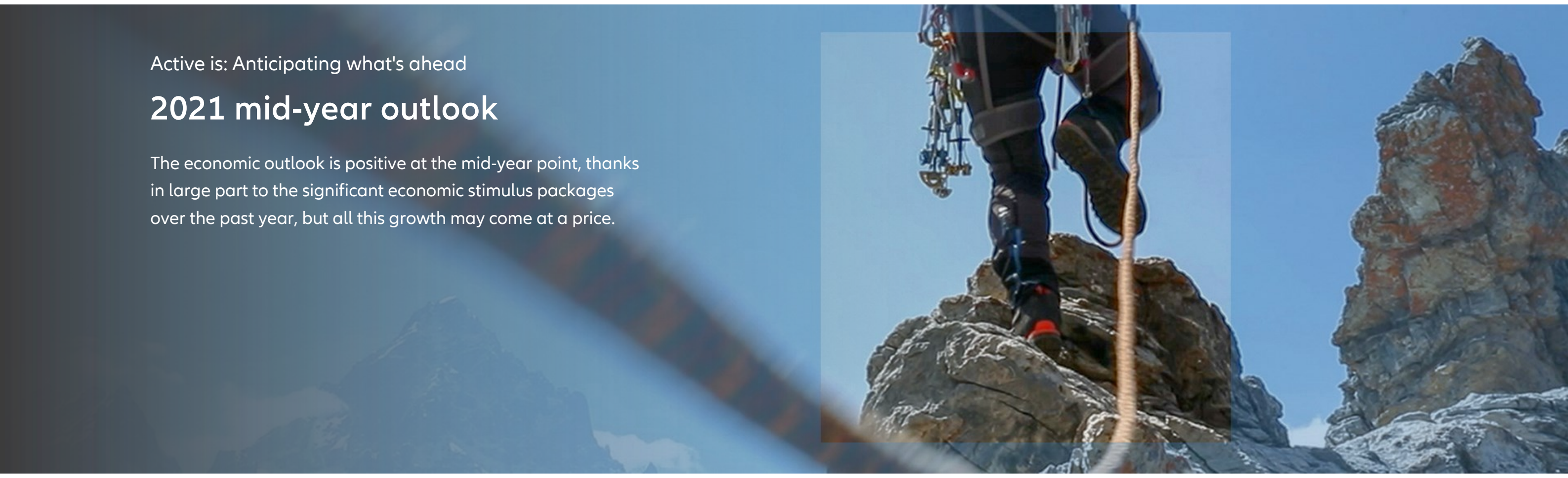


Active is: Anticipating what's ahead

2021 mid-year outlook

The economic outlook is positive at the mid-year point, thanks in large part to the significant economic stimulus packages over the past year, but all this growth may come at a price.

What's ahead for the rest of 2021?

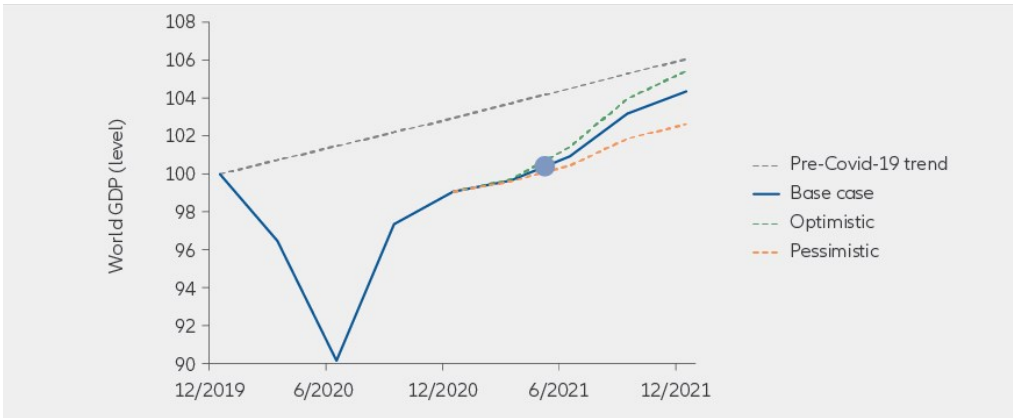
Overall, economic growth has returned forcefully after last year's severe pandemic-related slowdown, bringing a boost to capital markets – though growth will likely remain below the pre-pandemic growth trend for years (see chart). While the Covid-19 crisis isn't over, vaccines are helping some parts of the world turn the corner and the hope is that pandemic risks will decrease as the year progresses. This boom in the economy and markets comes at a potential price – not least a rise in inflation. Investors will also need to navigate uneven levels of economic growth across countries and sectors. And with diverging amounts of fiscal and monetary stimulus around the world, policymakers are responding in a way that investors will want to factor into their strategies.

Investment implications

- A spike in inflation this year – and potentially beyond – makes it important to preserve purchasing power with additional sources of return.
- The recent jump in inflation was a major factor behind the US Federal Reserve's decision to implement small rate hikes in 2023. The market has also been expecting the Fed to start "tapering" its bond-buying, probably in 2022. Both these moves could trigger some volatility depending on how they are managed by the Fed.
- We still have a bias for risk assets – albeit with some caution. As such, we don't think investors should "de-risk" their portfolios, but rather consider a more neutral position along the risk/return spectrum – at least for the short term.

Despite a sharp rebound, global growth is below the pre-Covid trend – which was already subdued

GDP forecast (2020-2021)



Source: Bloomberg, Allianz Global Investors. Data as at May 2021.

Listen to Head of Global Economics and Strategy Stefan Hofrichter discuss our mid-year global economic outlook, including his views on growth, inflation, productivity, labor shortages, supply issues, demographics and more. Also: Stefan contextualizes his forecasts in terms of portfolio positioning and available opportunities in the current fluid environment.

Key takeaways for investors

Keep an eye on inflation

Setbacks in Chinese equities are opportunities

Sustainable investing is the new standard

In this "lower for even longer" environment, keep an eye on inflation

Governments and central bankers dug deep in their pockets to address the Covid-19 crisis, and economic stimulus will continue to be a major factor for financial markets in the second half of 2021. It will likely be lower than the record-setting levels implemented last year, and some emerging markets are expected to raise interest rates. Still, stimulus will likely keep flowing in developed markets – particularly in the US. This is raising concerns about "nanny capitalism", with central banks effectively beholden to their governments by funding this spending. Major central bank balance sheets are at all-time highs and rising (see chart).

One consequence of this stimulus has been a notable spike in inflation that started in the second quarter. The Fed has already reacted by announcing small rate hikes in 2023, and other central banks could follow. But we continue to believe that over the long term, real interest rates (which are adjusted for inflation) will stay low compared with their long-term averages. That's because economic growth is also likely to stay low, and economic growth and interest rates historically track each other relatively closely.

Investment implications

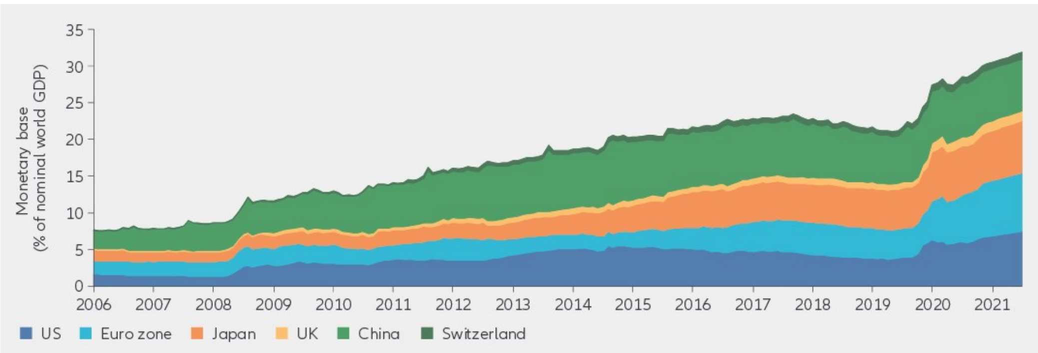
- Fixed income. We have a bias for keeping durations short. Many bonds are expensive, including sovereign, investment-grade and high-yield debt. If bond markets get nervous about inflation and central bank action, yields may rise (and prices fall). Investors will want to manage their positions actively in this environment, but lower prices may also present an attractive opportunity. Income replacement will continue to be a challenge in today's low-yield environment.

- Equities. Central bank liquidity and a general "risk-on" attitude have pushed up the prices of equities. US stocks are expensive – perhaps they're even in bubble territory – but could move higher in the near term. European and Asian equities are cheaper. We favour the value style of investing over growth but, in the long run, tech stocks have an important role to play. Focusing on companies that emphasise sustainable business practices – including environmental, social and governance (ESG) issues – can help investors navigate a possibly bumpy road ahead.

- Risk management. Consider agile risk management strategies. In a low-yield environment, many investors acknowledge that they will need to take more risk to achieve their objectives. The key is to take this risk in a managed way.

Central banks have ramped up already massive asset purchases

Monetary base (bank reserves + money in circulation) as a % of GDP



Source: Bloomberg, Allianz Global Investors. Data as at May 2021.

Our 2021 mid-year regional outlooks

United States

Euro zone

United Kingdom

China

Japan

Emerging markets

DOWNLOAD OUR FULL 2021 MID-YEAR OUTLOOK

Disclosure

[1]2022: The growth opportunity of the century, PwC

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