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Portfolio Update

June 2020

- Recovery continues apace
- The FOMO and TINA story

Review

Recovery continues apace

Anyone attempting to explain current valuations on the financial markets with reference to models of financial theory is likely to feel somewhat perplexed. Neither the present economic situation nor corporate forecasts could justify prices rising to this extent. And those who argue that the stock market always looks six to nine months ahead in trying to substantiate the surge in asset prices would struggle – not least in light of 21 million unemployed in the US – to explain just why they believe everything will be back to normal by then.

However, the fact remains that the rebound which commenced in late March is still intact and really started to gain traction in May. While initially just a small number of predominantly tech stocks were sending indices higher, the optimism has now taken hold across a broad base. In particular, stocks from the travel, automotive and financials sectors, which had incurred sharp losses, benefited from stronger demand in May. This was prompted by a slowdown in the spread of Covid-19 and the accelerating process of opening economies back up. Other than some isolated exceptions, these easing measures are generally being implemented without problems, which is encouraging for those hoping to see a near-term comeback for "non-essential" consumer spending.

But the support programmes put together by national governments and central banks are a far more significant factor than mere hopes of an improvement. And this is the crux of the matter. If even high-risk companies would receive support from the Federal Reserve if the worst came to the worst, where exactly is the risk for investors? This was precisely the underlying sentiment that appeared to be sweeping the markets in May. As a result, high-risk bonds – i.e. those rated lower than BBB – also made substantial gains. Europe helped to boost sentiment as well. The Franco-German proposal to establish a recovery fund worth a reported EUR 500 to 750 billion is sparking hope among lenders of debt mutualisation. In simple terms, if the EU member states unanimously back the plan, frugal nations within the EU would effectively guarantee the liabilities of highly indebted countries such as Italy and Greece. The mere prospect of joint EU debt being issued for the first time ever sent bond spreads of peripheral countries tumbling rapidly, with the prices of this paper therefore rising.

The oil price also played its part in bolstering sentiment. At the very least, at this oil price level the risk of energy companies going bankrupt is now substantially lower than it was a month ago. For their part, those who sought sanctuary in gold for fear of inflation also had reason to be satisfied as the price of the precious metal appreciated. All in all then, we can look back on a positive month for market participants.

Financial markets 2020 Total return

America	May	2020
S&P 500 (US)	4.8%	-5.0%
Dow Jones Industrial Average (US)	4.7%	-10.1%
EURO STOXX 600 (EU)	3.4%	-14.7%
DAX (DE)	6.7%	-12.5%
SMI (CH)	2.5%	-4.4%
MSCI Emerging Markets (EM) in USD	0.8%	-15.9%
Europe	**May**	**2020**
US Corporate Bonds Inv. Grade	1.6%	3.0%
US Corporate Bonds High Yield	4.4%	-4.7%
Pan-Europe Corporate Bonds Inv. Grade	-0.3%	-2.8%
Pan-Europe Corporate Bonds High Yield	2.3%	-7.7%
Alternative Investments	**May**	**2020**
Gold	2.5%	13.6%
Oil (brent)	54.6%	-44.9%

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%	2.9%	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%	4.3%	5.2%	7.1%	4.2%	5.4%	7.2%	3.9%	4.9%	6.9%
May 20	1.4%	1.8%	2.3%	1.7%	2.0%	2.6%	1.8%	2.3%	2.9%	2.2%	2.7%	3.6%
2020	-3.6%	-5.6%	-6.9%	-3.2%	-5.6%	-6.6%	-2.7%	-5.2%	-6.5%	-2.5%	-4.6%	-5.9%

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

TRANSACTIONS IN MAY FOR STRATEGY MANDATES

Melchior European Opportunity Fund European equity funds **EUR** LU0289523259	**Redemption** 14 May 2020 Conservative -3.5% Balanced Dynamic	The fund invests in companies that make highly efficient use of capital and have strong free cash flow and earnings quality. They are market leaders and exhibit undervalued structural growth. The strategic weighting in SMEs is around 50%. In Europe some fund managers who invest in all market caps have found it difficult to keep pace with performance since late 2018/early 2019. This has been particularly evident during periods of stress. Melchior has a strategic weight of around 50% in SMEs, which makes us cautious at the present time. Admittedly, Melchior has outperformed both its benchmark, the STOXX Europe 600, and its peer group over the last three years. However, over the past year we have noted the lack of excess returns on the investments made and see little prospect of this trend improving. Melchior is being replaced by the **BSF European Unconstrained Equity Fund**, an existing holding that takes a more flexible approach to weighting SMEs.
Memnon European Fund European equity funds **EUR** LU0578133935 **USD** LU0578134073	**Redemption** 14 May 2020 Conservative -2.5% Balanced Dynamic	The fund strategy is based on a mean reversion approach to valuation. The portfolio is concentrated, comprising around 25 stocks, and is flexible in terms of style, sectors and countries, also including mid caps. Since we invested in late January 2018, the fund has matched the performance of the STOXX Europe 600. We do not see any improvement in the relative performance trend for the investments made by the fund. Furthermore, we do not believe that the mean reversion valuation strategy will generate excess returns in the immediate future. We are therefore replacing this equity fund with the **Fidelity FAST Europe Fund**.
Fidelity FAST Europe Fund European equity funds **EUR** LU0348529875	**Subscription** 14 May 2020 Conservative +3.5% Balanced Dynamic	The fund managers are pursuing a directional long/short equity strategy (130/30) on the European equity market at a typical investment level of 90-110%. Both portfolio managers have been managing the fund using a pure equity selection approach since July 2017, without any restrictions relative to the benchmark. Macroeconomic factors are not taken into account, while structural changes have a role to play. The aim is to achieve an excess return via the long and short positions. The philosophy involves focusing on companies with good growth prospects and maintaining a concentrated portfolio (long and short).

POSITIONING

Liquidity (neutral)	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. While a temporary setback cannot be ruled out, we do not expect the March levels to be undershot.

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.

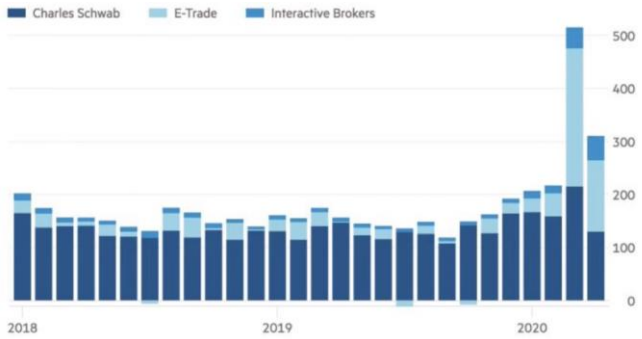
OUTLOOK

The FOMO and TINA story

It may sound like the title of another kitschy Hollywood comedy, but in reality – at least amongst private investors – this is an apt description of the current situation on the financial markets. **FOMO** – the fear of missing out – is primarily reflected by the sharp surge in new trading accounts being opened by private investors (see chart below). While retail customers are vigorously purchasing securities instead of spending their money on consumer goods, professional investors (financial institutions) remain sceptical. According to some asset managers, uncertainty about investing customer funds in securities that have become significantly riskier is too great at the moment. This is not surprising given the swathe of unanswered questions relating to Covid-19, especially the very real threat of a second wave of infections.

In any case, there is little enthusiasm for a rekindled Sino-US trade war as the dispute sparked various phases of volatility on the markets in 2018. The fact that Joe Biden is also keen to pursue a more aggressive policy towards China is hardly encouraging, as it poses a risk that both presidential candidates will try to outdo one another ahead of the US elections.

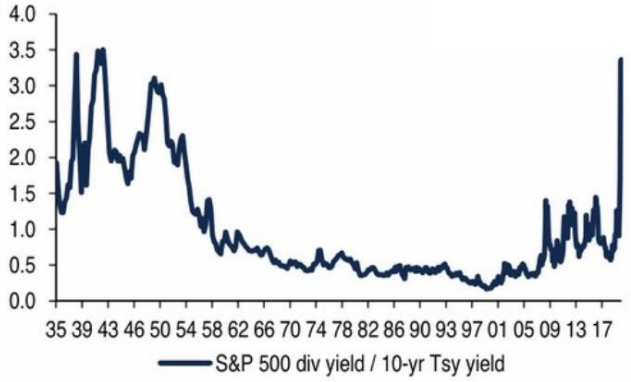
Retail customers are keen to invest New customers in the USA (thousands)



Sources: Markus Koch

All of these are reasons enough to remain cautious, were it not for **TINA**. There is no alternative: in other words, what else is there to buy apart from equities? This sums up the difficult situation facing investors who now have little choice but to purchase stocks in their quest for positive returns. The rate cuts implemented in the US in a bid to contain the effects of the coronavirus crisis have further curtailed the range of bonds that still offer returns. This is clearly illustrated in the following chart, which shows the dividend yield in the S&P 500 relative to the 10-year Treasury yield and highlights the huge anomaly versus the trend since the 1940s.

Dividend yield relative to government bond yields USA



Sources: S&P, BofA US Equity & Quant Strategy

It is a situation that cannot be ignored. Assets under management in pension funds worth billions rely on positive yields, which suggests that demand for equities is unlikely to subside any time soon despite the lack of real economic fundamentals to support this trend. The recent rise in the S&P 500 equity index above the crucial 3000 mark is a sign of investors' buying appetite. We consider the breach of this critical level to be extremely healthy and expect the uptrend to continue. However, given the ongoing coronavirus crisis and foreseeable dispute between the two major powers of the US and China, we still see potential for volatile trading sessions and temporary setbacks, which will call for strong nerves on the part of investors.

Editorial deadline: 15.00 CET, 31 May 2020

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