LimmatWealth

Investment Strategy – September 2020

Data & Forecasts

Developed Markets	Growth (%)		Inflation (%)		Equities			Bonds (10 Years)			Currencies (vs CHF)		
	GDP 19	GDP 20	CPI 19	CPI 20	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Switzerland	0.8	-5.8	0.4	-0.7	12'778	→	↗	-0.47	-0.45	-0.35	-	-	-
Germany	0.6	-6.1	1.4	0.6	13'089	→	↗	-0.48	-0.40	-0.25	-	-	-
Eurozone	1.2	-8.1	1.2	0.4	3'314	→	↗	-	-	-	1.08	1.08	1.09
United Kingdom	1.3	-9.9	1.8	0.8	5'880	→	↗	0.26	0.25	0.40	1.21	1.20	1.20
United States	2.3	-5.0	1.8	1.0	3'455	→	↗	0.65	0.80	1.00	0.91	0.92	0.91
Japan	1.0	-5.3	0.5	0.0	23'205	→	↗	0.04	0.00	0.00	117	115	114

Emerging Markets	Growth (%)		Inflation (%)		Equities			Bonds (10 Years)			Currencies (vs USD)		
	GDP 19	GDP 20	CPI 19	CPI 20	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Asia ex Japan	-2.8	-2.8	2.6	2.6	729	→	↗	-	-	-	-	-	-
China	6.1	2.0	2.9	2.7	3'355	→	↗	3.13	2.80	2.90	6.84	7.00	6.90

Review – Tech stocks are pushing equity markets higher

The American equity indices S&P 500 (+7.0%) and Dow Jones Industrial (+7.6%) posted the best August in more than 30 years. The rally in equity markets continues to be driven by the technology sector, which makes up almost 30% of both indices. The Nasdaq 100 Index calculated by the American technology marketplace Nasdaq even achieved a return of +11.1% last month.

Equity markets around the world ended last month with positive returns. Markets in the United States (+7.0%), Japan (+6.6%), and Germany (+5.1%) appreciated the most, but the Swiss equity market also finished August with a positive result (+2.0%).

Yields on ten-year government bonds increased worldwide in August. Interest rates rose the most in the United Kingdom (+0.21% to 0.31%) and the United States (+0.18% to 0.70%), but they also increased in Switzerland (+0.13% to -0.41%) and Germany (+0.13% to -0.40%).

Currency markets moved within reason last month. The Swiss Franc strengthened against the US Dollar (+1.1% to CHF 0.90), weakened against the British Pound (-1.1% to CHF 1.21), and remained unchanged against the Euro (CHF 1.09). The Euro strengthened against the US dollar (+1.3% to USD 1.19).

Alternative investments predominantly performed positively last month. Gold's upward trend was stopped (-0.4% to USD 1,968 per ounce), but the oil price (WTI, +5.8% to USD 42.61 per barrel) and hedge funds (+1.5%) appreciated last month.

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Outlook – Concentration of largest positions in the S&P 500 at a record high

While we increased our investments in healthcare and consumer staples over the past few months, we were too cautious on technology. After technology equities in the United States rose sharply last year (+38.0%, Nasdaq 100 index), we viewed the sector as rather expensive at the beginning of the year. This is why we decided not to increase our exposure any further during the crisis, but to keep the existing indirect exposure through funds.

The performance of technology stocks this year has also had a big impact on the broader equity indices, particularly in the United States. The spectacular returns of technology stocks, coupled with the large share of the technology sector in the S&P 500 index, has distorted the picture at the index level. As of the end of August, 55% of the equities in the index had a negative return this year. The index itself is up almost 10% since the beginning of the year. The return of the index is driven by the large proportion of technology equities which currently make up almost 30% of the index and have achieved a return of 36% so far this year.

	Weight	YTD Perf
S&P 500 Index	-	9.7%
S&P 500 Equal Weighted Index	-	-2.3%
Information Technology	27%	36.0%
Consumer Discretionary	11%	28.0%
Communication Services	11%	16.1%
Healthcare	14%	7.3%
Consumer Staples	7%	5.7%
Materials	3%	4.1%
Industrials	8%	-3.3%
Real Estate	3%	-4.8%
Utilities	3%	-6.7%
Financials	10%	-17.4%
Energy	3%	-39.3%

S&P 500 sectors (Source: Bloomberg, Forbes, Limmat Wealth)

The concentration of the five largest positions has increased steadily in recent years and is now at a record high. Today, the largest positions in the index are all technology equities (Apple, Microsoft, Amazon, Facebook, and Alphabet). Much of the increase comes from recent crowding in the market's biggest tech companies. Investors began piling into the firms at the start of the pandemic, betting the companies' software revenues and healthy cash flows would insulate them from the economic fallout. The shift to tech stocks drove the Nasdaq 100 index to record highs through the summer and erased the S&P 500's year-to-date losses. Investors' expectations that the tech mega-caps would outperform through the first phase of the pandemic were correct. The industry giants all trounced second-quarter earnings expectations and their share prices continued to rise in July and August. Amazon has rallied the most (+86.8% year-to-date as of end of August), followed by Apple (+75.8%) and Microsoft (+43.0%).

Concentration of the five largest companies in the S&P 500 Index as of April 2020 (Source: Compustat, Goldman Sachs)

Yet Wall Street experts fear the high concentration in a select few names poses a major risk to the entire market. The current trend has some striking similarities to tech bubble in the late 1990s. If any of the S&P 500's biggest components tumble, the decline could potentially kick off a wave of selling and strong bearish momentum.

We continue to be cautious with regards to the equity markets. We expect equity markets to trend sideways over the next few months. Our focus remains on the healthcare, technology and consumer staples sectors.

Market participants do not expect any further rate cuts in the United States and Europe this year.

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

Volatility remains high and therefore hedge funds should continue to benefit. The turmoil in the markets and the issues in the real economy (rising number of defaults, rising unemployment…) will provide hedge funds with 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.

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Limmat Wealth Ltd.