TRAMONDO
INVESTMENT PARTNERS

QUARTERLY

Tramondo's take on markets, monetary policy, politics and economics. And resulting investment opportunities that successful individuals, families, and institutional investors need to be aware of today.

A STEEPENING ROAD AHEAD

SUMMARY

- In Q2 2021, global equity markets continued on a positive path fueled by solid earnings reports and policy makers' commitment to keep floodgates open at both monetary and fiscal policy levels.
- Overall, inflation is definitely heating up. The only question is whether these price dynamics are transitory – as the central bankers expect – or prove to be permanent.
- In its quest to accelerate the return to economic normalcy, the US government has been pushing an aggressive agenda of substantial public spending. The long-awaited USD 6 trillion budget proposal for the fiscal year 2022 was recently unveiled and included quite a few surprises.
- After a stellar comeback in late 2020, consumer sentiment has levelled off most recently as the US population appears not to be too confident about the current upswing. The latest data indicate that especially households earning under USD 50,000 annually are concerned about their economic prospects.
- Despite the rather supportive fundamentals, new tail risks have emerged during Q2 2021. However, the medium- to long-term investment case for global equities still looks compelling, especially compared to nominal asset classes such as bonds. Thus, we reiterate our positive stance for equities while acknowledging that the road for the remainder of the year might get somewhat steeper and rockier.

INTRODUCTION

Finally, football is coming home again. With a delay of one year, the long-awaited European football championships started almost one month ago. This tournament marks one of the first major sports events since the COVID-19 outbreak more than 18 months ago. It is clear that this competition is not only about sports but also about bringing people together. The championships allow people from different countries and cultures to express and share their emotions face–to-face without being (severely) restricted by annoying COVID-19 measures. On the 11th of July, the last two remaining teams which made it to the championship final will compete in the world-famous Wembley Stadium in London in front of a crowd of roughly 60'000 fans. At the beginning of this year, who would have thought that this would be possible only six months later?

These championships reflect another important step towards a world after COVID-19. A world that is still under construction but takes more and more shape. Looking to financial markets, current asset valuations indicate that this new era seems very promising. Indeed, there are a few reasons that the positive momentum of risky assets could continue for quite a while. Economies and financial markets around the globe have been injected with enormous amounts of liquidity, both to stimulate economic growth and mitigate the devastating effects of the COVID-19 pandemic. These supportive factors will definitely not disappear overnight. However, the liquidity glut is likely to trend downward over the course of the next quarters. Consequently, risks and market volatility are prone to increase while the prospects for juicy investment returns might become increasingly gloomy in the second half of the year.

So far, accelerating inflation expectations and rising consumer prices have only unsettled investors for shorter time periods. The US central bank expects current inflation dynamics to be transitory and thus still sticks to its ultra-expansionary policy stance. Nevertheless, the coming quarters will prove whether the Federal Reserve (Fed) is right in its assessment – we would not be surprised if the central bankers would be wrong (once again). We believe that current valuations on financial markets hardly reflect a sustained inflation increase. In that context, we once again advocate investors not to comprise on the quality of their investments. In our research paper "Spotlight on Quality" – which we published back in May – we highlighted that stocks of high-quality companies had outperformed the broader equity market in times of rising inflation. Thanks to their superior business models, these companies are in an excellent position to protect their margins by handing down rising input costs (due to inflation) to their loyal customer base. Thus, we still consider quality the most essential selection criterion for successful investors, especially in times with an uncertain inflation outlook.

With these critical thoughts, we would like to wish you and your family only the very best for the upcoming summer holiday season. We hope you will find some time to recharge your energy reserves for the second half of 2021, which definitely will come up with new challenges for market participants.

Raphael Müller, CEO

Andreas Schranz, CIO

THE BIG PICTURE

MARKET REVIEW

WILD BONANZA IN THE FIXED INCOME MARKET

In Q2 2021, global equity markets continued on a positive path fueled by solid earnings reports and policy makers' commitment to keep floodgates open at both monetary and fiscal policy levels. In May, US president Biden unveiled a massive USD 6 trillion budget for 2022, the biggest budget in the country's recent history. The proposed budget is part of the administration's long-term plan to overhaul the US economy while running significant fiscal deficits for the rest of the decade. Regarding the battle against COVID-19, great progress has been achieved during Q2 2021. In the meantime, almost 25% of the world population have received at least one vaccine dose (up from roughly 5% at the end of Q1 2021). In Switzerland, almost half of the population have already been vaccinated with at least one shot – a pretty remarkable number after the country seriously struggled to vaccinate its population at the beginning of the year.

DURING Q2 2021, GREAT PROGRESS HAS BEEN ACHIEVED IN THE BATTLE AGAINST COVID-19,

ASSET CLASS PERFORMANCE

Market Review Index	Asset Class	01/07/2021 2021 YTD
MSCI World Index	*Equity*	13.3%
MSCI Emerging Markets Index	*Equity*	7.4%
S&P 500 Index	*Equity*	15.2%
Swiss Market Index	*Equity*	14.7%
Euro Stoxx 50 Price Index	*Equity*	16.6%
Barclays Glo.-Agg. Total Return Index	*Fixed Income*	-3.2%
Swiss Bond Index (SBI) Domestic Index	*Fixed Income*	-1.6%
Bloomberg Barclays Euro Agg. Index	*Fixed Income*	-2.3%
Gold Spot Price ($/Oz)	*Alternatives*	-6.5%
HFRI Equity Index	*Alternatives*	11.2%

ASSET CLASS PERFORMANCE AS AT 1 JULY 2021;
SOURCE: TRAMONDO INVESTMENT PARTNERS, BLOOMBERG

On the back of these positive developments, the US equity index S&P 500 and its European counterpart EuroStoxx 50 ended the quarter up 8.2% and 3.7%, respectively. Given the risk-on attitude of market participants, it is somewhat surprising that the defensive Swiss equity market could come up with a stellar quarterly performance (+8.1% in Q2 2021). It looks like market participants positioned themselves for a stormier second half of the year in which the defensive quality of the domestic equity market could prove very valuable. Overall, the MSCI World index gained 7.3%, while Emerging Markets clearly underperformed in the quarter under review (MSCI Emerging Markets +4.4%).

Turning to nominal assets, long-term inflation expectations in the US rose to multi-year highs during the quarter, causing significant volatility in nominal yields. As a result, yields of 10-year US treasury bonds fell 27 bps in Q2 2021. A rational investor may wonder how nominal yields could be falling in light of higher inflation expectations. One answer could be that yields of inflation-adjusted government bonds slid deeper into negative territory because investors desperately look for suitable strategies to hedge inflation.

IN SWITZERLAND, THE PRESSURE ON BONDS WITNESSED IN THE BEGINNING OF THE YEAR PARTIALLY FADED AWAY.

Since inflation tends to support companies in servicing their debt, both investment-grade (+3.6% in Q2 2021) as well as high-yield bonds (+2.7%) finished the quarter in positive territory. In Switzerland, the pressure on bonds witnessed in the beginning of the year partially faded away as yields of 10-year Swiss government bonds closed the quarter fairly unchanged.

Lastly, commodities such as gold experienced tailwinds in Q2 2021 amid increased inflation pressures. However, towards the end of the quarter, market participants began to price in a tighter monetary policy sending most commodity prices south. In June, gold had its worst month since February 2020 and closed the month 7.2% lower. At the end of Q2 2021, gold was quoted with a price of 1770 USD/oz, reflecting a gain of 3.7% for the quarter in USD, and of 1.6% in CHF, respectively.

MONETARY POLICY

INFLATION IS HEATING UP

Undoubtedly, last quarter's most debated topic among central bankers was inflation, or to be specific, the future trajectory of inflation. All over the world, supply shortages in certain areas of the economy (e.g., the semiconductor industry) and rising commodity prices have been lifting producer prices during Q2 2021. To make things even worse, companies in the US struggled to fill their job vacancies as many jobless people still refused to enter the labour market due to generous unemployment benefits. Thus, it is not really surprising that companies in labour-intensive sectors (e.g., retail industry) had to raise their minimum salaries to attract new employees.

US CONSUMER PRICES ON THE RISE

PCE CYOY INDEX (CORE PERSONAL CONSUMPTION EXPENDITURES); SOURCE: BLOOMBERG

Consequently, the Fed's preferred inflation measure – the so-called personal consumption expenditure index – came in at 3.4% last month, the highest number since April 1992. Thus, overall, inflation is definitely heating up. The only question is whether these price dynamics are transitory – as the central bankers expect – or prove to be permanent.

In its last meeting in June, the US central bank Fed slightly adjusted its forward guidance. As of now, the Fed expects to increase rates in 2023 for the first time in the new decade. This rather hawkish move came somewhat as a surprise. A couple of weeks ago, rate hikes before 2024 seemed to be somewhat unrealistic as the central bank always emphasized that the real economy needs further help to regain its full strength after COVID-19. In that context, US central bankers still consider the job market as a weak spot. There is an emotional debate going on whether current stimulus packages should be increased (given increased levels of poverty post-COVID-19) or reduced (to incentivize people to go back to the job market).

Turning eastward, the European Central Bank (ECB) decided not to signal when it intends to reduce its monetary stimulus program while mentioning that inflation would remain below target. In that context, it is essential to remember that the ECB committed to purchasing EUR 1.85 trillion worth of bonds until March 2022 as part of its Pandemic Emergency Purchase Program. In short, there are no material changes in its generous current and prospective monetary policy.

POLITICS

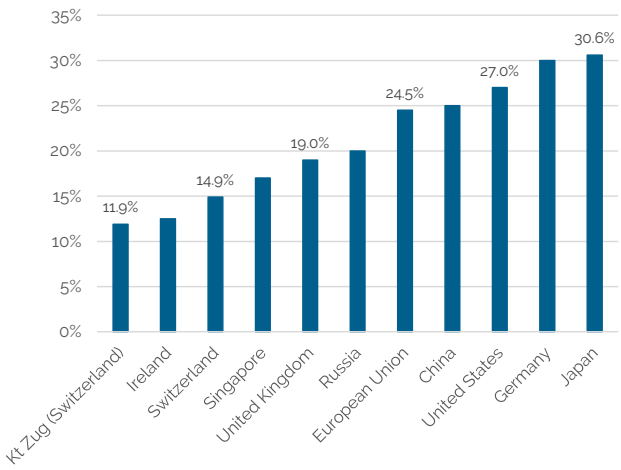
G20 LEADERS PUT PRESSURE ON SWITZERLAND

THE BIDEN/HARRIS ADMINISTRATION IS LIKELY TO RAISE FEDERAL SPENDING TO USD 8.2 TRILLION BY 2031, IMPLYING A USD 1.8 TRILLION ANNUAL FISCAL DEFICIT ON AVERAGE.

In its quest to accelerate the return to economic normalcy, the US government has been pushing an aggressive agenda of substantial public spending. The long-awaited USD 6 trillion budget proposal for the fiscal year 2022 was recently unveiled and included quite a few surprises. On the one hand, the Biden/Harris administration is likely to raise federal spending to USD 8.2 trillion by 2031, implying a USD 1.8 trillion annual fiscal deficit on average. This is considerably more than the USD 1 trillion deficit of pre-pandemic 2019 levels. On the other hand, this ambitious plan is expected to be funded through tax hikes that will ultimately make up 19% of the US GDP. Truly an outstanding figure that was last reached in 1998.

The second politically significant development in Q2 2021 was an emerging international consensus for a global minimum corporate tax. The draft - outlined by the G20 member states – indicated that they had achieved a historic agreement on what they believe to be a "fair and stable international tax architecture".

SWITZERLAND'S AVERAGE CORPORATE TAX RATE IS AMONG THE LOWEST IN THE WORLD



AVERAGE CORPORATE TAX RATES; SOURCE: SWI SWISSINFO.CH

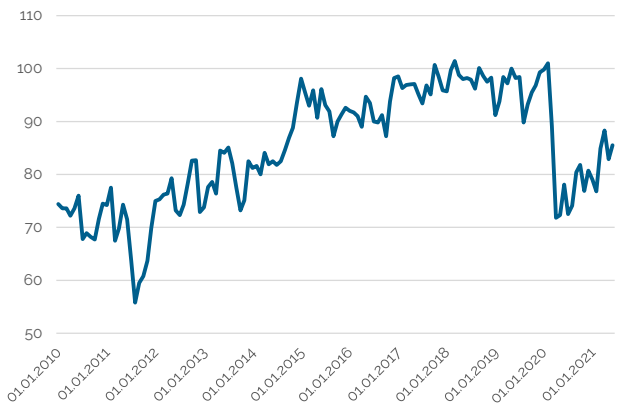
For tax havens like Switzerland, these efforts could threaten its status as a hub for multinational company headquarters. At the end of 2019, roughly 8,800 foreign companies had an operating base in Switzerland supporting more than 500,000 jobs. Moreover, with an average tax rate of 14.9%, Switzerland's corporate taxation is significantly lower than in the European Union (average tax rate of 24.5%) or in the United States (average tax rate of 27.0%). Overall, the above-mentioned tax reform could seriously endanger the prosperity of the domestic economy.

ECONOMICS

DETERIORATING CONSUMER SENTIMENT IN THE US

Economic growth in the US has recovered noticeably from last year's virus-induced hibernation. In Q1 2021, US GDP snapped back with an annual growth rate of 6.4%, its best reading since Q3 2003. However, it is remarkable that consumer sentiment still clearly lags the economic momentum. After a stellar comeback in late 2020, consumer sentiment has levelled off most recently as the US population appears not to be too confident about the current upswing. The latest data indicate that especially households earning under USD 50,000 annually are concerned about their economic prospects. From an economic point of view, this is not a big surprise. First of all, some states in the US will soon begin to reduce federal unemployment benefits definitely restraining the budgets of low-income households. Second, consumer prices are on the rise – as already mentioned in the section "Monetary Policy" – indicating that consumers are paying significantly more for the same than they did a year ago. Altogether, these adverse effects may somewhat impede the ongoing comeback story of the world's leading economy.

CONSUMER SENTIMENT FALLS SHORT OF THE ECONOMIC REBOUND



UNIVERSITY OF MICHIGAN CONSUMER SENTIMENT INDEX; SOURCE: BLOOMBERG

During Q2 2021, policymakers in China unleashed a series of rhetoric and administrative measures to rein in the commodities surge that is threatening to derail the nation's economic recovery. Among others, Chinese authorities raised commodity transaction fees, changed tax rules, and urged domestic commodity producers to sell inventories. In that context, it is worth remembering that China is still the biggest commodity consumer indicating that even marginal price increases are bound to hurt their economy significantly more than those of most developed countries. However, we seriously doubt that the aggressive measures taken by China will be able to stop the current commodity super-cycle given the buoyant global demand.

FINANCIAL MARKETS LIKELY TO FACE HIGHER VOLATILITY

ASSET ALLOCATION

CASH

FIXED INCOME

EQUITIES

ALTERNATIVES

Please note that this is an asset allocation snapshot as at 1 July 2021. Our portfolios are actively managed and allocations are reviewed daily for their accuracy and to ensure downside protection.

DESPITE THE RATHER SUPPORTIVE FUNDAMENTALS, NEW TAIL RISKS HAVE EMERGED DURING Q2 2021.

INVESTMENT CONCLUSION

So far, 2021 has been very generous to investors. The equity index MSCI World is up 12.2% since the start of the year and trades just shy below its all-time high. During Q2 2021, companies have proven once again that they have excellently mastered last year's big challenges. In the US, earnings growth for Q1 2021 came in at 46.3% - the highest number since Q2 2010 – while 86.1% of the reporting companies beat their analyst expectations. What a blowout quarter!

In the wake of the COVID-19 crisis, companies worldwide had been forced to cut down their operating costs to stay afloat. In the meantime, companies' order books have been filled to the brim due to a unique combination of an emerging economic recovery (after last year's pandemic fallout) and significant pent-up demand from both businesses and private consumers. Thus, companies currently benefit from stellar revenue momentum and a lower cost base, which, as a consequence, led to record-high operating margins for companies in 2021 so far. In that context, several Swiss industrial companies such as Bossard, SFS, or Bobst most recently increased their operational outlook for the remainder of the year.

However, despite the rather supportive fundamentals, new tail risks have emerged during Q2 2021. First of all, production bottlenecks in certain industries (e.g., a supply shortage in the semiconductor sector) and rising commodity prices might have the ability to heat up the ongoing inflation momentum. In that context, central bankers who still believe that most recent inflation readings will not prove sustainable might be caught on the wrong foot. And with that, also equity investors will find themselves in an uncomfortable position. Second, we believe that with the stellar earnings reports and the various guidance upgrades we have witnessed in the last couple of weeks, investors' expectations may have run ahead of underlying fundamentals. As a result, we expect earnings growth to normalize in the second half of 2021, which – in combination with record-high valuations for risky markets – might foster market volatility and short-term sector rotations.

However, the medium- to long-term investment case for global equities still looks compelling, especially compared to nominal asset classes such as bonds. Thus, we reiterate our positive stance for equities while acknowledging that the road for the remainder of the year might get somewhat steeper and rockier.

WE STRONGLY ADVISE CLIENTS TO RECONSIDER QUALITY CRITERIA WHEN STRUCTURING THEIR INVESTMENT PORTFOLIOS.

After equity markets' outstanding returns since the start of 2021, we believe it is time for investors to focus on fundamentals again. Given the somewhat more challenging roadmap ahead, the dispersion between good and bad companies will likely increase over the coming months. Accordingly, quality will become the most important selection criterion for portfolio construction once again. In our most recently published research paper "Spotlight on Quality" we pointed out that high-quality stocks – companies with superior business models and outstanding profitability characteristics – reveal lower drawdowns in times of increased market volatility. In these turbulent times, investors tend to shift their assets into stocks of companies with excellent market positioning and solid balance sheets (the so-called "flight to quality effect"). Furthermore, the latest empirical evidence underpins that those high-quality stocks can outperform the broader market in times of rising inflation as they can hand down increasing costs to their customers. Thus, we strongly advise clients to reconsider quality criteria when structuring their investment portfolios.

Turning to nominal assets, the market situation still looks more than challenging. Over the next quarters, longer-dated yields will continue to face upward pressure from the ongoing economic recovery and the uptrending inflation. Thus, we recommend that investors retain a cautious attitude towards duration. Overall, the current opportunity set in the fixed income market looks fairly restricted. However, we still believe that Emerging Market bonds offer interesting risk/reward characteristics, especially when the US Dollar resumes its downtrend. Beyond that, we stick to our strategic position in inflation-protected government bonds to combat higher inflation in the years to come.

Last but not least, a word to commodities. We still believe that this asset class has not yet re-synced with supportive fundamentals and stick to our overweight position. In today's environment, it is increasingly difficult to find asset classes that are independent from central banks' influence. Gold, as well as industrial metals, provide a good hedge against rising inflation or – as we call it at Tramondo – the greatest monetary policy experiment of modern times.

PERFORMANCE TABLE AND CONSENSUS FORECAST

Asset Classes 01/07/2021	Price	2021 YTD	Last Quarter	6 Months	12 Months
GLOBAL EQUITY MARKETS					
Regions					
MSCI World	3'017	13.33	7.88	13.33	39.71
SMI	11'978	14.65	9.58	14.65	22.44
EuroStoxx 50	4'076	16.59	5.25	16.59	29.01
DAX	15'581	13.21	3.48	13.21	26.16
S&P500	4'308	15.24	8.55	15.24	40.77
Nasdaq	14'503	12.92	9.68	12.92	45.29
Nikkei	28'707	5.75	-1.24	5.75	31.29
MSCI Emerging Markets	1'375	7.43	5.08	7.43	41.29
China CSI 300	5'230	1.01	4.27	1.01	27.73
Sectors					
S&P GL 1200 Energy Index	1'761	32.85	9.82	32.85	43.16
S&P GL 1200 CONS DISC IX	5'239	9.86	6.30	9.86	41.92
S&P GL 1200 CONS STAP I)	3'441	5.87	6.43	5.87	21.49
S&P GL 1200 Real Estate	2'530	18.39	10.96	18.39	31.01
S&P GL 1200 UTILITIES IX	1'804	0.57	-0.33	0.57	15.37
S&P GL 1200 Comm SRVS	1'765	16.41	8.17	16.41	41.88
S&P GL 1200 HEALTH CARI	4'674	9.76	8.89	9.76	23.10
S&P GL 1200 INFO TECH	8'673	12.91	10.48	12.91	44.96
S&P GL 1200 MATERIAL IN	3'714	13.12	6.28	13.12	49.29
S&P GL 1200 INDUSTRL IN	3'587	13.12	4.18	13.12	46.13
S&P GL 1200 FINANCIAL	1'647	19.75	6.29	19.75	51.30
GLOBAL BOND MARKETS					
Sectors					
USD Investment Grade	3'516	-1.27	3.55	-1.27	3.30
EUR Investment Grade	265	-0.39	0.29	-0.39	3.61
CHF Investment Grade	140	-1.25	-0.04	-1.25	0.13
USD High Yield	2'423	3.62	2.74	3.62	15.37
EUR High Yield	435	3.56	1.38	3.56	11.90
USD Emerging Markets Del	1'280	-0.59	2.99	-0.59	6.34
USD Contingent Convertibl	311	3.78	2.94	3.78	13.56
USD Senior Loans	491	3.48	1.44	3.48	11.67
GLOBAL FX MARKETS					
Currency pair					
EURUSD	1.19	-2.87	1.09	-2.87	5.46
USDCHF	0.93	4.31	-1.97	4.22	-2.24
EURCHF	1.10	1.49	-0.92	1.49	3.04
GBPUSD	1.38	0.86	0.35	0.84	10.52
AUDUSD	0.75	-2.73	-1.32	-2.73	8.23
USDJPY	111.58	7.47	0.35	7.51	3.68
USDCNH	6.47	-0.51	-1.47	-0.51	-9.25
MACRO DATA					
GDP Growth	**2018**	**2019**	**2020**	**2021E**	**2022E**
World	3.70	3.00	-3.75	6.00	4.50
United States	2.90	2.30	-3.50	6.60	4.10
Eurozone	1.80	1.20	-6.80	4.50	4.20
Germany	1.50	0.60	-5.30	3.50	4.20
Switzerland	2.60	0.80	-3.25	3.50	2.80
Emerging Markets	4.97	4.32	-0.62	5.32	5.17
China	6.60	6.10	2.30	8.50	5.5
Inflation	**2018**	**2019**	**2020**	**2021E**	2022E
World	3.30	3.00	2.20	3.30	3
United States	2.40	1.80	1.30	3.50	2.5
Eurozone	1.70	1.20	0.30	1.80	1.4
Germany	1.90	1.40	0.40	2.50	1.6
Switzerland	0.90	0.40	-0.70	0.40	0.5
Emerging Markets	3.53	3.88	3.26	3.43	3.6
China	2.10	2.90	2.50	1.50	2.3
3M Rate Expectations	**2018**	**2019**	**2020**	**2021E**	2022E
United States	2.74	0.25	0.24	0.25	0.39
Eurozone	-0.32	-0.42	-0.50	-0.51	-0.44
Switzerland	-0.72	-0.74	-0.74	-0.74	-0.75
China	3.05	2.82	2.96	2.75	2.81

PERFORMANCE TABLE AND CONSENSUS FORECAST AS AT 1 JULY 2021;
SOURCE: TRAMONDO INVESTMENT PARTNERS, BLOOMBERG

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