Our View in July

July 14, 2020

VP BANK

W-shaped recovery on the horizon

The economic indicators are recovering, but the question marks are increasing. Is the revival lasting? Are there still setbacks looming? In any case, we believe that the probability of a so-called "W scenario" has increased. This speaks in favour of taking precautionary measures in the portfolio.

Our VP Bank Corona Crisis Barometer has steadily improved in recent weeks and now stands at roughly 80% of its pre-crisis level. The underlying economic recovery was welcomed by the financial markets. Rising stock markets, falling risk premia and decreasing market volatility speak for themselves.

While being delighted with the rapid recovery, there are increasing signs that call for caution. For example, a number of government support measures, such as the suspension of the obligation to file for insolvency in Europe, will expire. It remains to be seen whether the measures will be extended to the same extent. In combination with the renewed regional lockdown measures, this could cause the economic recovery to stall. In terms of its course, this would then be a scenario similar to the letter W.

In addition, the stock market recovery to date has been strongly driven by a small number of companies. US technology stocks in particular have taken off to impressive heights. Underneath the surface, though, the recovery looks less convincing.

The fact that the price of an ounce of gold has risen above USD 1800 and is thus close to the all-time high of USD 1920 marked in 2011 can also be interpreted as an expression of scepticism. Against this backdrop, we have decided to maintain our cautious approach and leave our tactical positioning unchanged.

CIO Felix Brill, **Chief Investment Officer**

Our View on the **Portfolio**

- To hold more liquidity (money market) than usual makes it possible to seize opportunities when they appear
- Alternative investments help to stabilise returns

- Government bonds are not attractive from a risk-return point of view
- Insolvencies favour careful selection of corporate bonds

● ● ● ● ●	strong overweight
● ● ● ○ ○	neutral
● ○ ○ ○ ○	strong 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**

- Economic catch-up continues in the wake of easing measures
- Central banks are monitoring the situation closely
- Governments adopt generous fiscal stimulus plans

- Bankruptcies testify to crisis
- Record-high debt constrains fiscal policy
- Confidence crisis dampens consumer mood and delays capital expenditure

Positive records follow negative records

The global economy has contracted sharply as a result of the Corona pandemic. Following the easing of the countermeasures, record-high growth rates are now showing in economic data. Due to the low base effect, a small improvement is enough to report significant percentage gains. While the economic crash in the second quarter will break negative records since WWII, the decline is likely to be less pronounced than most economists currently expect. But in the end, it is not crucial how much the economy collapsed. The question of how fast economies can return to pre-crisis gross domestic product (GDP) levels is far more important. This will probably take some time. The echo of the crisis continues for a long time to come.

Our View on **Monetary policy**

- Central banks increase their asset buying programs
- Liquidity in money markets has improved significantly
- Fed and ECB support corporate lending

- Central banks' resources will be restricted in the future
- Zero and negative interest rates distort the price of risk for a long time to come
- Risk of renewed price bubbles elevated

Swiss National Bank remains true to itself

The Swiss National Bank (SNB) has maintained the key interest rate and the interest rate on cash balances at −0.75% at its last meeting. The SNB is still prepared to intervene more intensively in the foreign exchange market. In addition, the Covid-19 Refinancing Facility (CRF) provides additional liquidity to the banking system. However, the main focus continues to be the weakening of the Swiss franc. The foreign exchange market interventions is the quantitative easing (QE) of the SNB. The effects are immense. The ratio of the SNB's balance sheet to the economic output (GDP) of Switzerland is still the highest in comparison with the other large central banks. As far as the quantity of monetary policy is concerned, the Swiss monetary policymakers are on par with their counterparts at the ECB and the Fed.

Our View on **Government bonds**

strong underweight

- Rising demand for government bonds by central banks
- The EU recovery fund serves as a catalyst for debt mutualisation, supporting peripheral bonds

- Record high supply
- Rising public debt leads to credit ratings downgrades
- Government bonds carry high interest rate risk

Supply of government bonds increases massively

Governments' fiscal stimulus programs require record-high government bond issuance. The increasing supply basically argues for falling prices and rising bond yields. But central banks are doing their utmost to prevent a much higher interest rate level for longer maturities. Precisely because of the increase in the supply of sovereign debt, we do not expect another substantial decline in nominal bond yields despite the central banks' asset purchase programs. We see a particular dynamic in the euro sovereign-debt markets. The EU recovery fund is showing that crises ultimately act as a catalyst for debt mutualisation, even without creating a fiscal union. This reduces the short-term risk to peripheral countries' sovereign debt.

Our View on **Emerging market bonds**

neutral

- Higher yields offer support
- The International Monetary Fund (IMF) helps with the financing of emerging countries
- High preparedness to prevent the insolvency of countries

- Emerging countries could be closed out of capital markets
- In a number of emerging markets, political risks are elevated
- High duration of emerging market bonds carry high interest rate risk

IMF supports emerging economies

The economic damage caused by the Corona pandemic is immense for the emerging countries. Already, the International Monetary Fund (IMF) is supporting 77 emerging countries through various support programs. It seems capital markets don't want to know about that: The risk premiums on emerging market bonds have already fallen back to pre-crisis levels after a significant increase. On the one hand, the good mood in the stock markets and the higher level of yields help. On the other hand, the IMF's large-scale support measures are reassuring. Market participants might think that the default of a larger emerging country will be avoided at all cost. This is rational, because a large sovereign default would make the crisis management even harder. We believe, therefore, that a neutral weighting of emerging market bonds is justified.

Our View on **Equities**

underweight

- Fiscal support helps investment trends with a focus on digitisation and sustainability
- In the US and China, 80% of corporate revenues are generated in the home market, so government action is felt stronger and more directly there

- Companies with high export shares face higher costs, at least in the medium term
- The fundamental valuation reaches historically high levels

No crisis without opportunities

The mood in the stock market is positively influenced by good news due to the easing measures. Market participants are looking beyond the current problems and increased unemployment. However, due to the rise in Covid-19 infection rates, the recovery is likely to be less strong than the prices imply. Nevertheless, the power of fiscal policy should not be underestimated. We expect that governments will assert their interests in terms of digitisation and climate change. This opens up medium- to long-term opportunities which have already started to develop favourably.

Our View on **Equity sectors**

- Digitisation trends in education and work, digital security, online retailing and delivery services will get a boost because of the crisis
- Sectors with a focus on the home market such as telecoms, utilities or food are proving to be safe harbours

- The energy sector not only suffers from a low crude oil price, but also from a sustainability focus that limits the longer-term business outlook

Money rules the world

The consequences of the virus pandemic leave traces in the global economy and are particularly damaging to companies with high export sensitivity or narrow profit margins. Where governments invest is therefore crucial. The development of digital infrastructure is only one aspect of this, and in Europe, additional resources will be devoted to environmental sustainability projects. In addition, we expect taxpayers' money primarily to be used to safeguard or create domestic jobs. In addition to digital investment trends and sustainability investments, we see good opportunities for companies that are strong in their home market.

Our View on **Alternative investments - Gold**

overweight

- Increased number of new Covid-19 infections drives fear-driven investment demand
- Speculative buyer positions in futures markets have increased
- Low interest rate environment remains for longer

- Demand from jewelry-sector and from central banks has recently declined
- Progressive stock-market recovery increases opportunity costs

Gold ETFs show record inflows

With the world's growing number of new Covid-19 infections and the ensuing economic uncertainty, gold remains a safe haven. The fact that the gold price itself recently exceeded USD 1,800 is not due, as in the past, to the jewelry industry or central banks. Gold is now sought after by investors as evidenced by an increased demand for physical bars or ETF products. In June, gold ETFs showed net inflows for the seventh month in a row, resulting in record inflows in the first half of the year. While speculative buyer positions have recently increased in the futures market, the course of the Corona pandemic will be decisive for the short-term performance of gold. In a portfolio context, we continue to consider an allocation to gold attractive.

Our View on **Currencies**

- USD: No sustainable weakness yet
- CHF: Safe haven still in demand
- AUD: Benefits from a better economic situation in China

- Brazil's real remains on a downward path in the face of the rampant pandemic
- The British pound is threatened with short - term setbacks due to Brexit

Crises bring out the same habits

There has been little significant activity in the foreign exchange markets recently. Great movements were not visible. While stock markets celebrate the supposed end of the crisis, foreign exchange markets are more cautious. Safe haven currencies, such as the US dollar or the Swiss franc, remain in demand. It is fitting to this picture that emerging market currencies did not profit from the improved sentiment in the stock markets. Forex markets do not seem convinced that the worst is over. This is in line with our overall economic picture. The aftermath of the Covid-19 pandemic will only come to light, with some economic risks prevailing. That is precisely why the US dollar will still be supported for the time being. As long as that is the case, there will be no change of direction in currency markets.

Authors and Disclaimer

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