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Portfolio Update

October 2020

- **Triple witching day on the financial markets**
- **Hedging instruments in high demand**

Monthly review for September

Triple witching day on the financial markets

September saw the financial markets follow the conventional seasonal pattern for this month of the year – as reflected in statistical evaluations – by heading down. Once again, the market movements were not sparked by any change in economic fundamentals. While the rebound in data readings softened somewhat, there was no sign of a trend reversal. As a result, there were other reasons for the interim equity market correction of well over 5% in some cases. To many people's astonishment, some market commentators laid the blame at the feet of the central bankers, arguing that they had missed the recent opportunity afforded by the September meetings to agree on additional monetary policy support measures. To be perfectly candid, we find this accusation absurd.

Instead we would draw attention to the rising number of coronavirus cases at present. Just in time for the start of the flu season, case numbers are climbing sharply once again, above all in Europe. The following conclusion certainly sounds plausible to us: the more people whose movements are restricted, the less we tend to think about spending money on discretionary consumption. In the event of further lockdowns, the economy would suffer another setback even before it has fully recovered from the shock triggered by the first wave of the virus. Anticipating this downturn in sentiment, investors seemed to be looking to realise the solid share price gains made over the past few months. The deterioration in the political outlook also points to turbulent times ahead. Alongside heated US election debates and what could prove to be a very tight election outcome with the potential for the type of delay in announcing the result seen in the contest between George W. Bush and Al Gore, the risk of a US fiscal cliff edge and the prospect of a hard Brexit are making financial investors somewhat queasy.

The extent to which the correction was caused by last month's triple witching day still needs to be investigated. *(A triple witching day refers to the day each quarter on which stock index futures, stock options and stock index option contracts expire on the world's three most important derivatives exchanges.)* Empirical studies suggest that no great significance should be attached to this event, which usually occurs on the third Friday of the third month each quarter. However, it may have been an important factor last month given the huge rise in the volume of outstanding options stemming from private investors in the US. In brief, the line of thinking is as follows: if investor A buys warrants on Apple, the market maker will simultaneously buy shares in Apple to supply to investor A if the option is exercised. As the number of investors buying these warrants rises, so does the pressure on market makers to purchase the underlying stock. This obviously drives up share prices. When the warrants expire on triple witching day, the market makers have no further need to hold the underlying shares and can sell them. If at the same time there were no new buyers of Apple stock on the market, share prices would plunge due to the high volume of equities available. While this process may be logical in theory, it is difficult to follow in practical terms.

Financial markets 2020 total return

Equities	September	2020
S&P 500 (US)	-3.8%	5.6%
Dow Jones Industrial Average (US)	-2.2%	-0.9%
EURO STOXX 600 (EU)	-1.4%	-11.6%
DAX (DE)	-1.4%	-3.7%
SMI (CH)	0.6%	-0.9%
MSCI Emerging Markets (EM) in USD	-1.6%	-1.0%
Fixed Income	**September**	**2020**
US Corporate Bonds Inv. Grade	-0.3%	6.6%
US Corporate Bonds High Yield	-1.0%	0.6%
Pan-Europe Corporate Bonds Inv. Grade	0.1%	0.3%
Pan-Europe Corporate Bonds High Yield	-0.7%	-3.4%
Alternative Investments	**September**	**2020**
Gold	-3.8%	24.6%
Oil (brent)	-7.7%	-38.3%

Sources: swisspartners, Bloomberg

MANDATE RETURNS GROSS

Model Portfolio Performances Gross 30.09.2020

	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%
Sep 20	-0.2%	-0.5%	-0.5%	0.0%	-0.5%	-0.4%	-0.6%	-1.0%	-1.2%	0.2%	-0.1%	0.0%
2020	**-0.1%**	**0.3%**	**0.6%**	**0.2%**	**0.3%**	**1.1%**	**2.3%**	**2.6%**	**3.3%**	**1.4%**	**1.7%**	**2.3%**

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

TRANSACTIONS IN SEPTEMBER

Put spread warrant on S&P 500 Index

Equities USA

USD CH0553491348

Subscription

14 September 2020

Nominal

Conservative	-10.0%
Balanced	-20.0%
Dynamic	-20.0%

As announced in last month's Portfolio Update, we have built protection into the portfolio given the mounting uncertainties ahead until the end of the year. This takes the form of a put spread (short and long puts) on the S&P 500 and is therefore packaged as a warrant (structured product). The selected expiration date is 15 January 2021. The main reason for this hedge is our assumption that a delay to the US presidential election outcome caused by Donald Trump could spark rising volatility on the markets. As the flu season begins, we also expect coronavirus to become increasingly topical, which should ultimately be reflected in consumer spending behaviour.

The put spread is used in conservative profiles at a value of 10%, compared to 20% (all nominal amounts) in the balanced and dynamic strategies. This implicitly reduces the equity weighting in the balanced mandate from 50% to 30%. At the same time, however, this structure allows us to retain upside potential if the markets continue to rise.

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)

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 has been implemented 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

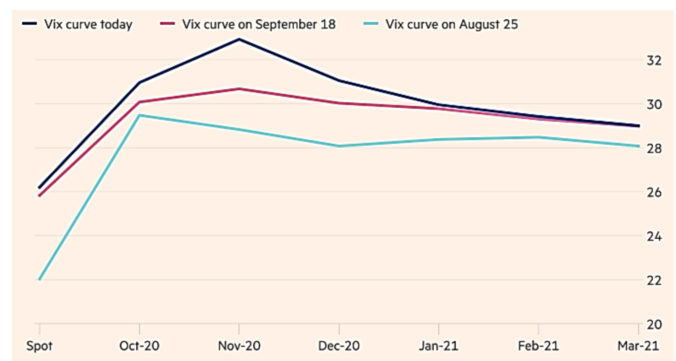
Hedging instruments in high demand

The first election debate between Donald Trump and Joe Biden gave us an initial foretaste of the weeks ahead. There is little prospect of a factual exchange of views given that the first meeting was barely worthy of the term debate. Within just a couple of days of the televised showdown, the organisers announced that changes would have to be made to the format as neither candidate gave the other a chance to speak at any length. A comedian hit the nail on the head when he said that the debate sounded like listening to a badly tuned radio playing two stations at once. Investors also appear to have found it difficult to arrive at a clear verdict on the televised duel, with equity futures initially plunging deep into the red before posting substantial gains on the subsequent day.

With the exception of this debate and several central bank meetings, which emphasised plans to stick with the current policy trajectory, there was little change to the fundamental situation. The problems that held sway in the previous month have not disappeared. At most, the setback for prices in September eased the high level of financial market valuations somewhat. What is missing is a vaccine, which would bring back confidence and the ability of businesses to make plans. While the wave of redundancies that had been anticipated over the summer months surprisingly failed to materialise, every new day brings reports of further job cuts. In view of the time lag effect, significantly higher corporate insolvencies are expected in 2021. As a result, there is correspondingly high pressure on governments to insulate the stuttering economic recovery against a second shockwave. The temporary avoidance of a US government shutdown (which has been postponed until 11 December) and renewed pledges by both political camps to establish a new US coronavirus aid package as soon as possible illustrate just how pressing this is. Without additional fiscal policy support, economic output would move into reverse gear according to the commentary from some central bank officials.

Meanwhile, the view from the stock market monitors seems much more relaxed. While the financial markets shed a few percentage points for the reasons mentioned above, their losses were quickly reversed by a countermovement. Is this a sign that investors are becoming too carefree again? Probably not, as if we take a closer look beneath the surface, we see that hedging products are in high demand:

Volatility futures curve over time (prices on expiration)



Sources: FT, Bloomberg

The rise in the price (cost) of hedging strategies around the time of the US presidential election from 20 October to 20 November is particularly pronounced. This suggests that investors are not selling off the equity positions in their portfolios (thereby keeping share prices high), but are instead hedging via derivatives on the futures markets. We also see potential for a delay to the election outcome if the final result is tight and can understand the rationale behind these moves. In September, we did in fact implement the hedge that we announced in last month's Portfolio Update. This allows us to maintain the same equity allocation in the portfolio, with scope to minimise losses in the event of a sharp sell-off.

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PORTFOLIO UPDATE

OCTOBER 2020

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