Our View in April

13 April 2021

VP BANK

Vaccination progress sets the pace

One year after the start of the Corona pandemic, it is still dominating our lives and the financial markets. What matters now is the vaccination rate. The faster the vaccination, the better.

The US is setting a brisk pace: Already 20% of the population is fully vaccinated. In Europe and Switzerland, the vaccination campaigns are only about to take off. This, as well as the spread of new virus mutations, has an impact on the re-opening prospects.

While in the US a return to normality is getting closer and closer, in Germany, for example, the "emergency brake" is currently being discussed again. The number of new infections is still too high, and there is too much concern that the beds in the intensive care units of the hospitals will become scarce in the current third wave.

And the financial markets? They are brimming with optimism. The S&P 500, the leading index for American shares, is going from record to record. Within a year it has risen by around 50 %. So the stock markets expect the pandemic to be over soon and the world economy to recover from the shock.

In our view, the optimism is justified in principle. Various vaccines have been developed in record time, herd immunity is within reach and economic indicators are pointing upwards across the board. However, despite all this justified optimism, one thing must not be forgotten: Markets tend to exaggerate. If we look at some sentiment indicators, it seems as if many investors are currently ignoring the risks. Whenever that is the case, the probability of short-term setbacks increases.

We are not letting ourselves be put off by this and are convinced that we are currently well positioned. In addition, we have sufficient liquidity to buy in the event of any price dips.

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

Our View on the **Portfolio**

- **European equities** have catch-up potential as vaccination campaign gains momentum
- **Insurance-linked securities** (ILS) offer portfolio diversification
- Currency-hedged **USD bonds** are more attractive than EUR and CHF government bonds

- **Bonds** feel headwinds as yield curve steepens
- **Sentiment indicators** signal some short-term equity market exuberance

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

● ● ● ● ● strong overweight
● ● ● ○ ○ neutral
● ○ ○ ○ ○ strong underweight

Based on mandate CHF balanced

Our View on the **Economy**

- Vaccination progress promises a **gradual return** to normal life this year
- Low interest rates **boost construction**
- The public sector remains ready to disburse **generous support**

- Certain **emerging economies** will continue to suffer the consequences of the pandemic for a long time
- Recovery is hampered by **rising insolvency figures**
- **High levels of new debt** will constrain future fiscal policy

Emerging economies suffer for longer from Corona

The International Monetary Fund's recent global economic outlook points to different recovery trends. While in the advanced economies all who want a vaccination will have had at least one by the end of 2021, this will not be the case in many emerging economies until the end of 2022. This makes the economic recovery in the latter more difficult.
At the same time, the major industrialised nations are strengthening their economies with government stimulus programmes. In some emerging economies, by contrast, financial resources are depleted. So the global economy as a whole will feel the consequences of the pandemic for a long time to come. Companies must therefore consider the recovery and growth potential of emerging markets in a differentiated manner.

Our View on **Monetary Policy**

- Need for **expansionary monetary policy diminishes** in view of economic recovery
- Central banks **keep the course they have set** for now

- In the coming months, the **discussion about the right level of monetary policy** is expected to intensify
- The **peak of expansionary monetary policy** is behind us
- **Risk of an abrupt increase in yield** at the long end of the yield curve

Turkish President dictates interest rate policy

In recent weeks, not the US Federal Reserve, has been in the spotlight for once, but the Turkish central bank. President Recep Tayyip Erdogan dismissed the governor of the central bank, Naci Agbal, after less than five months. Confidence in Turkish monetary policy and its independence has been further damaged by the intervention. Erdogan didn't like the economically necessary high-interest policy, so he replaced Agbal with Sahap Kavcioglu. He is in favour of a low-interest-rate policy. But he will hardly regain the confidence of international markets with easy monetary policy. Currency depreciations, and thus rising inflation rates, would in fact require a markedly tighter monetary policy. Turkey, meanwhile, shows how vulnerable some emerging economies are at this point. A balance-of-payments crisis on the Bosporus remains a risk that cannot be underestimated.

Our View on **Government Bonds**

strong underweight

- ECB's net purchases of government bonds **cover the net offer** in 2021
- **Peripheral eurzone bonds** may benefit

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

Yield rise paused

The increase in yields seems to have ended for the time being. Even the new large-scale infrastructure programme under the US administration of Joe Biden did not incite any additional inflationary concerns, and thus no further increase in returns at the long end of the US interest-rate curve. Even if a pause is likely for the time being, yields will continue to rise in the future. Because in periods of economic recovery, the US interest rate curve is steepening. In concrete terms, this means: Yields on 10-year government bonds are rising more than on shorter-term bonds. This development continues until the Fed raises interest rates for the first time. So although the rise in interest rates in the long-term bond market is taking a break, a continuation of the upward trend should be considered in the second half of the year.

Our View on **USD Bonds**

neutral

- **Long maturities** in USD more attractive
- Currency hedges **more favourable**
- **Fears of inflation will evaporate** when the base effect expires
- **Protection** against adverse economic surprises

- After the pandemic has been overcome, **central bank purchases will be cut**
- Residual risk of **inflation rising in the service sector**
- **Huge debt levels** of governments and companies

Worst quarter in 40 years

The first quarter was marked by vaccine progress and the economic recovery. While the short end of the yield curve went even deeper in USD, the long end increased by about 70 basis points. This resulted in the largest quarterly loss in 30-year government bonds in history, despite the Fed's purchase of such bonds for USD 253 billion. In the USD bonds market as a whole, the first quarter was the worst in 40 years.
In euro, the long end was less affected and yields have even increased in short maturities. Currency hedges therefore cost about 1.5 % a year less than in January 2020. If the US dollar yield rise is pausing for the time being, or if the future rise is less pronounced than in the euro, then currency hedged USD bonds will become more attractive.

Our View on **Equities**

neutral

- Continued **state support** to boost the economy
- Advantageous **financial market conditions**
- Increased **consumer confidence**

- Elevated **fundamental valuations** in many sectors
- **Euphoric market sentiment indicators**
- **Low risk premiums** currently make the future potential of stocks less attractive

Industrial trends trump high valuations

The stock market recovery since March 2020 has undergone some consolidation since mid-February. Fast rotations between growth and value can be observed, while Japan, the United States, and Europe are in a tight head-to-head race this year. Defensive Swiss equities and the volatile stock markets of emerging economies are worse off. A truly euphoric market sentiment and already high fundamental valuations may indicate an imminent correction. But strong, technology-driven industrial trends, urgent investment needs to improve existing infrastructure, and huge government-driven infrastructure investment should not be underestimated. The current consolidation improves diversification in the stock markets and thus opens up new opportunities for investors.

Our View on **European Banks**

Europe overweight

- Economic recovery **supports credit growth** and reduces cyclical risks
- High share of retail business in Europe is the basis for **stable returns**
- **Increased risk provisions** have worked in the current crisis

- **Risks of unexpected credit losses** due to pandemic
- **Low profitability** with little prospect of improvement in the near term
- Complex **banking regulation** puts European banks at a disadvantage to international peers

European banks are better than their reputation

The global pandemic has caused the collapse of globally interconnected and heavily credit-financed value chains. Up to now, potentially high credit risks have only arisen on a case-by-case basis and not on a sector-specific basis. On the contrary, robust business development and sound capital positions are making banks in Europe significantly better off than initially expected. This development started in 2019, with operating revenues regaining momentum in the crisis year 2020 only reduced by increased reserves. In the event of a progressive normalisation of economic activity, it is even expected that there will be special dividends or partial share buybacks. The fundamental valuation is fair and even attractive compared to other industrial sectors.

Our View on **Alternative Investments - Hedge Funds**

neutral

- Hedge funds may take over **the role of government bonds** in mixed portfolios
- **Fees have sunk significantly** in recent years
- Sound **performance**

- **Performance expectations** mostly too high
- Not all hedge fund styles **diversify relative to equities**
- All hedge funds **disappointed in the bear market**
- Not all hedge funds actually are hedge funds

Hedge fund is not equal to hedge fund

The spectacular "margin call" of the hedge fund Archegos scared financial markets in March. The media knows that negative news sells best. Yet there are good news from the hedge fund sector. Given the low interest rate environment, the global allocation to hedge funds has doubled in the past decade to USD 3,380 bn today, a new peak. The performance was positive in March and was not affected by Archegos.

Individual hedge fund strategies are in any case only accessible to qualified and professional investors. For private investors, diversified fund-of-funds strategies are available. These have increased in a more liquid form by about 16% in the last 12 months, and by 25% in a less liquid form. One alternative would be regulated funds, with characteristics similar to hedge funds.

Our View on **Currencies**

- **USD:** The dollar's temporary appreciation may still be a little more protracted
- **AUD:** Benefits from China's better economic prospect

- **Emerging market currencies** benefit to a limited extent from the weakness of the US dollar due to challenging fundamentals
- The **Turkish lira** remains beaten down
- **CHF:** We expect a weaker franc against the euro

EUR/USD: Analysts disagree

There is currently disagreement among analysts on the development of EUR/USD. Indeed, the currency pair is currently struggling with its 200-day line, and thus with an important technical mark in the short term. Our long-term outlook remains unchanged: We expect a weaker US dollar in the medium to long term. So we are talking about the next three to six months here. The position of speculative investors, who relied heavily on continued weakness in the dollar, has not yet been adjusted. The latter serves us as a counter indicator. While contracts have been reduced as a result of the recent dollar appreciation, they have not yet gone away fully. This is precisely why there might be a further strengthening of the Greenback in the short term.

Authors and Disclaimer

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