Our View in February

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VP BANK

The Fear of missing out

Whether economic indicators, stock markets, oil prices, inflation or interest rates: there is confidence across the board. Maybe a little too much. Extreme price swings as in the US stock Gamestop and contagions with the mutations of the Corona virus are a reminder to protect the portfolio for short-term setbacks.

Risk appetite has increased again in the new year. The stock markets are up compared to the beginning of the year, some like the German leading index Dax have even reached record highs. The explosion of the shares of Gamestop, a US computer game retailer, caused worldwide headlines. Even though this episode is behind us, it serves as proof that financial markets are prone to exaggerations.

If we look at valuation and sentiment indicators, they show the broad and growing confidence. The US equity market, for example, is trading at a 2021 price-to-earnings (P/E) ratio of above 30 and risk appetite has climbed to its highest level since the end of 2017, according to an indicator from the US investment bank Goldman Sachs. The recent rise is spurred by the prospect of a new stimulus programme in the US.

However, this pronounced appetite for risk has a downside: if too many investors feel they are missing out, short-term exaggerations may occur. This is better known as the "Fear of missing out".

Therefore, care should be taken to protect the portfolio from setbacks. To this end, we increased our position in insurance-linked securities in February, as these have proven to make the portfolio resilient. In addition, we are focusing regionally on European equities, as these are comparatively attractive in terms of valuation. Despite all this, however, our positioning is clear: the portfolio is geared towards the upswing.

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

Our View on the **Portfolio**

- Strategically align the portfolio for the **upswing**
- **European equities** are attractive in regional comparison
- The position in **insurance-linked securities** is being increased

- The current **inflation discussion** weighs on the outlook for fixed-income investments
- **Government bonds** are particularly unattractive due to their high duration

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

Base: Mandate CHF balanced

Our View on the **Economy**

- Progress in **vaccination** promises a gradual return to normality this year
- Low interest rates support **housing markets**
- The **public authorities** continue to provide generous aid

- Due to the particular anatomy of the Corona recession, **catch-up effects** will be **weaker**
- Recovery might be hampered by **rising insolvency numbers**
- Increasing **budget deficits** constrain future fiscal policy

Path to normality hinges on vaccination

The start into 2021 could have been better. Vaccine production is lagging behind expectations - especially in Europe. Instead of vaccination euphoria, gloom prevails in the political debate. Thus, the first quarter promises to be another tough one for the European economy. In China, too, recent Corona outbreaks are having a negative economic impact. In the US, meanwhile, the disbursement of government aid is having a positive effect. As things stand, the US economy will continue its recovery in the first quarter. Globally, there is still justified hope that there will be a broad-based upswing in the second half of the year - including Europe. The immunisation of a majority of the population will bode well for the economic recovery to gain strength.

Our View on **Monetary policy**

- The need for expansionary monetary policy will decrease as the **economic recovery gains strength**
- Central banks reiterate their **supportive policy stance**

- In the coming months, discussions about **monetary policy** are likely to intensify
- Risks of **yield spikes** at the long end of the interest-rate curve have increased

Exit discussions interrupted only briefly

US President Joe Biden, along with Treasury Secretary Janet Yellen, is advertising a USD 1.9 trillion new bailout package in Congress. Although it is unlikely that the entire program will be approved, parts of it are likely to be adopted. The larger the package, the less need for Fed support. It should not come as a surprise, therefore, that a debate in financial markets kicked off about a possible exit from ultra-loose monetary policy. This discussion has created some headache for the US Federal Reserve, as it leads to a rise in interest rates at the long end of the yield curve. While Fed Chairman Jerome Powell publicly declared a "no" to any possible early exit from the current asset purchases, the debate on the matter will likely to continue among investors. So it will be an interesting one to watch.

Our View on **Government bonds**

Strong underweight

- The ECB's net volume of purchases in 2021 **covers the net issuance** of government bonds
- **Peripheral bonds** may benefit
- Government bonds **diversify** a portfolio

- **Supply** of government bonds has increased enormously
- Rising public debt is likely to **hit sovereign ratings**
- Government bonds carry a **high interest rate risk**

Transatlantic yield spread on the rise again

The yields on government bonds on both sides of the Atlantic are behaving differently. In the US, investors are betting on a rapid economic recovery in the face of a well-started vaccination campaign and further public aid. The US yields thus preempt the post-corona period early on. In the eurozone, there is fear of a major wave of insolvencies and a long economic echo of the Covid-19 crisis due to continued containment measures. Therefore, it looks likely that the US Fed will be able to end ultra-loose monetary policy earlier than the European Central Bank. The rebound in the transatlantic spread is thus justified. A yield of 1.5% on the 10 year Treasuries would seem reasonable against this backdrop. So, despite the increase already recorded, there is still room to the upside.

Our View on **Corporate bonds**

neutral

- Central banks have **unlimited resources** to buy corporate bonds
- The **low-interest-rate environment** is likely to continue for a long time to come
- New **government support** will flow if necessary

- **Fundamental data** have **deteriorated** markedly due to the pandemic
- **Credit ratings downgrades** doubled in 2020 compared to the previous year and are expected to continue
- Central bank support will eventually be called into question as **inflationary risks** rise

Gamestop also for spreads?

The fact that the share price of a company without a viable business model was driven up from less than USD 5 to 500 by small investors raises some questions. One of them is whether central bank liquidity is creating new price bubbles and thus new risks. Central banks are aware of this. At the recent Fed Open Market Committee meeting, the topic of extremely low corporate bond credit spreads was discussed. US corporate debt has increased by 80% in the last 10 years, while nominal GDP increased by only 40%. The number of companies who can no longer pay the interest on their debt from their cash flow is increasing. This is one of the reasons why the Fed has pointed out its experience with the last balance sheet contraction. Against this background, higher spreads could soon be on the cards.

Our View on **Equities**

neutral

- European equities continue to offer **catch-up potential**
- Political changes in **Italy** send positive signals

- US stocks are in parts **expensive**
- The tactically **strong US dollar** can impede the relative strength of emerging economies

The beginning is always the hardest part

Stock markets had been off to a mixed start into 2021. Only emerging markets closed with a clear plus in January. Europe, the U.S. and Switzerland recorded slightly negative returns, although trading activity was certainly high and the first days of February have already turned many markets back into positive territory. The start of the year was initially marked by emerging fears that valuations have increased too much. Added to this was the Gamestop story. We expect that such episodes will remain the exception. Meanwhile, European markets were facing headwinds from the poorly coordinated Covid-19 vaccine distribution. However, in an improving economic environment, this actually creates opportunities. We continue to see catch-up potential for European equities and therefore confirm our regional overweight.

Our View on **US equities**

neutral

- A dynamic start for the **new administration** boosts investor sentiment
- **Strong positioning** in key global industrial trends

- Further **price excesses** in economically weak companies fuel concerns about market euphoria
- The fundamental **valuation** of US stocks remains high

Elevated valuations

US companies have so far been able to largely convince investors with solid profit statements for the fourth quarter. At the same time, the vaccination distribution and fiscal policy measures are giving investors a positive foothold. Nevertheless, January confirmed its seasonal statistical pattern and brought a negative return, which was often the harbinger of a difficult stock market year in the past. Market participants once again preferred the growth segment, which beat the so-called value shares by more than 6% in the past four weeks. This led to excessive price movements in some cases. In addition, the fundamental valuations of more and more shares are quite elevated. In view of this, there could be setbacks in the short term. However, the strategic outlook for US equities remains intact.

Our View on **Alternative investments - Gold**

● ● ● ○ ○

neutral

- **Economic uncertainty** often translates into higher gold demand
- Low interest rates provide an **opportunity dividend**
- **Diversification properties** in a portfolio

- The **flow of cash into gold** ETFs has slowed
- **Potential headwinds** if bond yields rise

Outflows weigh on gold price

Since the beginning of the year, the gold price has been crumbling. This was mainly due to the weakening of the risks which are positive for gold. This has led, among other things, to exchange-traded funds being mostly hit by outflows. In order to change momentum, investment demand will have to increase. This is countered by a lack of inflation and an oversold US dollar. Nevertheless, we still consider a gold allocation to be attractive for portfolio diversification. Due to the pandemic, the economic situation remains tense in the short term. In addition, rising jewellery demand, stable central bank buying and the low interest rate environment should support the gold price. All in all, the positive and negative influencing factors balance each other out.

Our View on **Currencies**

- **USD:** The Greenback's devaluation speaks for a backlash in the short term
- **GBP:** The Brexit Deal opens the door to further pound appreciation
- **AUD:** Benefits from better economic situation in China

- **Emerging-market currencies** benefited only partially from the weakness of the US dollar due to a difficult fundamental situation
- The **Turkish lira** remains weak
- **CHF:** We expect a weaker franc against the euro

The correction of the Dollar correction

The recent swing away from the depreciation trend is not over yet. Vaccination success are currently playing a central role on the currency markets. In contrast to the US, the EU is still struggling with the distribution of the vaccine. This means that the return to economic "normality" will probably take longer than in the US. The interest rate differential, which is already quite considerable again, is also currently in favour of the greenback. Even more: in view of this, there is a risk of a so-called "short squeeze" due to the large-volume bets on continued USD weakness. Speculative investors would have to close their positions and stock up on dollars. This would help the greenback to make further gains.

Authors and Disclaimer

Authors:

Dr. Felix Brill, Dr. Thomas Gitzel, Bernhard Allgäuer, Harald Brandl, Jérôme Mäser

Important legal advice