. The Fed is starting to unwind the corporate bonds facility put in place in March 2020 and will start selling down the fixed-income ETFs and corporate bonds it has acquired. But the amount of these sales is meagre, amounting to around USD 5 billion in corporate bonds and USD 8.5 billion in ETFs on a balance sheet approaching USD 8 trillion. The ECB, which meets on Thursday, is meanwhile expected to revise its GDP growth outlook upwards amid record business indicators and imminent plans to launch the European stimulus fund. However, it will probably stick to its accommodative monetary stance as the current economic-recovery phase requires strong support.

G7 members this weekend agreed to a minimum tax rate of 15% on corporate profits. Under these plans, countries will be given the right to tax profits wherever they are generated.

G7 members agree on minimum corporate tax rate of 15%

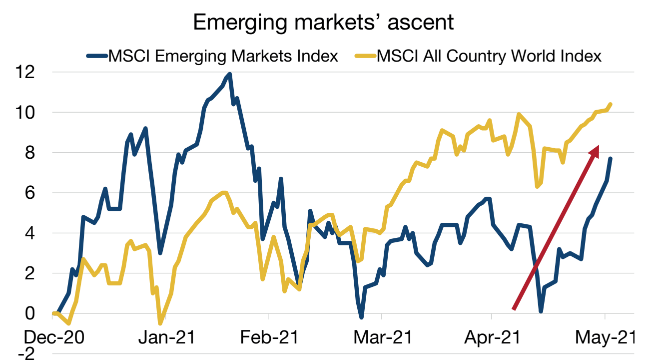
The OECD estimates that this could generate between USD 50 billion and 80 billion in additional tax revenues per year. After this basic agreement, aimed mainly at closing the loopholes that multinationals have been exploiting to reduce their tax bills, the road to genuine global tax reform will still be long.

Key data

	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI Emerging Markets
Latest	0.90	1.09	11'570.68	4'089.38	15'692.90	6'515.66	7'069.04	4'229.89	13'814.49	28'941.52	1'381.56
Trend	➡	➡	⬆	⬆	⬆	⬆	➡	⬆	⬆	⬆	⬆
YTD	1.61%	1.15%	8.10%	15.11%	14.39%	17.37%	9.42%	12.61%	7.19%	5.46%	6.99%

(values from the Friday preceding publication)

Emerging opportunities?



Emerging economies are benefiting from both the global recovery and the weaker dollar. In May, the MSCI Emerging Index was lifted by a renewed risk appetite among investors, who hoisted it back to the uptrend line last seen in February.

China – where the recovery has been stronger and which dominates the EM index – is largely responsible. The Chinese equity market has rallied strong recently, pushing its market capitalisation to USD 12 trillion, which is 55% higher than when the pandemic began in March 2020. Supportive fiscal and monetary policies together with ample liquidity have fuelled the economic recovery and strengthened the yuan, driving the value of Chinese equities higher since last October, when the index hit USD 10 trillion for the first time since 2015. While some of the market value stems from new listings and the total amount is still a far cry from America's USD 48 billion, China's recent market-cap numbers have sent EM indices soaring.

The current business environment and the significant growth differential tilted in their favour are helping emerging economies. The prospects for returns, plus the attractive valuations compared with developed economies, are likely to continue luring fresh capital. In particular Asia, which already represents 80% of global EM indices' weightings, is benefiting most from the recovery in world trade, thanks notably to the November 2020 trade treaty uniting 15 Asian countries representing 30% of world trade.

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