swisspartners
The art of finance.

Portfolio Update

September 2020

- **Investors taking significantly higher risks!**
- **Is the time ripe to hedge portfolios?**

Review

Marked increase in risk appetite

Despite growing evidence of second waves of Covid-19 infections at a regional level, August again saw investors flocking to buy equities. But in contrast to the preceding months, there was also greater demand for stocks outside of the technology sector. In particular, the Dow Jones Transportation Average Index, which covers the 20 biggest transport companies in the US, suggests that the stock market rebound is now becoming increasingly broad-based, having climbed by more than 14% in August. Although European and some Asian stock market indices are still lagging well behind their US counterparts in the year to date (see table), in a recently published analysis Barclays pointed out that payment flows are increasingly heading out of US stocks towards European and Japanese assets. In the view of some market participants, US equities are now exhibiting high valuations having already performed very well, while the upcoming presidential elections in the country are a source of concern – worries that are not currently present in Europe in this form.

The fact that the leading US equity index, the S&P 500, has already hit a fresh historic high – a rather exceptional development given the speed of the 62% rebound since the outbreak of coronavirus – is also a product of the ongoing market-friendly policies adopted by the central bank. This was the message that was sent out by the change to US monetary policy recently announced by Fed Chair Jerome Powell. But what may at first glance look like an unremarkable tweak to an average inflation target of 2% instead of “close to but below 2%”, alongside Powell’s statement that full employment alone was not a reason to tighten monetary policy, was in fact far from inconsequential. In other words, this provided a clear indication that monetary policy normalisation is further away than ever. It appears likely that the economy will continue to have access to high levels of liquidity and low interest rates for some time yet, which should continue to boost the inflationary trend in stock market valuations.

Given that inflation expectations are now heading higher again, this statement from the Fed chief did not come as a complete surprise. It seems he wanted to make a pre-emptive strike against future pressure to hike interest rates. Following his speech, demand for the US dollar was correspondingly weak, with the greenback losing more ground against the Swiss franc and the Euro as the yield differential fell (CHF/USD +7.0% and EUR/USD +6.3% in the year to date).

Regional returns and asset classes really make clear just how much risk appetite investors are demonstrating. Accordingly, the defensively positioned SMI Index lags well behind its peers with gains of 1.6%. There was also either little or muted demand for gold and bonds of companies with solid finances, as the table below illustrates:

Financial markets 2020 Total return

America	August	2020
S&P 500 (US)	7.2%	9.7%
Dow Jones Industrial Average (US)	7.9%	1.3%
EURO STOXX 600 (EU)	3.1%	-10.3%
DAX (DE)	5.1%	-2.3%
SMI (CH)	1.3%	-1.4%
MSCI Emerging Markets (EM) in USD	2.2%	0.7%
Europe	August	2020
US Corporate Bonds Inv. Grade	-1.4%	6.9%
US Corporate Bonds High Yield	1.0%	1.7%
Pan- Europe Corporate Bonds Inv. Grade	0.1%	0.2%
Pan- Europe Corporate Bonds High Yield	1.5%	-2.7%
Alternative Investments	August	2020
Gold	-0.2%	29.5%
Oil (brent)	3.7%	-33.2%

Sources: swisspartners, Bloomberg

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%
Jun 20	1.4%	2.5%	2.9%	1.4%	2.2%	2.6%	1.7%	2.8%	3.2%	1.8%	2.8%	3.4%
Jul 20	0.9%	1.5%	1.7%	0.9%	1.8%	2.2%	2.1%	3.1%	3.8%	0.7%	1.3%	1.5%
Aug 20	1.5%	2.7%	3.9%	1.2%	2.7%	3.8%	1.8%	3.2%	4.4%	1.3%	2.5%	3.6%
2020	**0.1%**	**0.9%**	**1.1%**	**0.2%**	**0.8%**	**1.6%**	**2.9%**	**3.7%**	**4.5%**	**1.2%**	**1.8%**	**2.3%**

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

TRANSACTIONS IN AUGUST & POSITIONING

ML Coburn Barrett E-GLI Enhanced Equities UCITS Fund Global Macro (AI) USD IE00BL1NKN72	Subscription 19 August 2020 Conservative Balanced +2.0% Dynamic +1.5%	The fund follows a decidedly model-driven strategy, which belongs to the global macro group within the alternative segment. The fund aims to beat the equity markets over the long term via a better risk/return profile. The fund is generally invested long and sets its target volatility at 16%, which is roughly equal to average stock market volatility. The aim is to beat the S&P 500 in two out of three years, while the fund targets a level of downside volatility no higher than that of this benchmark index. The strategy would take a short position on equities if there were signs of a sustained recession emerging. To achieve the desired asset allocation, the fund predominantly invests in futures and ETFs. The weighting of the SSF Liquid Alternative FoF was lowered to fund this investment.
Abbott Laboratories Health care USD US0028241000	Sold 28 August 2020 Conservative Balanced -1.5% Dynamic -1.5%	Abbott has benefited hugely from the rapid tests required for coronavirus in recent months. After we took profits several weeks ago, the stock posted further substantial gains and completely met our share price expectations. As our price target has therefore been reached for the second time, we think this a good opportunity to exit given the high market levels in the US. Nonetheless, we would like to reiterate that we still consider Abbott to be a strong company and do not rule out further investments at a later date. However, for this to happen, consolidation or new share price drivers would be required to justify another uptrend in the stock.

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)	In an environment of mounting debt, we favour bond issuers with solid balance sheets, a healthy business model and correspondingly good credit ratings. At the same time, however, investors need to look beyond the top borrowers with AAA/AA ratings if they wish to achieve positive yields to maturity. Diversification is absolutely essential. In light of the limited scope for interest rates to be cut further, we are keeping duration – i.e. interest rate risk in the portfolio – low and are therefore better protected against sudden interest rate hikes.
Equities (overweight)	The outbreak of the COVID-19 pandemic is noticeably hampering the economic trend. We do not expect to see any near-term improvement until a vaccine is readily available. Other factors such as ultra-loose monetary policy, ample fiscal policy stimulus from governments and the lack of investment alternatives on the financial markets bode well for an overweight in equities. If these supports are removed, the situation will have to be reassessed. Until then, while temporary setbacks cannot be ruled out, we do not expect the March levels to be undershot. Hedging is advisable at the current level in the form of a put spread.
Alternative investments (overweight)	A combination of investments in gold, 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 continue to benefit from a positive roll yield due to the interest rate differential versus the EU/Switzerland. In fundamental terms, however, the US faces a bigger dilemma, especially as the coronavirus pandemic is evidently far from being under control. Now that the starting gun has been fired for the EU's fiscal union, the euro is appreciating significantly.

OUTLOOK

Is it time to hedge?

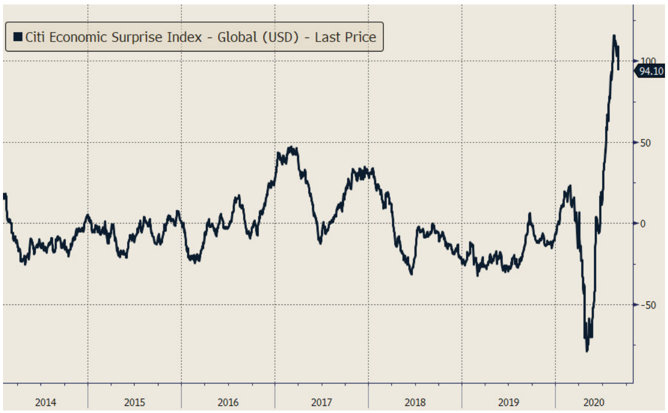
Whether you take an upbeat or downbeat view of the markets, there are more than enough reasons to justify either opinion in the current climate. Here is a brief summary of the main arguments in support of each camp:

- Second wave of coronavirus infections and flu season
- US election/election delay
- Sluggish economic recovery
- High financial market valuations

- Extremely accommodative monetary and fiscal policy
- Declining death rates
- Economic recovery
- Near-term availability of a vaccine

We have now actually reached the point where risks are being overlooked amid buoyant investor sentiment. Admittedly, society is gradually learning how to deal with the virus and the sense of panic that previously infused our daily lives has been fading for some time, while consumer appetite has rapidly picked up again over the summer months. Many economic numbers have been correspondingly positive and have far exceeded analysts' expectations (see chart). That said, we cannot deny that the world we now live in is very different from what we were used to – and where would we be today if the central banks and governments had not pulled out all the stops to halt the economic downturn?

Citi Economic Surprise Index
(shows how far economic data differ from economists' expectations)



Sources: swisspartners, Bloomberg

We certainly do not wish to be pessimistic and are maintaining our generally positive outlook for the markets. In our view, an election victory for the Democrats would not be as problematic for the markets as some of the other financial institutions seem to think. Based on statistics from Worldometer, coronavirus death rates also appear to be falling significantly, which suggests that the effects of a second wave should be less dramatic. Monetary and fiscal policy is at the ready to prop up the stuttering economy and will ensure an uninterrupted supply of liquidity. Moreover, we do not believe that cross-country lockdowns are politically viable at present.

Nevertheless, we think that now is the time to adopt a hedging strategy. Both the favourable market performance in recent weeks and the prospect of a brutal election campaign in the US – with the possibility of a delay to the election result – have prompted us to take a cautious approach for the short term. In any case, the end of the summer period usually heralds the beginning of the flu season, which is likely to create logistical challenges for doctors, companies and governments.

Thus, while we are aiming to benefit from positive performance in the longer term, we will use option hedging as a form of protection against short-term setbacks. To do so, we do not have to sell off equities in the portfolio per se, but can simply obtain this protection by paying an option premium. This will have no bearing on the portfolio structure. If the insurance is not required, the option will expire worthless on maturity (the maximum loss will be the premium). In the event of a market correction, the option would gain considerable value and minimise losses in the portfolio. We would be happy to discuss the details of this strategy in a one-to-one meeting upon request.

Editorial deadline: 15.00 CET, 31 August 2020

This portfolio update was written by:

Nick M. Jenni, Partner
Head Investment Management & Solutions (CH)

This document is purely for information purposes and does not constitute an offer, request or recommendation on the part of swisspartners AG (referred to below as swisspartners) or its group companies (also referred to below as swisspartners). It is based on data provided by third parties, the company's own findings and publicly available sources that swisspartners considers reliable. swisspartners does not assume any responsibility for the information provided being accurate, complete or up-to-date. The information provided in this document is not intended as a substitute for individual advice. No liability can be assumed for any loss or damage arising from the use of this document.