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Investment **News**

Economic upturn losing momentum (for now)

A vaccine as a "game changer"?

The world is facing serious and lasting economic consequences from the corona-virus pandemic, yet needs to continue with restrictions on personal mobility for the foreseeable future. This is particularly true for the United States and Europe, who are facing record numbers of new infections. Vaccines, once proven safe and effective, will likely only achieve population immunity by mid-2021. Equity markets however will move in anticipation of this and investors should position themselves accordingly.

A volatile year in every respect

For more than half a year now, almost only one topic has been dominating the media and public life, namely COVID-19. The hard to very hard lock-downs at the end of the first quarter of 2020 have led to a massive slump in economic growth in almost all countries, which has been far more severe than in the wake of the global financial crisis. However, the decisive factor for financial markets performance was not so much the sharp economic downturn, as the extremely expansive monetary and fiscal policy, which flooded economies with financial and monetary injections to an extent that historically has only been seen in post-war phases.

Few hits – but plenty of misses

Looking at equity markets, it is evident that year-to-date the number of underperforming companies (losers) significantly outweigh the outperforming ones (winners) and the performance of the individual stocks diverge widely.

The losers include all companies in travel-related industries and those with physical customer contacts. However, the economic slump has also led to a significant decline in demand in the energy sector and, for example, the automotive industry. Equities in the banking sector came under pressure because investors fear rising loan provisions, at the same time as insurance stocks are suffering due to increased liability risks. Conversely, share prices of companies in online trading and related service providers (payment transaction processors, etc.) shot up to unimaginable heights. Similarly successful were the shares of software companies that support the trend towards home office work or the exponentially growing cloud services area. Winners can also be found in the alternative energy sector (wind, solar, hydrogen, electromobility, etc.), which are profiting from the trend towards economic decarbonisation and helps reduce the costly consequences of climate change.

The second wave is different

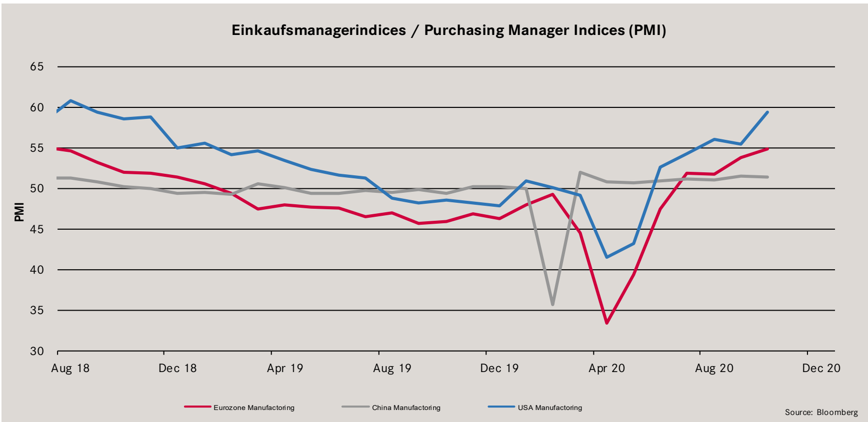
In view of the exploding corona infections and the threatening bottlenecks in intensive care departments of hospitals, most European countries are forced to introduce new partial lockdowns. It is hoped that an extremely costly full lockdown can be avoided, especially since COVID-19 mortality has decreased for various reasons (more frequent tests, increased infection of younger people, mutations of the virus, better treatments, etc.).

Even though there are increasing signs that multiple vaccines could soon be approved in so-called fast-track procedures, we must prepare ourselves for a long winter with continued high infection rates and massive restrictions on economic life and personal mobility. In an optimistic scenario, we can assume that companies such as BioNTech/Pfizer, Moderna and also Astra Zeneca will receive approval for their vaccines this year or early next year. However, it must be assumed that the vaccine will initially be distributed to specific risk groups (elderly people, health care personnel and nursing homes, etc.) under strict monitoring, particularly with regard to undesirable side effects. Thus a broad immunity of the population is likely only achieved by the middle of next year at the earliest.

Shifting market preferences

In the United States, with a new President Biden and a probable majority of Republicans in the Senate, the elections have produced a result that the stock markets can live with. Given this stalemate in Congress, the Democrats' room for manoeuvre with regard to extensive corona stimulus and aid programs and tax increases should not be too great. Even more than the change of president, the availability of vaccines could have a major impact on the stock markets. For example, the recently published positive study results of a vaccine developed by BioNTech/Pfizer have led to a veritable price firework among the badly battered corona losers, while typical corona winners such as the video conferencing provider Zoom have suffered massive price losses. Since, on the one hand, the trend towards digitalization and partial home offices is likely to continue and, on the other hand, the prospects of various corona losers should brighten in the medium term, we recommend a multi-pronged strategy for equity investments (as described on page 3).

Prof. Markus Ruffner



Second wave: putting the brakes on

Just a few weeks ago, it looked as if the economic "brake" effect of the first corona wave would be less than originally feared, given ultra-expansive fiscal and monetary policies. In the meantime, the recovery has lost much of its momentum in the face of recent selective lockdowns. Instead of a significant economic recovery in the last quarter of 2020 and the first quarter of 2021, most EU countries must expect another economic slump, or at least a further slowdown in growth (the United States). The economic recovery therefore seems to be postponed to the second half of 2021, if as hoped, the number of new infections can be reduced due to effective vaccines and restrictions can be eased.

In general, GDP growth in the current year is strongly influenced by the extent and nature of the country-specific lockdown measures. Despite high infection rates, the restrictions in the United States were relatively mild compared to other countries. GDP in the United States is expected to weaken by about 3.5% for 2020, increasing to about 5% growth in 2021, assuming a scenario with soon available vaccines. The widely expected stimulus package, following Biden's election victory with the split Congress, is likely to be significantly lower than expected before the elections, at around USD 1 trillion.

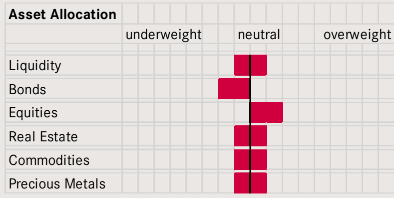
In Europe, with comparatively hard lockdowns, growth is expected to decline by around 7% in 2020 (-12% for Spain) and recover by around 5% in 2021. Notwithstanding, it can be seen in Germany, for example, that the economic damage of the second corona wave is less severe than that of the first. This is also due to the fact that the economic sectors most affected by hard lockdowns (restaurants, cultural events etc.) account for less than 5% of GDP.

China: as if it never happened

As in the global financial crisis, China is once again proving to be the global economic growth engine. Following a brief slump in the first quarter of 2020, consumption in particular has recovered surprisingly rapidly and strongly. Supported by extensive fiscal policy measures, coupled with an expansive credit policy, China is looking to show GDP growth of around 2% in the current year and as much as 7.5% next year. As a result China has also begun the process of slightly reducing its expansive credit policy. It is also quite possible that China will benefit from a more rational foreign trade policy of the new US administration. Other Asian countries such as Taiwan, Thailand and Vietnam have the virus under control just as well as China. The newly concluded Asian trade agreement RCEP will give the region an additional boost.

In contrast to China, infections in India are still very high. Accordingly, the country is expected to experience a GDP drop of almost 10% in 2020, with an equally significant increase expected in 2021.

Strategy



Bonds: In an environment of record low interest rates bonds should be underweight. Within bond markets, corporate bonds, as well as high-yield and emerging market bonds, should be preferred to government bonds.

Equities: A rotation is to be expected. Previous losers from the COVID crisis are likely to benefit strongly from a normalisation, while the share prices of highly valued COVID winners could take a turn for the worse. Interest rates, which are expected to remain low for the foreseeable future, are likely to continue providing support for the equity markets.

Real Estate: The global trend towards increased home working is in particular expected to have a significant adverse impact on commercial real estate prices. On the other hand, housing markets appear to have remained largely stable in the face of the effects of coronavirus. Real estate companies that have specialised in properties with cloud infrastructure remain compelling.

Commodities: The global economic recovery anticipated in 2021 is also expected to bolster oil prices.

Precious metals: Immunisation provided by vaccines in 2021 will reduce economic risks and likely have a dampening effect on gold prices.

	Real GDP growth in %			Inflation in %			Output gap in %	Deficit in% GDP	Debt in% GDP	CDS spread in bp	Real Interest rates in %
	2019	2020E	2021E	2019	2020E	2021E		2020	2020		
USA	2.3	-3.5	5.0	1.8	1.1	1.3	-4.09	-15.3	131.2	18.22	-0.27
Eurozone	1.2	-7.5	5.0	1.2	0.3	0.4	-2.31	-9.0	n.e.	n.e.	n.e.
Germany	0.6	-6	5.5	1.3	0.5	0.6	-1.87	-7.2	73.3	11.98	-1.09
France	1.3	-10	6	1.3	0.7	0.5	-0.96	-10.4	118.7	19.84	-1.06
Italy	0.2	-9	6	0.7	-0.1	0.3	-4.10	-11.0	161.8	109.33	0.73
UK	1.3	-10	6	1.8	0.6	0.4	-3.43	-18.9	108.0	21.09	-0.30
Switzerland	0.8	-4.5	3	0.4	-0.9	0.4	-2.47	-4.6	35.0	8.74	0.39
Japan	0.8	-5.5	3.5	0.4	0.2	0.3	-1.19	-11.3	266.2	18.5	-0.19
China	6.1	2	7.5	2.9	2.5	2.6	n.e.	-5.6	61.7	33.09	0.78
India	4.9	-9	9	3.4	6	5.5	n.e.	-7.8	89.3	76.96	-0.12
Russia	1.1	-4	5	4.5	3.2	3	n.e.	-4.1	18.9	81.98	2.61
Brazil	0.9	-5	4	3.6	3	3	n.e.	-15.9	101.4	180.1	0.28

Sources: Bloomberg, Goldman Sachs, IMF, Economist, NPB Neue Privat Bank

Equity markets – fundamental valuations (performance in local currencies)

	Performance Equities (in %) 2020	Price/ book value Current	P/E ratio Current	P/E ratio 2021E	Dividend yield 2021E	Index
USA	10.11	3.89	27.75	20.87	1.73	S&P 500
Germany	-0.28	1.70	65.78	14.98	2.99	DAX
France	-8.07	1.71	56.73	17.85	2.94	CAC 40
Italy	-7.65	1.09	53.50	14.17	3.89	FTSE MIB
UK	-15.58	1.60	229.66	14.40	4.03	FTSE 100
Switzerland	-0.84	2.81	24.82	17.11	3.12	SMI
Japan	7.91	1.94	35.64	19.85	1.78	NIKKEI
China	-6.06	1.09	14.55	11.41	3.34	Hang Seng
India	6.25	2.88	32.18	19.35	1.51	Nifty
Russia	-17.13	1.21	13.96	8.26	n/a	RTS
Brazil	-8.30	2.13	97.26	12.22	3.53	BOVESPA

Indices dominated by a few high flyers

Looking at the past performance of the most important equity indices, it is clear that there have been a few big winners and numerous losers. Among the former are the NASDAQ Index (up 30%) and the CSI 300 (up 25%), which is made up of Chinese A-shares. Brazilian, British and Spanish stocks recorded particularly marked price declines. However, there are also huge differences in performance between the losers from the coronavirus crisis (travel sector, aircraft manufacturers, etc.) and those who have profited from COVID-19. It is worth noting that the 10% price gain on the S&P500 Index is almost entirely attributable to the bullish prices of the five largest US technology stocks (Facebook, Apple, Amazon, Netflix and Google).

Vaccines trigger rotation

On November 9, 2020, the pharmaceutical companies BioNTech/Pfizer reported surprisingly positive results of their COVID-19 vaccine. The announcement led to heavy losses for stocks that had benefited strongly from the trend towards home office, such as Zoom and Logitech, but also to large price gains for stocks such as Carnival, TUI and Airbus. This gave investors a foretaste of a possible price change that could be triggered by the availability of a reliable vaccine. As there are increasing signs that a number of vaccines could soon be available in larger quantities, it is important to position oneself early enough.

Old and new favourites after Corona

Even though the record pace of vaccine development can lead to setbacks, renowned experts believe that next year there will be enough vaccines available to achieve immunization against corona in most countries. Conversely, the current health crisis has irreversibly strengthened the trend towards new technologies, including increased remote working. In addition, various mega-trends such as electric mobility and alternative energies will create new winners and losers for companies and industries.

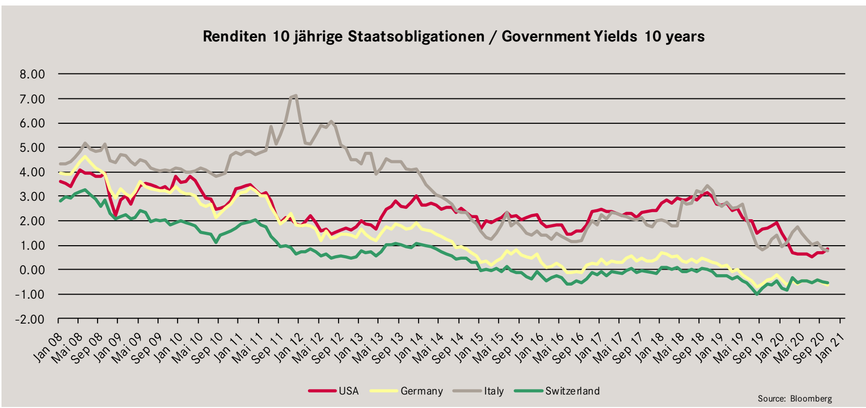
Against this background, we recommend a three-pronged strategy for equity investments:

1) Higher weighting of previous corona losers, which will benefit strongly from a normalization, including insurance companies, banks and cyclical stocks, small and mid-caps should also generally benefit;
2) Focus on technology growth stocks with reasonable valuations and stable competitive advantages;
3) Shares of companies that have the potential to upset large industries (so-called disruptors).

Government bond rally runs out of steam

The interest rate cuts by the most important central banks triggered by the corona pandemic, and the flight to safe havens, led to further attractive price gains for government bonds in the first two quarters of 2020. US government bonds were among the biggest winners due to the drastic interest rate cuts by the US Federal Reserve (FED). Since money market rates in Euro and CHF are negative and close to zero for USD, there is hardly room for manoeuvre downwards and the decades-long rally in government bonds is inevitably coming to an end. The announcement of an effective vaccine and the hopes for a normalization of social and economic life have already led to a slight increase in Treasury yields.

This of course raises the question of what will happen to yields of government bonds if next year, with the help of vaccines, it is possible to immunize the population. We expect a further increase, which should not be too high for the following reasons: On the one hand, with the exception of China, it will probably take years before potential growth is reached again after the massive cyclical setbacks. Accordingly, central banks will hold back on raising interest rates until at least 2023. On the other hand, there is no compulsion to act, also due to the inflation trend. At present, inflation is falling anyway, and the deflationary risks outweigh the inflationary risks. With its new average inflation targeting, the US Federal Reserve has in any case created more room for manoeuvre in monetary policy. Thus if inflation picks up again slightly when the economy normalizes post-COVID, there will be no need to tighten the monetary reins prematurely due to the fact that inflation has been falling below the long-term average for many years.



Trends & Forecasts

November 2020

Short-term interest rates (money market 3-month Libor)

We do not anticipate further interest rate changes for the US and Europe in 2021. Central banks will have to maintain ultra-expansive monetary policies for several years to offset the economic damage caused by the coronavirus.

	End of 2019	Actual	12 months
CHF	-0.69	-0.7678	-0.70
EUR	-0.41	-0.5439	-0.50
USD	1.91	0.2049	0.25
JPY	-0.05	-0.1020	0.00

Long-term interest rates (10-year government bonds)

The prospect of successful immunisation in the second half of 2021 will lead to higher bond yields and steeper yield curves in USD, CHF and EUR.

	End of 2019	Actual	12 months
CHF	-0.50	-0.51	-0.10
EUR/GER	-0.19	-0.59	-0.20
USD	1.92	0.83	1.00
JPY	-0.02	0.01	0.05

Equity markets

We anticipate a rotation away from previous coronavirus winners to losers. We see US and Europe as equally weighted, while cyclical stocks in Europe also offer recovery potential. Chinese equities still offer attractive valuations and are expected to profit from the fact that the country is emerging relatively stronger from COVID-19 crisis. Many companies in the ASEAN countries are likely to get an additional boost from the new RCEP trade agreement.

	End of 2019	Actual	YTD %	12 months
United States	3'221	3'557	10.11%	3'800
Germany	13'249	13'211	-0.28%	13'800
France	5'982	5'495	-8.07%	5'900
Italy	23'506	21'706	-7.65%	22'500
United Kingdom	7'587	6'367	-16.07%	7'200
Switzerland	10'617	10'527	-0.84%	11'000
Japan	23'657	25'527	7.91%	28'000
China/HK	28'319	26'480	-6.49%	29'000
India	12'256	12'928	5.49%	13'500
Russia	1'549	1'283	-17.13%	1'600
Brazil	115'645	106'042	-8.30%	120'000

Oil and gold

Oil prices came under pressure as a result of the slump in demand caused by lockdowns, as well as the structural shift away from fossil fuels. The anticipated economic recovery is likely to provide support for oil prices. Gold remains, despite price pressure from economic normalisation, a sensible hedge against global (political) risks.

	End of 2019	Actual	YTD %	12 months
Crude oil (WTI)	61.68	43.06	-30.19%	45
Gold	1515.20	1874.21	23.69%	1850

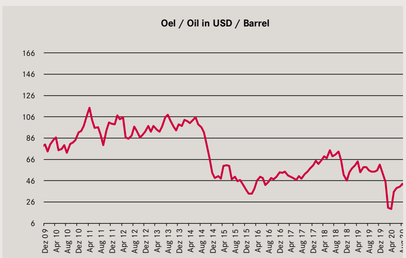
Exchange rates

We anticipate a slight downward pressure of the USD due to inflation differentials with the EUR and CHF. The USD's role as a "safe haven" is also expected to become less significant.

	End of 2019	Actual	YTD %	12 months
EUR/CHF	1.0854	1.0804	-0.46%	1.08
USD/CHF	0.9681	0.9104	-5.96%	0.89
EUR/USD	1.1211	1.1868	5.86%	1.21
EUR/JPY	122.1100	123.1700	0.87%	123

Source: **Bloomberg 23/11/2020**

Interesting Charts



Source: Bloomberg 23/11/2020

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