LimmatWealth

Investment Strategy – November 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	-5.0	0.4	-0.7	12'376	→	↗	-0.50	-0.50	-0.40	-	-	-
Germany	0.6	-5.9	1.4	0.5	11'984	→	↗	-0.61	-0.40	-0.25	-	-	-
Eurozone	1.2	-7.9	1.2	0.3	3'071	→	↗	-	-	-	1.07	1.08	1.10
United Kingdom	1.3	-10.0	1.8	0.9	5'747	→	↗	0.26	0.30	0.45	1.19	1.20	1.22
United States	2.3	-4.0	1.8	1.2	3'310	→	↗	0.87	0.80	1.10	0.92	0.91	0.90
Japan	1.0	-5.6	0.5	0.0	23'295	→	↗	0.05	0.00	0.00	114	115	115

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	3.9	3.9	2.4	2.4	740	→	↗	-	-	-	-	-	-
China	6.1	2.1	2.9	2.8	3'271	→	↗	3.18	3.00	3.00	6.68	6.80	6.75

Review – Spike in Coronavirus infections dampens the mood

Record increases in the number of new infections and renewed, partial economic standstills in several European countries depressed investor sentiment last month. As a result, equity markets in developed economies ended last month with negative returns. Markets in Asia (+2.8%) and China (+0.2%) appreciated, while those in Switzerland (-5.7%), Europe (-7.4%), and Germany (-9.4%) declined.

Yields on ten-year government bonds moved differently in October. Interest rates rose slightly in the United States (+0.19% to 0.87%) and China (+0.04% to 3.19%), but decreased in Switzerland (-0.04% to -0.53%) and Germany (-0.11% to -0.63%).

Currency markets moved within their normal ranges in October. The Swiss Franc remained unchanged against the US Dollar (CHF 0.92) and the British Pound (CHF 1.19), but strengthened against the Euro (+1.1% to CHF 1.07). The US Dollar also strengthened slightly against the Euro (+0.6% to USD 1.16).

Alternative investments also performed negatively last month. Gold (-0.4% to USD 1,879 per ounce) as well as oil (WTI, -11.0% to USD 35.79 per barrel) and hedge funds (-0.2%) declined.

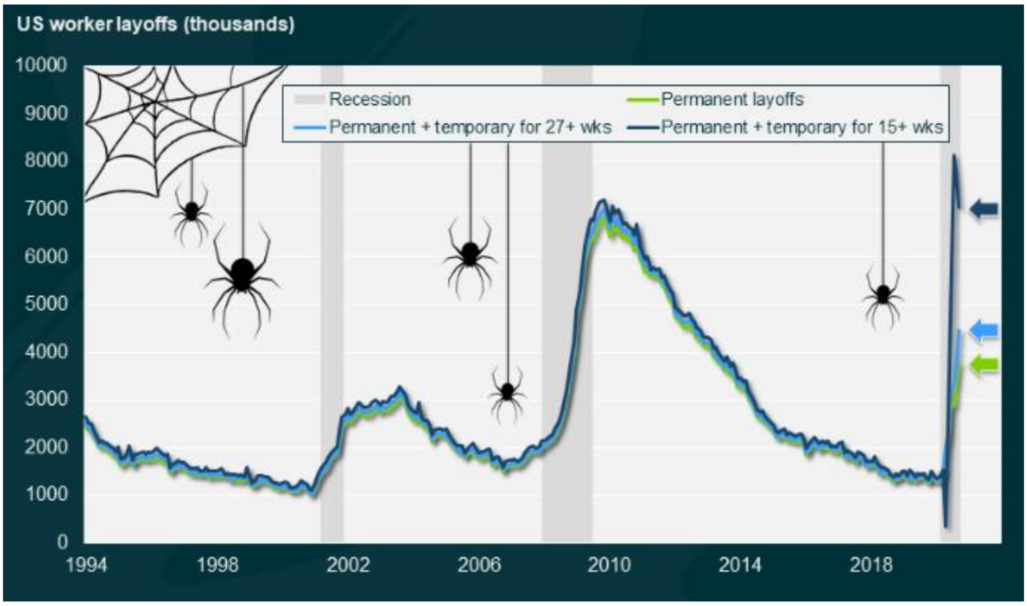
Outlook – Halloween and the US presidential election

Investors are currently watching the United States and the race for the White House with an eagle-eye. It is less a question of whether US President Donald Trump can assert himself or whether his Democratic challenger Joe Biden will prevail. By and large, both will be fairly business-friendly. Therefore, US Federal Reserve Chairman Jerome Powell is ultimately more important than the next President for the capital markets. Powell has already set the course: keep interest rates low for an extended period of time. Investors expect this course to be confirmed after the US Federal Reserve meeting this coming Thursday.

Experts see the real risk in dealing with the election results. Trump is expected to make the process of transferring power as difficult as possible should he lose the election. In addition, the first projections are likely to produce a distorted picture, as the counting of the numerous mail-in ballots usually only begins after the polling stations have closed. Around 60 million Americans of the around 240 million citizens who are potentially eligible to vote have cast their votes by mail. It is expected that counting will take a few days, if not weeks, especially in populous counties and states. Investors should therefore be prepared for more volatile trading days.

Whoever wins the election will have a challenging time ahead. This is also evidenced by the Halloween charts that are published every year on Halloween by the fixed income team of the British investment manager M&G Investments. These spooky charts could scare investors. We took a closer look at three of these charts (source: M&G Investments*):

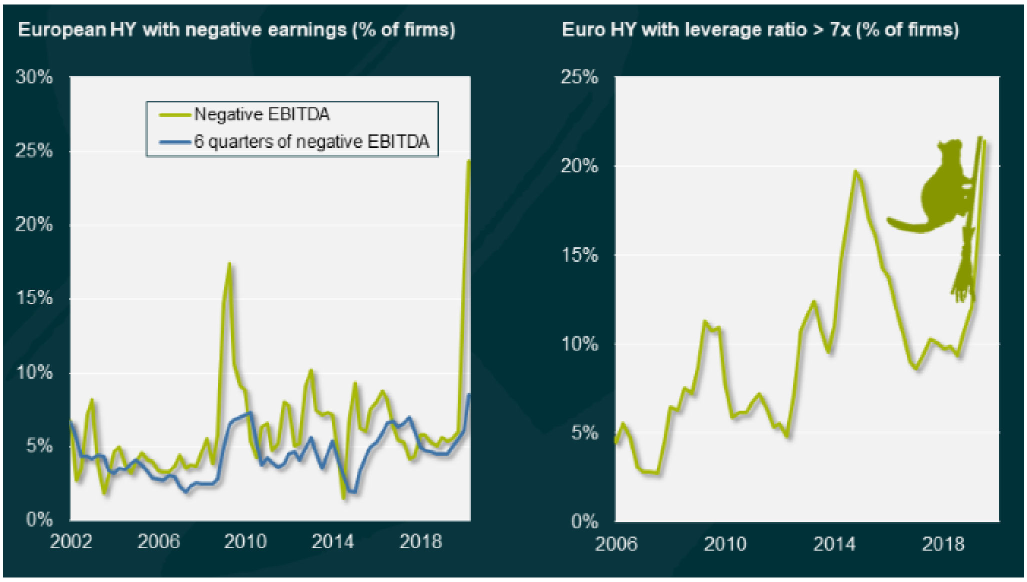
Does headline unemployment capture the true extent of this crisis?



Reading the latest unemployment statistics, there has been no shortage of scary numbers and charts this year. Fortunately, government support and furlough schemes have provided much-needed support to many workers in developed markets, keeping both households and the economy afloat. But this brings with it a scary corollary: how many workers are unemployed and don't know it yet? In other words, what will happen when furlough and other support schemes come to an end?

This chart may be even scarier than headline US jobless claims. It illustrates current unemployment figures with the addition of those who classify themselves as temporarily unemployed. If one includes workers on temporary leave for at least 15 weeks, the number of "unemployed" workers is around double the reported number.

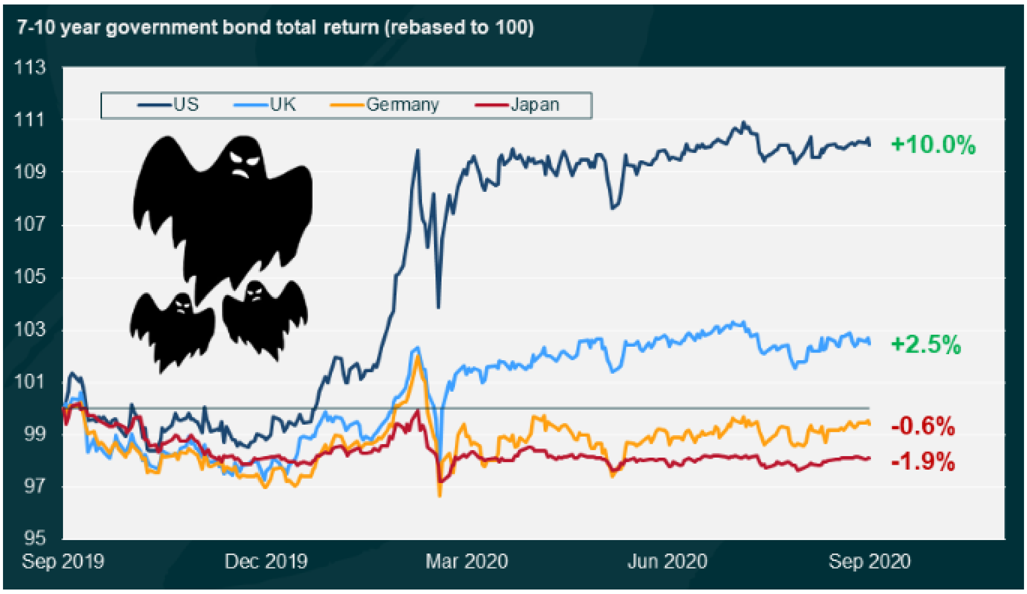
European solvency looks scary



The next spooky chart reveals some worrying signs in European high yield solvency. While many high yield companies have managed to keep up liquidity during this year, balance sheets are looking rather fragile. As lockdown restrictions begin once again to tighten across Europe, poor earnings and high leverage in many companies mean we may not have seen the last of the weakness in European high yield.

Having reached highs around 8.9% in March from its January low of 3.0%, the Euro high yield index is now trading with a credit spread of about 4.0%. Given the shaky fundamental picture that one can see in the chart, this gives a scary indication of just how much asset prices have been boosted by central bank support with a lack of underpinning earnings quality.

Duration was key recently: if you held US Treasuries or UK gilts



This year the cushion provided by falling interest rates meant that holding duration in a bond portfolio was key in protecting investor capital, but only if that duration was in the United States or United Kingdom. By contrast, Japanese and European duration posted negative returns for investors.

Why the difference? The answer is simply that the US central bank Fed and Bank of England had space to cut interest rates while Europe and Japan did not. Now that rates are close to zero in the United States and the United Kingdom, this begs the question of where investors can go now to get such a risk-off hedge.

We continue to be fairly cautious with regards to equity and bond markets. On the one hand, there are the rapidly increasing Coronavirus infections, which have led to massive restrictions in everyday life in many places. On the other hand, it remains to be seen whether the US presidential election will take place without any background noise (irregularities in the elections, lawsuits...). Either way, the markets will remain volatile for the time being. We continue to favor developed countries and China over emerging markets and focus on equities of high-quality companies with strong balance sheets in the healthcare, technology, and consumer staples sectors. An eventual election of Joe Biden could be positive for equities in green technology and alternative energy companies. We have already identified funds that meet these requirements.

Market participants do not expect any further rate hikes by the US central bank Fed this year. In Europe, on the other hand, further rate cuts by the European Central Bank ECB are expected in the next 12 months.

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 and the recent turbulences in the markets 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.

* You can find all Halloween charts under the following link: https://www.bondvigilantes.com/blog/2020/10/30/seven-scary-charts-happy-halloween/

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Limmat Wealth Ltd.