Our View in October

October 13, 2020

VP BANK

All eyes on the US election

Joe Biden should not feel too safe. Four years ago, Hillary Clinton was also comfortably in the lead in the polls but lost in the end. Nevertheless, the chances of a clear victory for Biden and the Democrats in the US presidential election on November 3 have increased recently. That makes us confident.

Donald Trump taught statisticians and election researchers the meaning of fear in his election of 2016. Despite a considerable lag in the polls, 304 of the 538 electors voted for him. That was a clear victory over Clinton. Four years later, the pollsters tell us that they have learned their lesson. They adapted their methods and forecasting models.

Even if that were true and the predictions are more accurate, one thing is clear: forecasts remain just that, forecasts. There is no such thing as a "100 per cent guarantee".

Even if the 86% probability of Biden's election victory seems very high: Trump still has a chance to be re-elected*.

As investors, what do we conclude from the current opinion polls? On the one hand, that the chances of the Democratic ticket winning are significantly greater than those of the Republicans running with Trump as incumbent. On the other hand, we note that the probability of a narrow election defeat for Trump has recently fallen noticeably. Thus, the fear scenario for the financial markets of a president who doesn’t accept a narrow defeat has almost completely evaporated.

In our view, this is all good news. Not least against this backdrop, we have decided to increase the equity allocation in the portfolio to neutral. Part of this is taking opportunities offered by sustainable urbanisation as an investment theme.

Dr. Felix Brill, **Chief Investment Officer**

*Source: FiveThirtyEight.com

Our View on the **Portfolio**

- A **clear victory in the US presidential election** by Joe Biden and the Democrats
- Support for **fiscal and monetary policy**
- Investment issues focusing on **sustainable development**

- A **narrow defeat in the US presidential election** for the incumbent Donald Trump
- **National lockdowns** in response to new infections out of control
- A **"hard Brexit"** after all

● ● ● ● ● Strong overweight
● ● ● ○ ○ neutral
● ○ ○ ○ ○ Highly underweighted

Base: Mandate CHF balanced

Money market	● ● ● ● ○
Bonds	● ● ○ ○ ○
• Government bonds	● ○ ○ ○ ○
• Corporate bonds	● ● ○ ○ ○
• USD bonds	● ● ○ ○ ○
• Emerging markets	● ● ● ○ ○
Equities	● ● ● ○ ○
• Switzerland	● ● ● ○ ○
• Europe	● ● ● ○ ○
• USA	● ● ● ○ ○
• Pacific	● ● ● ○ ○
• Emerging markets	● ● ● ○ ○
• Themes	● ● ● ○ ○
Alternative assets	● ● ● ● ○
• Hedge funds	● ● ● ○ ○
• ILS	● ● ● ○ ○
• ABS	● ● ● ○ ○
• Convertible bonds	● ● ● ○ ○
• Gold	● ● ● ● ○

Our View on the **Economy**

- In the third quarter, growth rates will be high
- Short-time workers' money in Europe and special government payments in the US **help private consumption**
- Monetary policy **continues to support**

- **Rising insolvency** numbers could slow down the recovery
- The number of new cases of Covid-19 could trigger **new lockdown measures**
- The sharp widening of budget deficits will **constrain fiscal policy** in the future

The intermediate sprint is followed by a break

The economic recovery appears to be stalling. There are many reasons for that. First of all, there is the second wave of Covid-19-infections that is gaining in intensity. Consumers are becoming more cautious again. Companies, however, are reluctant to invest, either due to uncertainty about the future economic development or because of a lack of financial resources. But structural growth difficulties that existed before the Corona crisis are also becoming apparent again. The transition to electric mobility lowers Europe’s growth potential. This is reflected in some declining economic indicators and the rather sluggish recovery of the labour market. Following record high growth rates for the third quarter, growth in the fourth quarter is expected to be more moderate.

Our View on **Monetary Policy**

- The **liquidity situation** in money markets has improved significantly
- Central banks **remain alert**
- Markets still **have faith in central banks**

- **Central banks' tools will be limited** in the future
- Zero and negative interest rates **distort the price of risk** for a long time to come
- Risk of **asset price bubbles** have increased

Monetary supply growth will weaken

Money supply volumes on both sides of the Atlantic continue to increase sharply. Lending to the private sector is growing strongly in the face of emergency credit programs, while governments are issuing new debt. But these are special effects, growth rates in money supply and lending will soon decline. In addition, commercial banks are currently parking a lot of liquidity at the central bank. All of this speaks against a sustained rise in inflation. Inflation rates in both the US and Europe are likely to remain low for some time to come. As the economic recovery seems to be stalling in the near term, central banks may even face calls for additional measures soon.

Our View on **Government Bonds**

Highly underweighted

- The second wave of Covid-infections could boost **demand for government bonds** once again
- Government bonds contribute to **diversification** in the portfolio

- The **supply of government bonds has expanded** enormously
- Rising public debt is likely to **worsen** sovereign **credit quality**
- Government bonds carry a **high interest rate risk**

Hardly any movements in yields

Government bond prices now seem somewhat fixed. Although equity prices have risen sharply since the end of March, investors have continued to seek shelter in the form of government bonds. The Fed's and ECB's large-scale asset-purchases also played their part. Moreover, inflation is now in deep straits. In the eurozone, inflation has recently fallen to a four-year low of -0.3% year on year. Therefore, investors are not asking for higher inflation premiums. But while public debt is now fairly stable, government bonds remain subject to a negative risk/chance ratio. Low or even negative yields provide little protection against price losses in the event of slight increases in interest rates. In asset management, we therefore maintain our clear underweight of government bonds.

Our View on **Emerging Market Bonds**

neutral

- The **higher yield** make emerging market bonds attractive
- Emerging economies are attractive in **tandem** with good-quality government bonds and equities

- The **lack of tourism** reduces foreign income in many emerging economies
- **Currency depreciations** increase debt burden in foreign currency
- The **risk of default** increases

Yield advantage and risks are balanced

Emerging market bonds denominated in US dollars now offer a yield of around 4% relative to a broad index. Given the current level of risk, this seems small by historical standards, but it is decent when compared to the 0.78% yield on 10 year US government bonds. It is above all the interest rate advantage that speaks for emerging market bonds. However, from a fundamental point of view, the situation in many emerging economies is currently difficult. The Corona pandemic is causing massive economic damage. Moreover, currency devaluations have increased the debt burden of many emerging economies, making matters even worse. In our view, the higher yield and the risk involved are currently balanced, so we keep our allocation to emerging market bonds in the portfolio on neutral.

Our View on **Equities**

neutral

- Exceptionally strong **economic recovery** in the third quarter
- Stimulating **consumer demand**
- Global **fiscal policies** provide business support

- High Covid infection rates unsettles market participants
- Possible short-term uncertainty due to the forthcoming publication of the **third-quarter results**

The bumblebee paradox

According to the laws of aerodynamics, it seems impossible that a bumblebee can fly with its large body and its relatively small wings. However, the elasticity of the small wings must be observed. The same is true for stock markets, which, despite the low corporate profits and short-term subdued earnings prospects, are reaching ever-higher highs. Here too, we must not only look at the "size" of profits, but also take into account the dynamics of profit development. The coming weeks and months are likely to be characterized by uncertainty, but a lockdown as experienced in the spring is unlikely. The spread of digital business models and state-sponsored investment packages provide support and generate promising growth momentum.

Our View on the **Equity Theme «Green City»**

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As a topic in the portfolio

- The **digital transformation** creates new business models for urban mobility
- Strong focus on **alternative energy**
- Modern resource management requires high **replacing investments**

- High **financing needs** for infrastructure projects
- The theme might be pushed into the background by **short-term developments**

The opportunities of sustainable urbanisation

More than half of the world's population now lives in cities, with an additional 1.5 million people moving to metropolitan areas each week for the next 30 years. To cope with this, cities need to rethink. Ecological sustainability and resource management as well as digital transformation are the key points.

The global health crisis has increased attention and acted as a catalyst for financial support for health care and digital transformation. The latter provides the technological platform for the conservation and ecologically sustainable development of modern cities and metropolitain areas. A trend is developing here, which at the same time offers promising investment opportunities for sustainable and long-term investors.

Our View on **Alternative Investments - Gold**

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overweighted

- **Rising uncertainties** often translate into higher gold demand
- Low interest rates provide **opportunity dividends**
- Identified **diversification property** in the portfolio

- Demand for **jewellery** will recover slowly
- **Potential headwinds** if bond yields rise, the US dollar gains strength, or liquidity shortages arise in markets

Environment speaks for gold

After the price of gold had become a little too hot in the summer, the current quotations are again more interesting. The continued strong net inflows in listed gold funds, which in September again increased stocks by 70 tons, confirm that the recent correction was not a fundamental reappraisal of investors. Instead, the low-interest-rate environment, expansionary monetary policies of central banks, and the continuing economic and geopolitical risks continue to speak for a portfolio allocation of gold. In addition, the normalisation of the gold-silver price ratio is supportive of prices. In view of this, we continue to recommend keeping gold in the portfolio for diversification. However, we discourage speculative gold purchases.

Our View on **Currencies**

- **EUR:** EU reconstruction fund provides tailwind
- **CAD:** Benefits from a weaker US dollar
- **AUD:** Benefits from a better economic situation in China

- The **US dollar** could come under pressure depending on the outcome of the US presidential election
- The **Turkish lira** remains under downward pressure
- Brexit is coming back to the fore: **British pound** faces short - term setbacks

US presidential election and Brexit in focus

In foreign-exchange markets, the presidential election is coming to the fore. Both Donald Trump and Joe Biden have growth-enhancing and growth-slowing aspects in their election program. But should Trump speak of cheating after a narrow defeat, the situation in the US could become turbulent. In this case, more pronounced price losses of the greenback cannot be ruled out.

As the end of the year approaches, a possible hard Brexit, i.e. a UK exit from the EU without any follow-up agreements is becoming more likely. If this were to become reality (which we do not assume), both the pound and the euro will be at risk of loosing. In the opposite case, both currencies could in turn benefit against the US dollar.

Authors and Disclaimer

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Important legal advice