LimmatWealth

# Investment Strategy – February 2021

## Data & Forecasts

| Developed Markets | Growth (%) | | Inflation (%) | | Equities | | | Bonds (10 Years) | | | Currencies (vs CHF) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | GDP 20 | GDP 21 | CPI 20 | CPI 21 | Actual | 3 Mths | 12 Mths | Actual | 3 Mths | 12 Mths | Actual | 3 Mths | 12 Mths |
| Switzerland | -3.4 | 3.4 | -0.7 | 0.2 | 13'471 | ↗ | ↗ | -0.39 | -0.50 | -0.35 | - | - | - |
| Germany | -5.4 | 3.5 | 0.4 | 1.3 | 14'014 | ↗ | ↗ | -0.46 | -0.50 | -0.30 | - | - | - |
| Eurozone | -7.2 | 4.3 | 0.3 | 0.9 | 3'625 | ↗ | ↗ | - | - | - | 1.08 | 1.10 | 1.10 |
| United Kingdom | -10.6 | 4.7 | 0.9 | 1.5 | 6'551 | ↗ | ↗ | 0.38 | 0.30 | 0.50 | 1.22 | 1.20 | 1.21 |
| United States | -3.5 | 4.1 | 1.2 | 2.2 | 3'830 | ↗ | ↗ | 1.14 | 1.00 | 1.30 | 0.90 | 0.90 | 0.89 |
| Japan | -5.3 | 2.6 | 0.0 | 0.0 | 28'342 | ↗ | ↗ | 0.06 | 0.00 | 0.00 | 117 | 116 | 116 |

| Emerging Markets | Growth (%) | | Inflation (%) | | Equities | | | Bonds (10 Years) | | | Currencies (vs USD) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | GDP 20 | GDP 21 | CPI 20 | CPI 21 | Actual | 3 Mths | 12 Mths | Actual | 3 Mths | 12 Mths | Actual | 3 Mths | 12 Mths |
| Asia ex Japan | 5.1 | 5.1 | 0.9 | 0.9 | 921 | ↗ | ↑ | - | - | - | - | - | - |
| China | 2.3 | 8.4 | 2.5 | 1.6 | 3'502 | ↗ | ↑ | 3.23 | 3.30 | 3.30 | 6.46 | 6.50 | 6.40 |

## Review – Robinhood retail investors cause volatility in equity markets

After 2021 had started relatively well for equity markets, there was a lot of volatility in the second half of the month. The trigger was retail investors who had organized themselves mainly via the online platform Reddit. They wanted to attack hedge funds and investment firms that had carried out a large number of short sales* of equities in various American SMEs. The main focus was on shares of Gamestop, a retail chain for computer games and entertainment software. The retail investors brought about a so-called short squeeze with their share purchases, which they made through apps such as Robinhood. A short squeeze is a situation in which short sellers, especially hedge funds, have to buy back previously sold shares at a much higher price. Melvin Capital, the main target of the attack, suffered billions in losses in a short period of time and posted a -53% return in January.

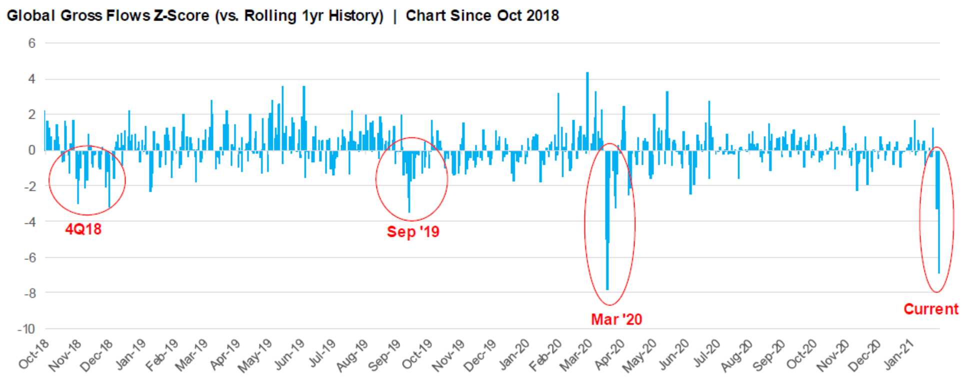
Even though the well-organized purchases of equities that were the target of short sellers were only directed against selected hedge funds, the big players on Wall Street felt indirectly attacked. They fear that they could soon become the target of such attacks and have therefore reduced their exposure to equity markets worldwide to a large extent. This so-called "de-grossing" includes the sale of long positions as well as the coverage of short sales. As can be seen in the graph below, this led to movements in hedge funds that were almost at the same level as in March 2020. At that time, hedge funds had to accept huge losses due to uncertainties about the spread of the coronavirus.

* Short selling is an investment or trading strategy that speculates on the decline in a security's price. Traders may use short selling as speculation, and investors or portfolio managers may use it as a hedge against the downside risk of a long position in the same security or a related one. In short selling, a position is opened by borrowing shares of a security that the investor believes will decrease in value by a set future date. The investor then sells these borrowed shares to buyers willing to pay the market price. Before the borrowed shares must be returned, the trader is betting that the price will continue to decline and they can purchase them at a lower cost. The risk of loss on a short sale is theoretically unlimited since the price of any asset can climb to infinity.



Limmat Wealth AG Gartenstrasse 32 Postfach 1882 CH-8027 Zürich
T +41 44 208 24 50 F +41 44 208 24 51 info@limmatwealth.com www.limmatwealth.com

**Figure 1: Rapid De-Grossing (i.e. Selling Longs + Covering Shorts) This Week – Global Flows Across Strategies**




De-Grossing of hedge funds, Oct 2018 – Jan 2021 (Source: Morgan Stanley)

This recent attack by retail investors on what they believe to be predatory American hedge funds is likely to be viewed in retrospect as a dramatic event in Wall Street's long history. The effects of the events and the changes that will be triggered cannot be fully assessed at the moment. The high volatility in equity markets has also called the top financial regulators on Wall Street on the scene. US Treasury Secretary Janet Yellen has called a meeting with the heads of the SEC, the CFTC futures market authority and the central bank Fed. It is unclear whether the supervisors will draw conclusions from this heightened volatility. However, experts expect that the topic of hedge funds and their market power will move more into the focus of regulators in the future.

The uncertainty among hedge funds and other large investors led many markets to give back their profits of the first half of the month. And so, equity markets around the world closed January with slightly negative returns, with the exception of Asia. The markets in Asia (+4.0%), Japan (+0.8%), and China (+0.3%) appreciated, while those in the United States (-1.1%), Europe (-2.0%), and Germany (-2.1%) declined. The Swiss equity market also ended the month with a negative return (-1.0%).

Yields on ten-year government bonds worldwide increased in January. Interest rates increased the most in the United States (+0.15% to 1.07%), the United Kingdom (+0.13% to 0.33%), and Switzerland (+0.13% to -0.42%).

Currency markets barely moved last month. The Swiss Franc weakened slightly against the British Pound (-0.9% to CHF 1.22) and remained unchanged against the US Dollar (CHF 0.89) and the Euro (CHF 1.08). The Euro weakened slightly against the US Dollar (-0.7% to USD 1.21).

Alternative investments performed differently last month. Gold (-2.7% to USD 1,848 per ounce) and hedge funds (-0.2%) declined, while oil (WTI, +7.6% to USD 52.20 per barrel) appreciated significantly. The oil price is well on the way to fully recovering from the corona-related crash in the first trimester of 2020. At the end of 2019, the price per barrel of WTI crude oil was USD 61.06.

## Outlook – Biden's policy plan

On January 20th, Joe Biden was sworn in as the 46th President of the United States. Biden's first two weeks mark a welcome return to normality at a time which is anything but ordinary. It's been less than a month since a mob instigated by Donald Trump stormed the US Capitol. With almost half a million Covid-19 deaths, the United States mourns more victims than in World War II and the economy is suffering from the consequences of the pandemic. A large part of the carefully prepared decrees and legislative initiatives of the first few days are aimed at reversing Trump's worst excesses in office. From re-entry into the Paris climate agreement to lifting the ban on Muslims to stopping the construction of the border wall to Mexico. This is not sustainable legislation because the next president can quickly repeal it but Biden can set an exclamation point and spread a noticeable atmosphere of optimism. But in which direction will the new administration steer the American economy?

Relations with Asia (especially China) and Europe suffered enormously during the tenure of former US President Donald Trump, so things can only get better under his successor Joe Biden. There is also a lot of trouble with economic relationships. In particular, the trade disputes instigated by Trump with his "America first" policy caused great resentment. After four years of threatening gestures, rumbling and chaos, there is great hope for a new beginning. But a 180-degree turn is not to be expected under Joe Biden. Biden will adhere to international rules, be less threatening and more reliable than Trump, but according to experts, not much will change in the US' protectionist trade policy.

With his slogan "America first", Trump had placed great emphasis on giving preference to products made in the United States and supporting domestic industries. Biden uses similar rhetoric. "America first" becomes "Made in America". Biden's policy is to create "millions of well-paid and unionized jobs" in the United States. Unlike Trump, he wants to attach great importance to the expansion of renewable energies and environmentally friendly technologies in addition to a comprehensive infrastructure program.

At the top of the Biden government's trade list, of course, is China. With no other country or economic bloc, the United States fell out so much under Trump. Biden has to quickly decide how to proceed with companies such as Huawei or the Tiktok app that were blacklisted by Trump or threatened with bans. According to analysts, there are a number of common denominators between the European Union and the United States when it comes to China, so that without Trump going it alone, the two regions could possibly pull together more in the future.

Among the areas in which the fastest U-turns are likely to be made under Biden, experts include environmental and climate policy. Here, too, the potential effects on the economy and companies are great. One of the first measures that could be taken under Biden is, for example, the withdrawal of a relaxation of emissions regulations decided by Trump's government. Biden also wants to aggressively counter environmental pollution from oil and gas production, therefore alternative energies would benefit. The prospect of a major infrastructure investment program is also putting the economy in a good mood. In the coming month, Biden wants to present his specific plans for this. He wants to invest "bravely and wisely". It depends on whether the United States will take on a leadership role again or will be overtaken by others.

In a first step, Biden now wants to launch a new USD 1.9 trillion economic stimulus package to deal with the Corona crisis. He presented the plans for this in January. To get his intentions through, he has to rely on Congress. His Democrats will control both chambers of parliament in the future, so it should be easy for Biden.

Thanks to the vaccinations that have started around the world and further economic stimulus packages, we are generally positive for equity and bond markets over the next 12 months. We favor Switzerland, the United States, and China over Europe and continue to focus on equities of high-quality companies with strong balance sheets in the healthcare, technology, and consumer goods sectors.

Market participants do not expect any further rate changes by the US central bank Fed and the European Central Bank ECB over the next 12 months. There are also no rate changes expected by the Swiss central bank SNB.

Trade disputes and geopolitical developments can lead to strong movements in currency markets. The Swiss franc serves as a safe haven in such cases.

Hedge funds continue to capitalize on the increased volatility which should provide for good opportunities over a longer period of time (in particular distressed, structured credit, and global macro funds). We maintain our gold position for diversification reasons.

February 5, 2021
Limmat Wealth Ltd.