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Portfolio Update

May 2020

- Mounting questions
- Mandates recoup a good portion of losses
- Don't fight the Fed!

Review

Mounting questions

Anyone who thought they had seen it all probably learned a thing or two in April. After all, we remain in lockdown and have to come to terms with a situation that is virtually unknown to all of us, at least in the western world. At the same time, we are seeing developments on the financial markets that are difficult for both observers and investors to comprehend. On the one hand, the financial markets do not in any way reflect the current economic situation given the rally in April. On the other hand, the fact that a barrel of oil could be purchased for minus USD 40 just a few days ago is astonishing. To put it simply, this meant that anyone buying oil would be handsomely compensated for doing so.

While the latter is partly the result of a shortage of storage capacity in the US and Canada, in the former case there are good reasons to justify the current valuation levels on the equity markets and strong share prices in April. One explanation is the consistently clear message being reiterated by the central banks: liquidity will be provided for as long as required in the current challenging times. As well as the help available for companies, emergency loans have also been pledged to member states and jurisdictions that face financial shortfalls due to an absence of tax receipts and increased healthcare costs.

Another factor that contributed to April being the strongest month for equities since 2009 in some cases is the changing perception of the Covid-19 crisis. While reporting of the crisis was extremely negative in March, there was a shift towards a more optimistic tone in April. News of falling infection rates, restrictions being eased more quickly than planned and numerous studies proving that certain drugs can improve the health of Covid-19 patients came to the fore.

As a result, instead of being preoccupied by the immediate economic repercussions of the pandemic, which will undoubtedly be highly damaging, investors seemed more hopeful of a return to normality in the near future. The financial markets are therefore fulfilling their role as a leading indicator of future economic performance and may well decouple noticeably from current economic developments in extreme phases.

The economy should be able to tolerate the adverse effects that have emerged thus far if the lockdown is eased in the near future and consumer spending picks up. Companies and consumers would then find themselves in an environment defined by hugely accommodative monetary policy. In turn, this would equate to the Goldilocks scenario of moderate growth, low inflation and market-friendly monetary policy which is favourable for the financial markets. That at least is the theory maintained by numerous financial market players.

Financial markets 2020 total return

America	April	2020
S&P 500 (US)	12.8%	-9.3%
Dow Jones Industrial Average (US)	11.2%	-14.1%
EURO STOXX 600 (EU)	6.5%	-17.5%
DAX (DE)	9.3%	-18.0%
SMI (CH)	4.8%	-6.7%
MSCI Emerging Markets (EM) in USD	9.2%	-16.6%
Europe	**April**	**2020**
US Corporate Bonds Inv. Grade	5.2%	1.4%
US Corporate Bonds High Yield	4.5%	-8.8%
Pan-Europe Corporate Bonds Inv. Grade	4.5%	-2.4%
Pan-Europe Corporate Bonds High Yield	6.2%	-9.8%
Alternative Investments	**April**	**2020**
Gold	5.6%	10.8%
Oil (brent)	10.4%	-64.3%

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%**	**2.9%**	**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%
Feb 20	-2.0%	-3.3%	-5.3%	-2.1%	-3.5%	-5.5%	-1.9%	-3.3%	-5.4%	-1.6%	-2.8%	-4.7%
Mar 20	-7.1%	-8.7%	-10.5%	-6.8%	-8.3%	-9.5%	-6.7%	-8.6%	-10.0%	-7.0%	-8.6%	-10.6%
Apr 20	4.1%	5.4%	7.4%	4.5%	5.2%	7.1%	4.2%	5.4%	7.2%	3.9%	4.9%	6.9%
2020	**-4.9%**	**-7.2%**	**-9.1%**	**-4.6%**	**-7.5%**	**-9.0%**	**-4.4%**	**-7.3%**	**-9.1%**	**-4.6%**	**-7.2%**	**-9.2%**

Actual portfolio returns may differ from the values shown above owing to costs and restrictions on implementation.

TRANSACTIONS IN APRIL FOR STRATEGY MANDATES

T-Mobile US8725901040	Buy 8 April 2020 Conservative Balanced +1.5% Dynamic +1.5%	Individual equities have held up well in an environment of uncertainty created by Covid-19. In our portfolios, these primarily included Ubisoft, Amazon, Zoetis and Alibaba. As part of our rebalancing process, we scaled back these positions to the original weights when they were purchased. We used the proceeds to invest in the US telecommunications company T-Mobile, which is one of the most successful mobile providers in the US. Thanks to the long-awaited merger with Sprint, we see the following opportunities: ▪ Flexible pricing and cost-cutting/synergies, leading to higher margins ▪ Access to Sprint's network and benefits of first-mover status in 5G ▪ Improved market position owing to higher number of customers (now between AT&T and Verizon) ▪ Stronger competitive position thanks to better network quality

POSITIONING

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. Short-dated bond and trustee investments offer opportunities in US dollars.
Bonds (underweight)	The focus is on global active 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.
Equities (overweight)	Due to the COVID-19 pandemic, the improvement we are expecting to see in economic fundamentals will be delayed by several months. We are currently adhering to our generally positive outlook and consider the interim ceasefire in the Sino-US trade dispute to be favourable for the equity markets. Moreover, the central banks are ready to deploy all of the instruments at their disposal to stimulate global economic growth and support companies in overcoming financial shortfalls.
Alternative investments (overweight)	A combination of insurance securitisations, market-neutral, arbitrage and option-based volatility strategies. In contrast to traditional asset classes, these instruments exhibit low levels of correlation and offer a degree of protection from geopolitical risks. In normal market conditions, the aim is to achieve a positive market yield while minimising volatility. A high level of liquidity is a fundamental requirement.
Foreign currencies (strategy-related)	Foreign currency allocations differ depending on the risk strategy. Hedging foreign currency positions for US dollar strategies is advisable in the current interest rate environment. These strategies benefit from a positive roll yield due to the interest rate differential versus the EU/Switzerland. Conversely, euro and Swiss franc strategies pay high premiums for hedging US dollar positions. At the same time, we expect demand for the Swiss franc to decline in the medium to longer term.

OUTLOOK

Don't fight the Fed!

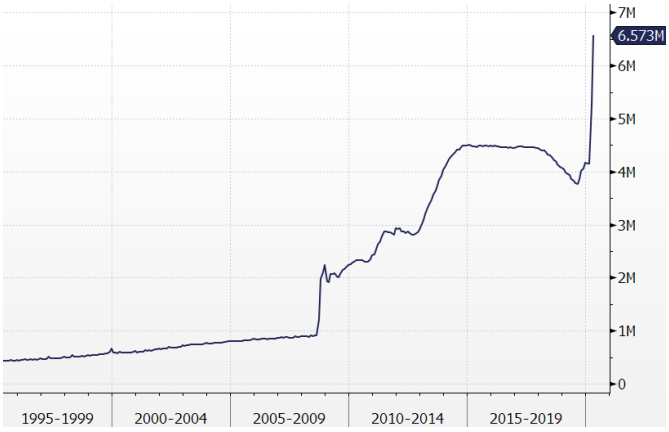
While the lockdown in China has already been loosened substantially, initial steps towards easing are now also being taken in Europe and the US. However, there are signs that governments are planning a return to what will be the new normal at different speeds. This depends in part on the varying infection rates across countries and regions, and on the specific situation facing individual governments. On the whole, though, the normalisation process is taking considerably longer than was assumed at the start of the outbreak. At the same time, authorities are widely urging caution, in line with the comments of France's Prime Minister Édouard Philippe, who has warned that the easing process will only be maintained as long as there is no further increase in the reproduction number. Spain and Italy are also aiming to engineer a measured exit from the crisis. As a result, there are growing question marks over the hoped-for V-shaped economic recovery. Under this scenario, the pandemic would be limited to one or a maximum of two quarters.

These reservations are certainly justified in view of mounting unemployment, bleak corporate outlooks and plunging consumer sentiment. With the lockdown continuing, these data readings now point to such a sharp economic downswing that the question is no longer whether there will be a recession, but rather how long it will last. This is a highly invidious situation, in which health risks have to be weighed against the economic costs. Each additional month in lockdown claims numerous new victims in the form of business insolvencies, from small firms through to big companies.

For now, this state-mandated pain can be alleviated at most by injections of liquidity, which is why governments have opened up the public purse. The central banks – above all the Fed – are singing from the same hymn sheet, true to the motto of «the more the better». The money supply has been expanded at an unprecedented pace in recent weeks, making a return to normality a huge task on this front as well.

With a view to safeguarding economic stability and full employment, an active approach by the central banks is certainly justified at a time of widespread recessionary fears. That said, the extent of the action taken gives us pause for thought. The emergency measures implemented also permit the purchase of junk bonds to keep the funding costs of their low-rated issuers artificially low. The euphemistic description of these speculative bonds as «fallen angels» illustrates the extreme nature of the current situation.

Federal Reserve balance sheet in trillions



Sources: Bloomberg, swisspartners

While it is impossible to assess the long-term consequences of this central bank largesse, these measures are sending financial markets higher, benefiting many people in the process. Ultimately, the central banks' message is clear: the greater the uncertainty and the risk of economic collapse, the bigger and more ingenious the measures taken to restore confidence among investors. Those who are – understandably – betting on falling equity prices at present because of the poor economic fundamentals are inevitably losing money.

Numerous economists are right to flag up the risk of relying too heavily on central bank support during times of crisis, as this can ultimately prove to be an expensive habit. But for the time being such words of wisdom are of little help. Investors who offloaded risky assets as the pandemic took hold failed to consider the power of the central banks. However much uncertainty there may be over the duration of the Covid-19 pandemic, we can count on monetary policy support for the financial markets.

To cut a long story short: Don't fight the Fed!

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