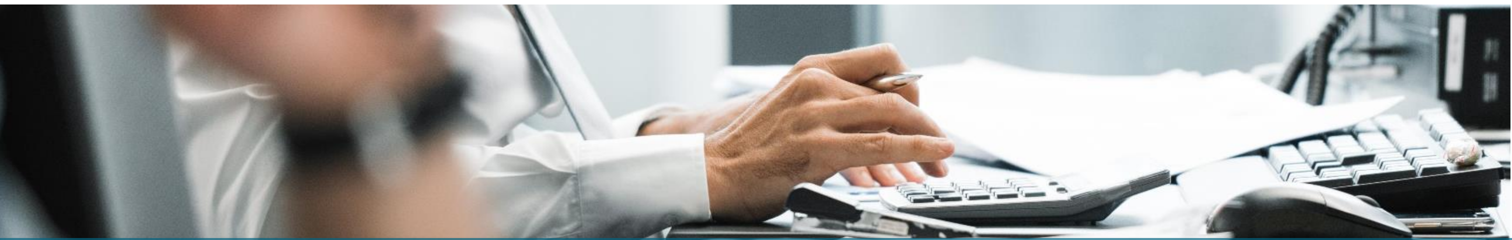

NEWSLETTER

Sébastien Gyger, Chief Investment Officer

“Controversial elections”

With the pandemic now under greater control, but still with us, the economy is sending out encouraging signs of recovery. Massive support for companies and for household income has helped employment to recover and boosted consumption. However, the trajectory varies from one region and one sector to the next – China recovered very fast, while sectors such as cultural products, travel & leisure, and hotels will continue to limp along for a while. Only a safe, effective and widely available vaccine will get us back towards a “normal” situation on the health and economic fronts. A little less than two months before the elections Trump, incidentally, is counting on a vaccine roll-out by election time to catch up with Biden, his Democratic rival. Markets’ concentration in a small number of stocks and speculative bets are exacerbating the risk of corrections. **Against this backdrop, we are keeping our portfolios well diversified in quality assets.**

Market trends

Global equities advanced in August for the fifth consecutive month, with a 6.1% gain sending them to new record highs. US markets turned in their best-performing August since the 1980s (with the S&P 500 gaining 7.0% and the Nasdaq up 9.6%). US bond yields rose, by 18bps to 0.70% in the case of the 10-year bond, including +6bps after Powell’s Jackson Hole speech. The yield curve steepened (the US 10Y-2Y by 15bps to 0.57%), and US high yield (+1.0%) outperformed investment grade US (-1.4%). Gold consolidated below 2000 dollars per ounce, pulling back by 0.2% on the month, and oil gained 5.8%, a sign that the global economy is improving. On the currency front, the US dollar continued to give up ground, albeit at a slower pace (EUR/USD +1.4% to 1.1944), while the Swiss franc confirmed its “safe haven” status (no major currency has outperformed the franc this year).

Market performance as of 31 August 2020

STOCKS MARKETS	LEVEL	CHANGE SINCE	CHANGE SINCE
	31.08.2020	31.07.2020	12.31.2019
Index			
MSCI World	2455.5	6.53%	4.11%
USA			
Dow Jones Ind	28430.1	7.57%	-0.38%
S&P 500	3500.3	7.01%	8.34%
Nasdaq Comp	11775.5	9.59%	31.24%
Europe			
Euro Stoxx 50	3272.5	3.09%	-12.62%
SPI (Switzerland)	12658.9	2.03%	-1.39%
CAC 40 (France)	4947.2	3.42%	-17.24%
DAX (Germany)	12945.4	5.13%	-2.29%
FTSE 100 (UK)	5963.6	1.12%	-20.93%
Japan + Emerging			
Nikkei 225	23139.8	6.59%	-2.18%
CSI 300 (China)	4816.2	2.58%	17.57%
MOEX Index (Russia)	2966.2	1.88%	-2.62%
S&P BSE Sensex (India)	38628.3	2.72%	-6.36%
Ibovespa (Brazil)	99369.2	-3.44%	-14.07%

BONDS & ALTERNATIVES MARKETS	LEVEL	CHANGE SINCE	CHANGE SINCE
	31.08.2020	31.07.2020	12.31.2019
Rates			
Germany 10 y	-0.40	13 Bps	-21 Bps
France 10 y	-0.10	10 Bps	-21 Bps
Italy 10 y	1.09	8 Bps	-32 Bps
US 10 y	0.70	18 Bps	-121 Bps
Debt			
Investment Grade US	335.2	-0.31%	6.37%
Investment Grade Europe	260.2	0.18%	0.47%
High Yield US	2219.2	0.95%	1.67%
High Yield Europe	401.8	1.52%	-2.69%
Emerging Debt	900.0	0.30%	2.06%
Currencies			
EUR/USD	1.19	1.34%	6.45%
EUR/CHF	1.08	0.27%	-0.63%
USD/CHF	0.90	-1.01%	-6.51%
Commodities			
Crude Oil (WTI)	42.6	5.81%	-30.22%
Gold	1967.8	-0.41%	29.69%

Economic highlights

The Fed gives itself greater leeway. At the Jackson Hole symposium, the US Federal Reserve made a historic shift in its monetary policy, adopting an "average-based" inflation rate. This means that it could allow inflation to drift above 2% to offset past instances when it has been below this level. We will come back to this development and set out our conclusions in the next letter.

A faster-than-expected recovery. Economic indicators since April have pointed to recovery that is faster than many economists expected. The US economy is going strong, with 1.37 million new jobs created in August, and massive household income aid has triggered a rather vigorous upturn in consumption. Moreover, Congress is currently debating a possible extension in assistance and is set to vote on it this month. In Europe, the recovery can also be seen in PMI survey data (the European composite is in the expansion zone, at 51.9) and retail sales are close to pre-crisis levels.

The US presidential election in the line of sight. The 2020 presidential election has already made history, as it is playing out in the midst of a global pandemic, an unprecedented economic recession, and racial tensions cross America. Historically, the incumbent party loses 80% of the time when the US is in recession on election day. A stabilisation of the economy and an ongoing market rally will therefore be decisive in whether Trump wins a second term.

Trump posing as an angry outsider. 55% of Americans polled disapprove of his management of the pandemic. Trump is therefore counting on the development of a vaccine by election day to make up his gap in the polls. Whereas the "standard" cycle for approving a new vaccine takes an average of 10 years, potential Covid-19 vaccines are on a fast-track and could be ready in as little as 12 to 18 months. The head of the Federal Drug Administration (FDA) denies that he is yielding to pressure from the Trump administration, even though Trump has rich track-record in this area. Didn't he deliberately try to paralyse the US postal service, in order to promote his chances of re-election? Wasn't it him who called on voters to vote twice? Anything goes over the next two months in what is shaping up to be the worst election in US history.

What would a Biden victory mean? One of the key elements in his program is the partial reversal of the corporate tax cut put through in 2018. A rate hike from 21% to 28% (which would mean reversing half of the tax cut) would subtract 12.7% from after-tax profits of S&P 500 companies. Based on effective tax rates (which historically have been lower than the marginal tax rate) this would mean just a 4.2% decline in profits. Biden is still comfortably ahead in the polls, with his lead estimated at between 6% and 10%, depending on the survey and in key states like Wisconsin, Michigan and even Florida (according to fivethirtyeight.com).

Covid cases could decide the election. Despite the Democratic lead, the markets have just kept roaring ahead. Biden's shift to the centre is soothing fears, as is the economic context, which should head off any desire for an overly punitive tax reform. Trump constantly repeats that polls don't reflect the America's state of mind and says he is confident of an upset, as in 2016. The game is not over, especially as the recent decline in Covid cases coincides with a reduction of Biden's lead in the polls.

Number of Covid-19 cases (black line), compared with the gap between Trump and Biden in the polls (red line), source: Bloomberg

Investment decisions

Gains by some Nasdaq stocks (Tesla up by 74% just in August and Apple by 21%) suggest a troubling degree of complacency or even outright speculation. The big tech stocks (Apple, Microsoft, Amazon, Facebook and Google) account together for more than 23% of the S&P 500's market cap and almost 50% of the Nasdaq 100's. We therefore continue to recommend a diversified regional exposure, including emerging markets, Europe and Japan, which offer cyclical exposure. We reiterate our preference for quality companies with solid balance sheets and competitive business models. Regardless of the US election's outcome, we expect the dollar will continue to trend downward, as the fiscal deficit will continue to balloon, as there is no longer any interest rate gap to support the greenback, and as the euro is once again in investor favour. **The "monetary flood" that is raising fears of currency depreciation is good news for gold, on which we remain bullish.**

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