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PORTFOLIO UPDATE

FEBRUARY 2020

- YEAR OF THE BLACK SWANS?
- ONLY MINOR LOSSES DESPITE A CHOPPY START TO THE NEW YEAR
- EPIDEMICS AND STOCK MARKETS

REVIEW

Year of the black swans?

> *In the world of finance a **black swan** is a term used for an unexpected event with drastic consequences that can suddenly throw the financial markets off course.*
>
> *Wallstreet-online*

In his book *The Black Swan*, which was published in 2007, Nassim Nicholas Taleb wrote about *"the impact of the highly improbable"* with reference to unforeseeable risks to the world of finance, arguing that they occur more frequently than is generally assumed. In 2020 at least, it looks like the author could be proved right. At the very beginning of the year, the drone strike on Iranian general Qasem Soleimani raised the spectre of a widespread conflagration in the Middle East. We have the absence of serious retaliatory attacks by Iran and a military mishap to thank for the fact that this situation did not escalate further, enabling the financial markets to recover from the shock scenario relatively quickly. Meanwhile the situation regarding the current outbreak of novel coronavirus remains unclear. The only certainty is that the virus emerged at a time of equity market highs, which has probably given many investors a reason to offload risky – and in some cases overvalued – assets.

In between these two events, the long-awaited signing of the phase one trade deal between the US and China and the preceding anticipation stoked optimism. This had less to do with the content of the agreement itself than the fact that further escalation had been averted for the time being. Accordingly, some hopes were dashed in that existing tariffs remained in place, while the purchasing commitments covering goods exports to China looked rather unrealistic in light of the target volumes agreed. Nonetheless, the financial markets were satisfied with this outcome. In any case, sentiment amongst managers, economists and investors appeared to be picking up, which was due in no small part to the stabilisation in economic data.

In the midst of this emotional rollercoaster ride, the US fourth-quarter reporting season is already in full swing. It is too early to draw any conclusions just yet, but on the whole it appears that revenues and earnings have come in stronger than expected. Companies from the utilities and communication services sectors in particular have posted robust earnings growth, while energy and commodities firms have seen their numbers fall. In Europe, the reporting season has yet to begin. Thanks to this essentially positive trend, the financial markets' reaction to the worries sparked by the coronavirus has so far been relatively restrained.

Financial markets 2019/2020 Total return

America	January	2019
S&P 500 (US)	0.0%	31.5%
Dow Jones Industrial Average (US)	-0.9%	25.3%
EURO STOXX 600 (EU)	-1.2%	26.8%
DAX (DE)	-2.0%	25.5%
SMI (CH)	0.1%	30.2%
MSCI Emerging Markets (EM) in USD	-4.7%	18.8%
Europe	**January**	**2019**
US Corporate Bonds Inv. Grade	2.3%	14.5%
US Corporate Bonds High Yield	0.0%	14.3%
Pan-Europe Corporate Bonds Inv. Grade	1.6%	8.1%
Pan-Europe Corporate Bonds High Yield	0.4%	12.3%
Alternative Investments	**January**	**2019**
Gold	4.4%	18.8%
Oil (brent)	-15.2%	24.9%

Sources: Bloomberg, swisspartners

MANDATE RETURNS GROSS

	Euro			Swiss Franc			US Dollar			British Pound		
	CONS	BAL	DYN	CONS	BAL	DYN	CONS	BAL	DYN	CONS	BAL	DYN
2012	6.6%	7.4%	10.5%	4.3%	6.5%	10.9%	5.9%	8.4%	11.8%			
2013	1.5%	6.5%	13.5%	1.9%	8.3%	16.7%	2.8%	9.4%	18.5%			
2014	6.1%	8.0%	10.2%	4.9%	6.5%	9.2%	1.6%	2.2%	3.1%			
2015	2.7%	6.3%	9.9%	-0.8%	0.0%	1.8%	-0.3%	0.0%	1.0%			
2016	2.3%	5.3%	7.1%	1.3%	3.9%	5.7%	2.8%	6.2%	7.2%	4.6%	9.5%	12.1%
2017	3.5%	7.3%	10.8%	4.3%	8.9%	15.0%	7.1%	12.7%	18.1%	4.7%	8.7%	14.2%
2018	-4.3%	-9.0%	-10.5%	-5.6%	-10.1%	-12.1%	-2.5%	-7.9%	-9.8%	-3.3%	-8.6%	-10.4%
2019	9.2%	15.7%	21.6%	8.3%	14.8%	19.6%	11.5%	17.5%	22.0%	9.4%	15.3%	19.8%
Jan 20	0.4%	-0.3%	-0.1%	0.0%	-0.7%	-0.7%	0.3%	-0.5%	-0.5%	0.3%	-0.4%	-0.3%
2020	0.4%	-0.3%	-0.1%	0.0%	-0.7%	-0.7%	0.3%	-0.5%	-0.5%	0.3%	-0.4%	-0.3%

Actual portfolio returns may vary from the results shown above due to limitations in implementing the strategies.

While a major sell-off has not yet materialised, there has been a palpable shift in sentiment. Inevitably, we also suffered losses on our strategies in this setting, albeit at a level that we consider acceptable given the two shock scenarios.

Conservative strategies with significantly lower exposure to equities were less affected by the price corrections. Rising bond prices were also beneficial in these strategies. Bonds were in greater demand due to the visible increase in risk aversion amongst investors and the lower risk of losses in this asset class. As expected, positions classified as alternative investments also provided some degree of protection.

Individual positions that are reliant on China as a sales market have been hit particularly hard. In terms of sectors, this mainly applies to consumer goods, especially the automotive industry. On a regional basis, the German equity market tends to come under greater pressure if there is a risk of damage to global trade due to the strong export dependency of the underlying companies.

True to portfolio theory, a broadly diversified portfolio has so far proved to be the best defence against any unforeseeable transmission of the novel coronavirus. We will find out in the coming days whether the Chinese government's quarantining efforts have been successful in containing the spread of the virus.

POSITIONING

Equities (overweight)	Thanks to stabilising soft indicators, improving economic fundamentals and the current ceasefire in the Sino-US trade dispute, our outlook for the equity markets is positive. Moreover, the central banks are ready to stimulate global economic growth using all of the instruments at their disposal. As we expect a continued pick-up in economic activity in this attractive environment for the stock markets, we have increased the equity allocation to the detriment of liquidity.
Bonds (underweight)	Focus on global flexible strategies in combination with high-yield bonds, senior loans and floating-rate investment products with low interest rate sensitivity, while underweighting direct investments in government and European corporate bonds that offer too little compensation for risk.
Alternative Investments (overweight)	Combination of insurance securitizations, market-neutral or option-based volatility strategies, which exhibit low correlations, unlike traditional asset classes.
Liquidity (overweight))	Outside of the US dollar investment universe, there are few opportunities to avoid the negative interest rates applied by the central banks. If necessary, we are parking excess liquidity in cash and accepting a negative return, which is partially passed on to customers, especially as there are no other risk-free alternatives. Trustee investments offer opportunities in US dollars.
Foreign currencies (underweight)	The foreign currency allocation is reduced in the portfolio by deploying foreign exchange futures transactions. A higher share in the reference currency is favoured at present on the basis of risk considerations.

OUTLOOK

Epidemics and stock markets

A dip in sentiment amongst purchasing managers tends to be the first sign of economic weakness. However, in the case of the coronavirus, we will have to wait for the next survey results to see whether there are any initial signs of a slowdown in economic activity. That said, the possible economic fallout of the virus infection is gradually becoming foreseeable based on the reactions of numerous companies. Despite the statement issued by the World Health Organisation on 30 January 2020 which concludes that restrictions on trade or travel will not be necessary, large international firms such as Tesla, McDonalds, Starbucks and various airlines are shutting the door on significant parts of China for the time being. Further reports of this ilk are likely to follow. Branches and production facilities are being closed for varying periods of time, which will probably be adjusted in accordance with the latest information as it is difficult to predict how far the virus will spread.

It is already clear that this is having an impact on global economic momentum. Unsurprisingly, a flight to safe havens has been evident on the financial markets. Equities have suffered losses, while assets that are considered safe such as government bonds, gold or the Swiss franc have posted considerable gains. With a total of 5,327 reported cases of SARS infection and around 350 deaths (global statistics: 8,100/770), Capital Economics estimates that economic growth in China fell by 3 percentage points from 8% to 5% on the basis of GDP in 2003. Compared to the current situation, the main difference is that 17 years ago, China ranked 6th in terms of economic power (based on GDP) and only accounted for 8% of global trade (exports). Today, the Chinese economy is the second-largest in the world, representing around 20% of global exports. Moreover, it is clear that the new coronavirus has already overtaken SARS in terms of the infection rate. While the mortality rate has been significantly lower so far, the temporary shutdown of China's economic powerhouse will have palpable repercussions.

A contrasting trend on the financial markets cannot be ruled out per se. As we know, the markets tend to act as leading indicators for future economic developments. Unless the situation deteriorates drastically, we continue to expect a revival of global economic activity as envisaged before the coronavirus outbreak. In this environment, we cannot imagine that the central banks will opt for a less supportive policy. As a result, we still see the economic revival remaining intact, albeit possibly delayed by a few months. We advise against seeking the timeliest opportunities to invest or sell off exposure during market phases such as these and recommend opting for a broadly diversified portfolio. At the time of the SARS virus, the height of media interest coincided with the beginning of the Hong Kong stock market's race to catch up, which shows just how rapidly sentiment can change on the markets.

Hang Seng equity index & peak media interest

Sources: The Economist, Commerzbank, Bloomberg

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