Baloise Market View

Current economic and financial market expectations

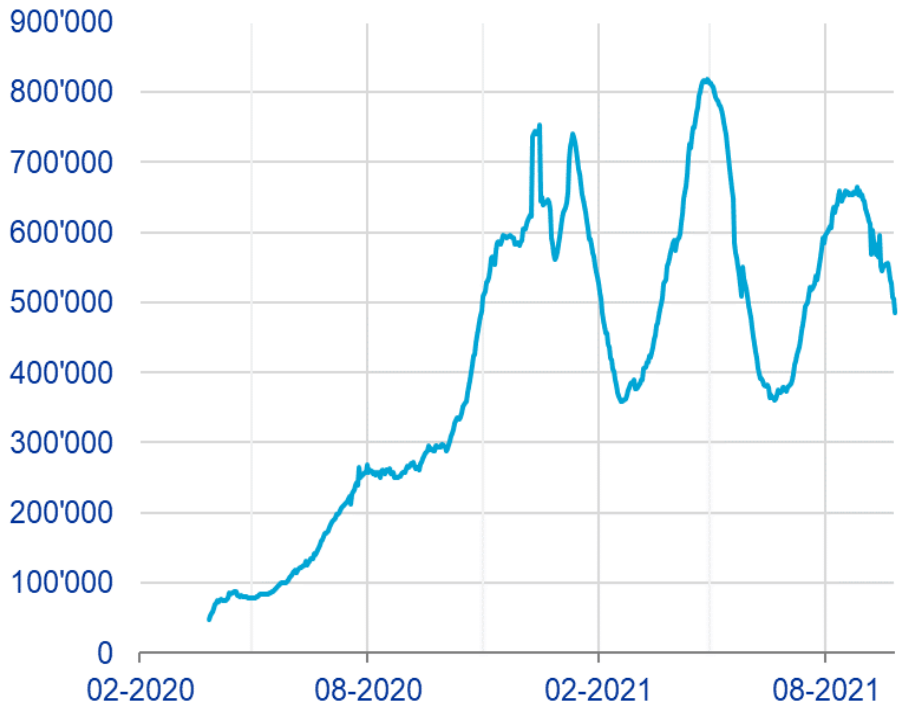
Baloise
Asset Management

COVID-19 Monitoring

Falling case numbers provide some relief

Global case numbers

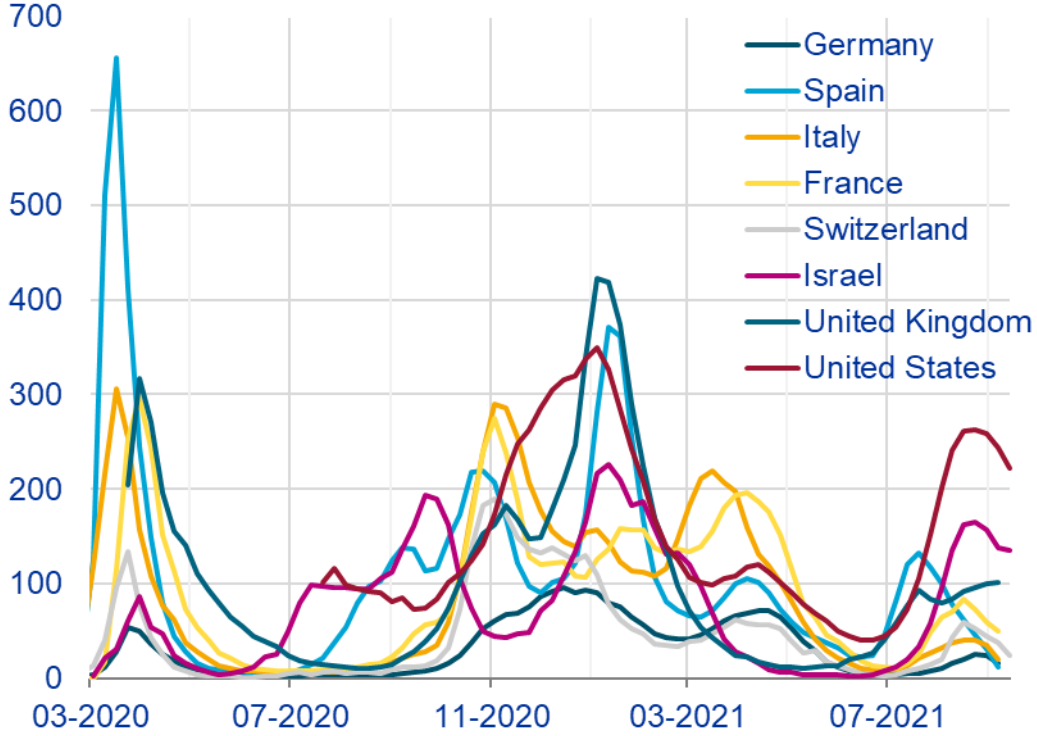
7-day average



Sources: Baloise Asset Management, Bloomberg Finance L.P.

Global hospitalizations

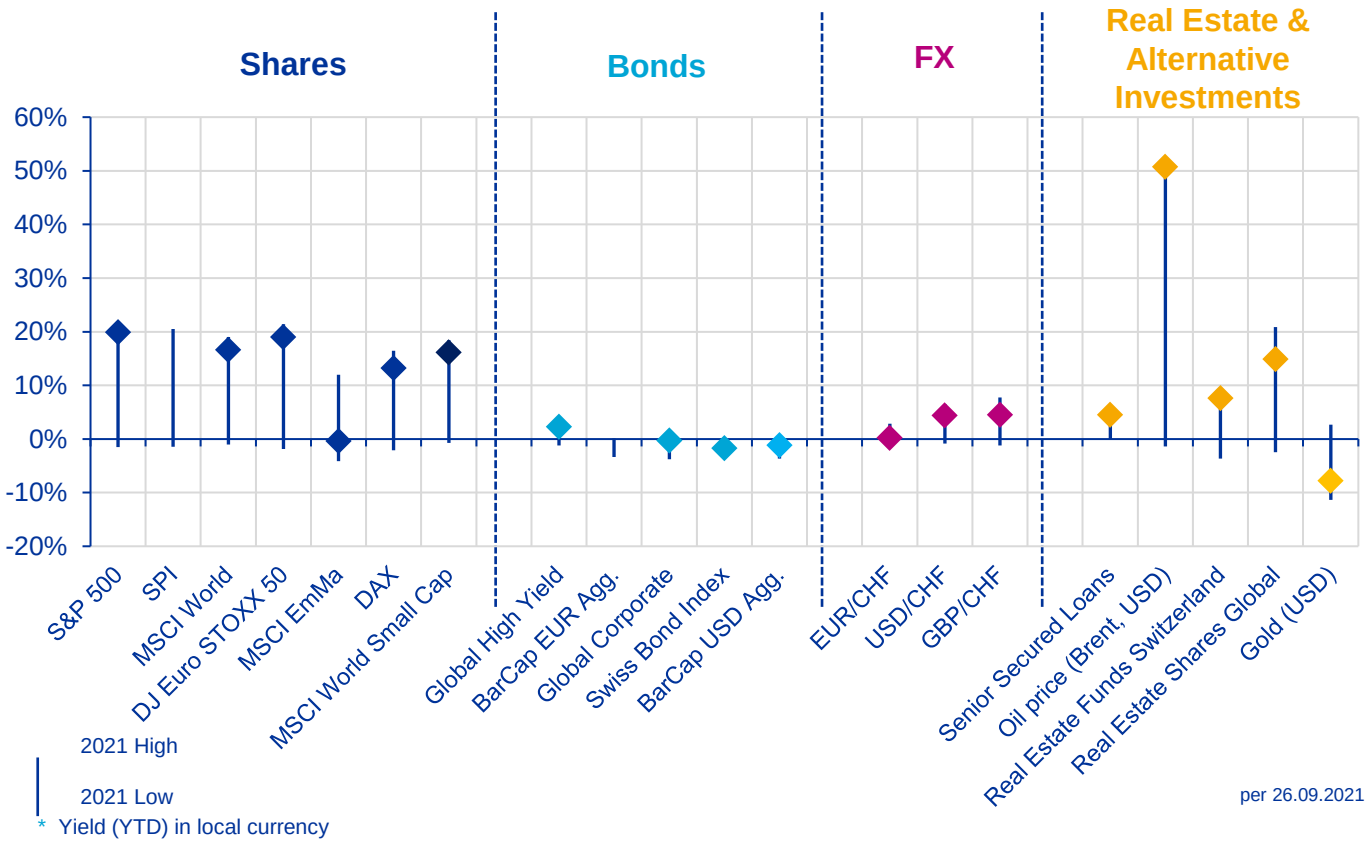
Weekly hospital admissions per 1 million inhabitants



Sources: Baloise Asset Management, Our World in Data

Financial market developments since the beginning of the year

The Evergrande Group crisis in China unsettles global investors



Sources: Baloise Asset Management, Bloomberg Finance L.P.

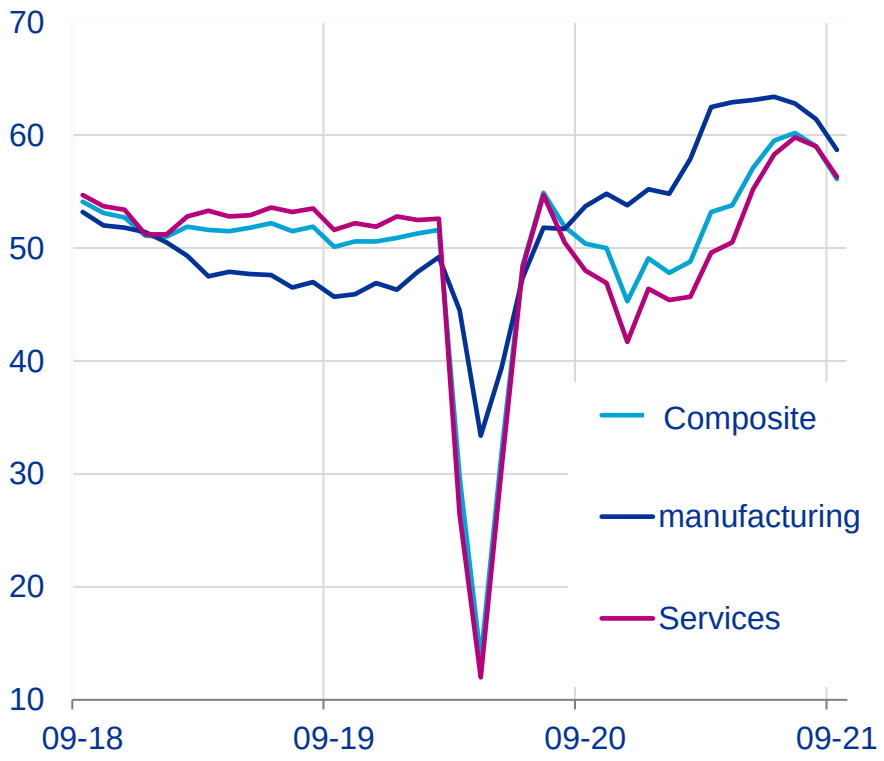
Development

- The impending bankruptcy of Evergrande, the second largest real estate company in China, is fuelling uncertainty in global markets.
- The VIX index, Wall Street's so-called fear barometer, briefly rose to its highest level since May 2021. It is now only slightly above levels seen in early September.
- Most equity markets continue to post double-digit year-to-date performances.

Macroeconomic environment: Summary

Supply bottlenecks dampen economic momentum

Eurozone Purchasing Managers' Indices



Sources: Baloise Asset Management, Bloomberg Finance L.P.

Economic activity and inflation

- Global economic growth is losing steam. Delivery delays, bottlenecks and ever higher prices for input materials are weighing particularly heavily on the manufacturing sector. However, higher costs are also increasingly impacting the service sector.
- The current consumer **inflation rate** is 4.2% in the **US.** In **Europe,** the rate is 3.0% for the eurozone and 0.9% for **Switzerland.**
- The rise in inflation rates is being driven by special effects and supply bottlenecks. Both factors should ease somewhat over the next few quarters (more on this topic here). However, there is a risk that regional lockdowns, especially in emerging markets, will delay the normalisation of supply chains.

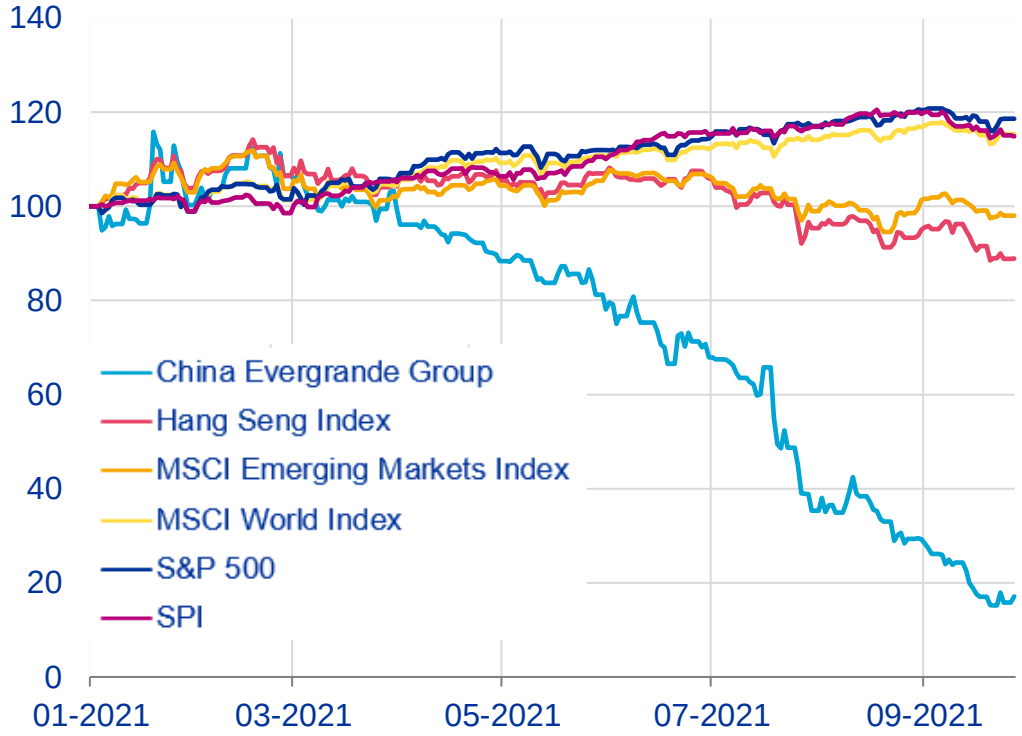
Monetary policy

- The **US key interest rate** is set at a target range of 0.00-0.25%. If the US economic situation does not deteriorate significantly, the monthly bond purchases of USD 120 billion are to be reduced slightly from November 2021. The first interest rate hike could then take place as early as the end of 2022.
- The **European Central Bank** is reducing the pace of its bond purchases. However, the QE volume still totals EUR 1.85 trillion and runs until at least the end of March 2022. The interest rate on the deposit facility remains at -0.50%.
- In **Switzerland**, the key interest rate remains at -0.75%.

Financial Market Outlook: Focus Evergrande

China's real estate giant shows vulnerabilities in China's economy

Share performance since the beginning of the year



Sources: Baloise Asset Management, Bloomberg Finance L.P.

- The impending bankruptcy of Evergrande, the second-largest real estate company in China, is fuelling uncertainty in global markets. China's central bank subsequently provided markets with additional liquidity.
- We do not expect the collapse of Evergrande to trigger a global financial crisis, as was the case with the Lehman bankruptcy, the escalation of the US real estate crisis in 2008. Evergrande and China's real estate sector are too little interconnected in the global financial markets for that.
- Real estate sector, however, is a driving force for China's economy. The sector accounts for around 30% of gross domestic product. In most OECD countries, this figure is 15-20%.
- Even without a financial crisis, a slowdown in China's real estate sector would have global implications for commodity prices and, correspondingly, for countries exporting to China.

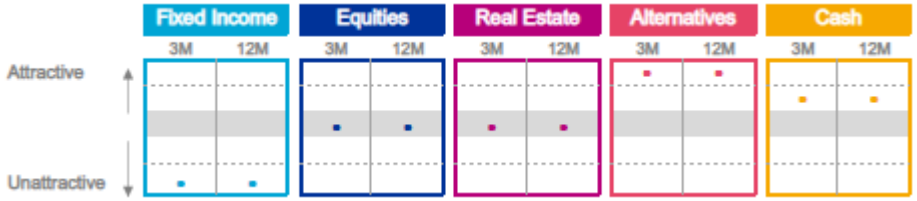
Economic and Financial Market Outlook: Global

Our current scenarios for the coming 12 months

	70% Base scenario	20% Negative scenario	10% Positive scenario
Assumptions	› The pandemic is increasingly manageable due to progressive vaccination and containment measures are less drastic than in spring 2020 › Expansionary fiscal and monetary policies remain supportive	› Renewed worsening of the global pandemic wave due to newly emerging virus mutations and lower protective efficacy of licensed vaccines › Due to the high level of debt, governments are reluctant to put together further aid packages	› Faster than expected containment of global pandemic thanks to very effective and widely available vaccines › Only minor restrictions, so that overall economic activity is no longer impaired
Economy	› Economic recovery is progressing › However, the dynamics of the recovery varies greatly across countries and sectors › Increased inflation rates over next few months	› Necessary further containment measures lead to a renewed slump in growth or recession › Rising unemployment and payment defaults in the hard-hit sectors	› Strong and sustained recovery due to catch-up effects in consumption › Improved prospects lead to higher investment and falling unemployment
Monetary policy	› Central banks reduce their bond purchases, but monetary policy remains expansionary overall › Temporary overshooting of inflation targets is tolerated by central banks	› Inflation rates and expectations fall again › Renewed QE expansion and extension of existing measures	› Gradual tapering of QE measures and first rate hike in 2022 (USA) › Inflation normalises faster than expected
Financial markets	› **Long-term interest rates** slightly rising › **Credit spreads** mostly move sideways at very low levels › Volatile **stock market development** with slight upward trend in the medium term	› **Interest rates** reach new lows › Sharp increase in **credit spreads** › Renewed sell-off on the **stock markets** (losses 15-20% from current levels)	› Gradual and sustained rise in **long-term interest rates** › Slight decline in **credit spreads** › **Stock markets** rise again significantly (>10%) and reach new highs

Baloise Market View: At a glance

Positioning against benchmark



Equities: Equities remain attractive in the stubbornly low interest rate environment. However, uncertainty around China's real estate sector, the general inflation outlook, and concerns about slowing global economic momentum are likely to drive market volatility somewhat higher in the coming months. We therefore prefer a neutral equity allocation in line with the strategy. A possible technical correction would offer the opportunity to make targeted reallocations to cheaper stocks and markets. At present, emerging market stocks are relatively cheap, but these are weighed down by various risks.

Bonds: We consider bonds to be unattractive overall, as we continue to expect a prolonged low interest rate environment. Overall, government bonds continue to be unattractive and serve primarily as a stabiliser in the portfolio in the event of market distortions. Credit spreads on corporate bonds remain at very low levels. We expect credit spreads to remain stable, which is why we consider corporate bonds to be somewhat more attractive due to the higher yield compared to government bonds. However, caution is called for in credit selection, as many rating segments are now very expensive, especially in the US dollar. Also, sectors that have been hit particularly hard by the Corona crisis no longer have an additional credit risk premium compared to pre-crisis levels.

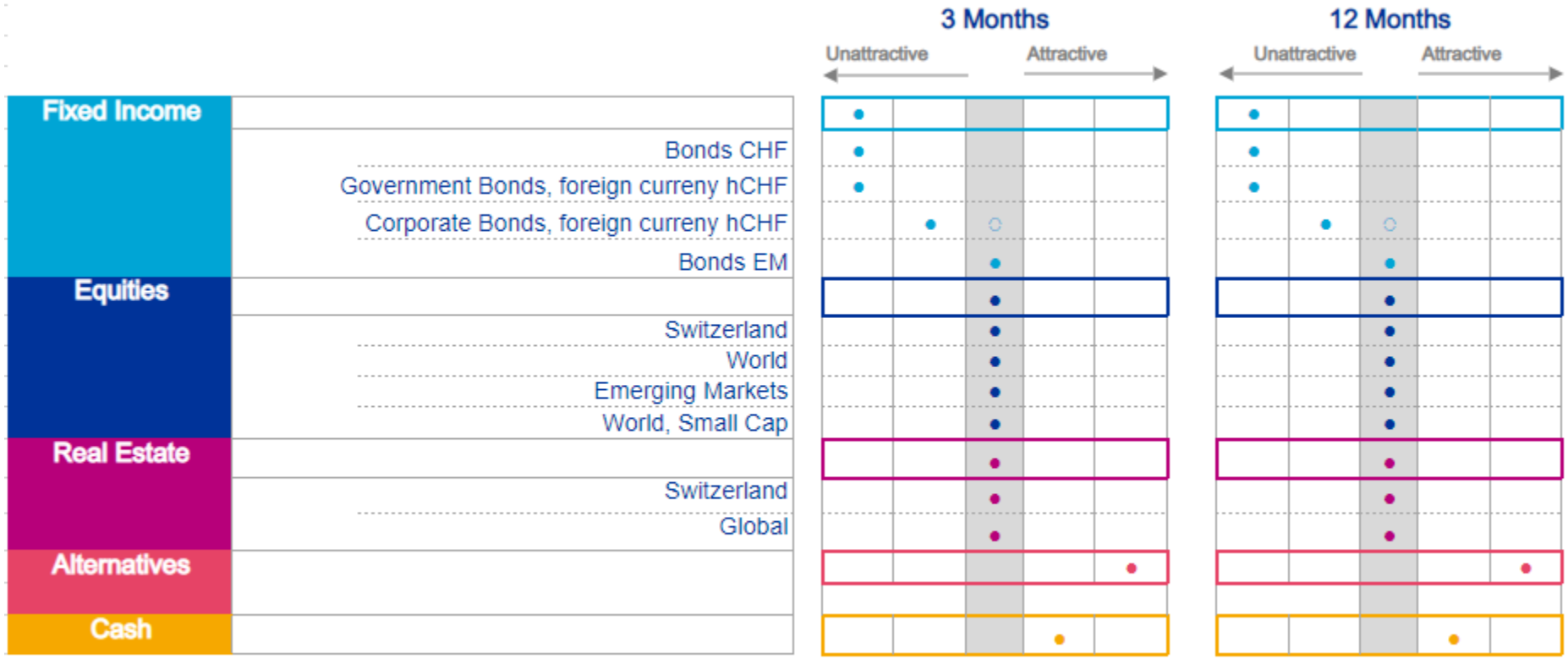
Real estate: A prolonged low interest rate environment is fundamentally positive for real estate markets. However, real estate investors should keep in mind that, in light of the Corona crisis, real estate portfolios with high allocations to hotel, restaurant and leisure properties continue to be most exposed to rent defaults and declines in market value. The strongest demand continues to be for residential properties in good locations.

Alternative investments: In the alternative investments segment, attractive sources of return can be found due to the lower liquidity relative to other asset classes. In the current environment, for example, senior secured loans (SSLs) offer attractive yields compared to high yield bonds. We also consider convertible bonds and infrastructure investments to be strategically attractive segments. As we expect more volatile markets in the coming months, we also see gold as a good portfolio stabiliser.

Cash: In view of the more volatile market environment, an increased liquidity ratio is indicated in the short term despite negative interest rates. This can be reduced in a targeted manner to take advantage of market opportunities as they arise.

Baloise Market View: In detail

Positioning against benchmark



Current view: •; previous month: ○

Sources: Baloise Asset Management as of 24.09.2021

Note: Alternative investments include commodities, gold, infrastructure, senior secured loans and convertible bonds.
"hCHF" means hedged in Swiss francs, EM/ Emerging Markets stands for emerging markets

Baloise Asset Management
Aeschengraben 21
CH-4002 Basel

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