Compass

2nd Quarter 2020

Leading economic indicators require further caution

COVID-19: the coronavirus

During a global financial storm - gold is a safe harbour

Your wealth, our responsibility.

Coronavirus - a world short of breath

The new decade started with positive momentum across all asset classes which came to a sudden halt once COVID-19 developed into a global pandemic. In an attempt to slow down the spread, governments across the world locked down their economies. This resulted in a global recession, the extent of which cannot yet be quantified. Our proprietary risk indicator predicted such a development early on. For example the purchasing managers' indices, which are part of our "GMRI", collapsed across all countries, signalling significant pressure on the manufacturing sector.
The potentially devastating economic consequences of lockdowns sparked a coordinated response by leaders globally. Central banks slashed interest rates and expanded their asset purchasing programmes further by implementing "whatever it takes" to supply markets with sufficient liquidity. Moreover governments are launching aggressive fiscal packages to save companies and individuals from financial hardship.
To provide further perspective about the coronavirus, this compass compares the current pandemic with other infectious diseases. To do so we analyse how rapidly infections rose across the different pandemics and look at which countries are currently experiencing the highest growth in registered infections. Finally, aside from having a compass, the best way to navigate a storm is to identify safe harbours. Gold can be considered as such and hence we conclude by explaining how we expect the gold price to evolve in the near future.

Neutral across asset classes and defensive sector rotation within equities

Since financial markets remain highly uncertain we are sticking to a slightly defensive approach.

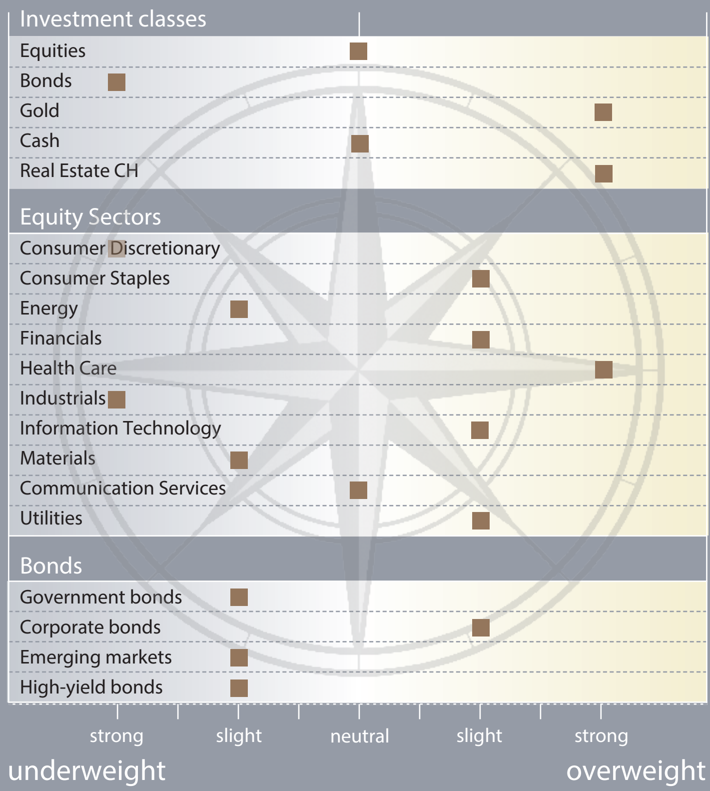
We remain neutral on equities, but are rotating towards more defensive sectors. Because real interest rates fell, we are reducing our allocation to bonds. To compensate we increase the allocation to Swiss real estate and gold.

Within equities, given the current situation, we prefer the following defensive sectors: consumer staples, healthcare and utilities. We strongly under-weight the more cyclical sectors consumer discretionary and industrials. Moreover we slightly overweight information technology and financials.

Due to the fall of the oil price and the corona crisis we increase the allocation to healthcare at the expense of energy. We also recommend focusing on software companies within the technology sector and reducing the allocation to consumer staples, materials and communication services. Moreover within financials, we prefer insurance companies to banks.

Regarding bonds, we continue to prefer corporate bonds over government bonds. However, we maintain our slight underweight in emerging market bonds and high-yield debt.

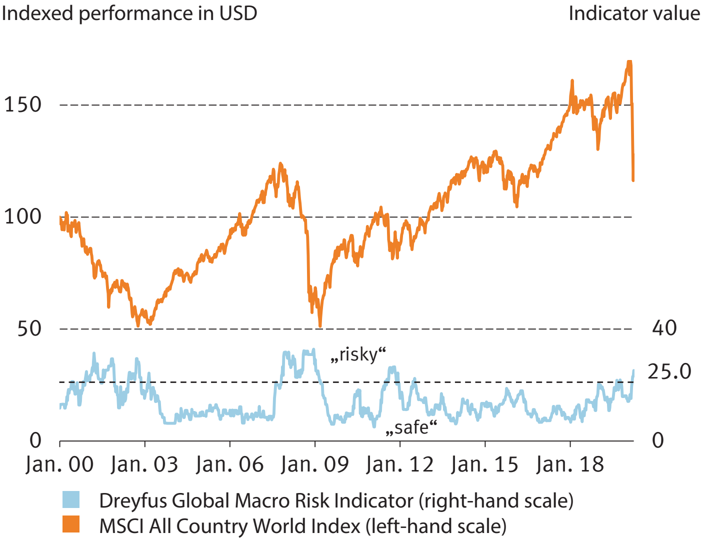
Asset allocation recommendation as of April 14th, 2020 for investors with CHF as their reference currency.



Basic Trend:
Leading economic indicators require further caution

Basic Trend 1:

Indexed performance in USD



Epidemics and oil crises are a burden for equities

To be able to identify early on long-lasting corrections in equity markets, Dreyfus Banquiers developed the Global Macro Risk Indicator “GMRI”. It is based on 27 indicators which forecast economic activity globally across countries. The GMRI is expressed on a scale from 5 to 35, whereby values above 20 forecast a crisis. The pandemic and the related oil crisis have driven equity markets to a 4 year low (based on the MSCI AC World Index). Currently our GMRI lies at 25, expressing increased risk for equities, which in return creates interesting mid-term to long-term investment opportunities.

Basic Trend 2:

Purchasing Managers‘ Indices (manufacturing industry)

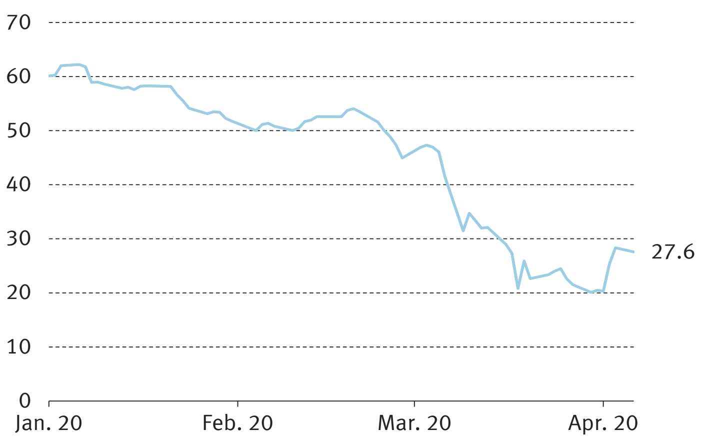
	Oct. 19	Nov. 19	Dec. 19	Jan. 20	Feb. 20	Mar. 20
USA	51.3	52.6	52.4	51.9	50.7	48.5
Eurozone	45.9	46.9	46.3	47.9	49.2	44.5
Germany	42.1	44.1	43.7	45.3	48.0	45.4
France	50.7	51.7	50.4	51.1	49.8	43.2
Switzerland	48.9	48.5	48.8	47.8	49.5	43.7
Italy	47.7	47.6	46.2	48.9	48.7	40.3
Spain	46.8	47.5	47.4	48.5	50.4	45.7
China	49.3	50.2	50.2	50.0	35.7	52.0

The gloomy mood of purchasing managers

To assess economic activity, purchasing managers in manufacturing industries are regularly surveyed. The metrics include, among others, the development of purchase prices, the new orders received and current outstanding orders. The resulting index, called the PMI, is an indicator of economic activity. If it is above 50 it signals improved conditions compared to the previous period. The current lockdown and quarantines, which have impacted more than 3 billion people worldwide drove the PMI down significantly. We expect a recovery of the PMI once the pandemic can be controlled and lockdowns phased out.

Basic Trend 3:

Price of one barrel of WTI crude oil in USD



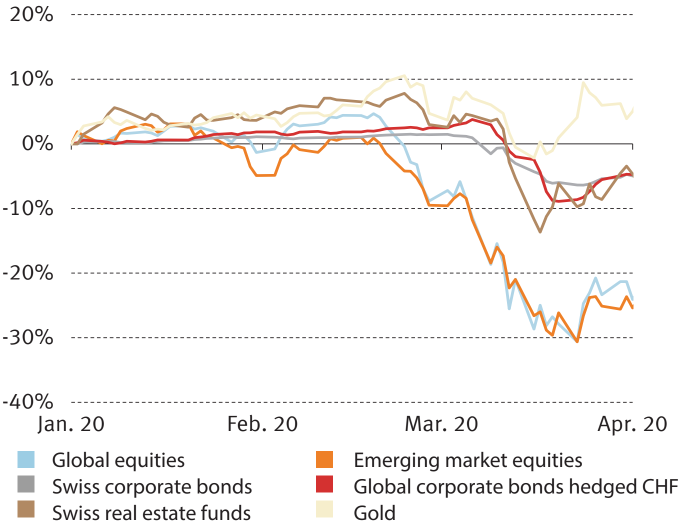
The oil crisis accentuates the pandemic

On March the 5th, Saudi-Arabia, Russia and other OPEC-countries met to discuss reducing the oil output to avoid further downward pressure on oil prices. Back then, oil was trading above USD 50 per barrel. Russia however rejected the proposed reduction by the Saudis, who then reacted five days later by dropping its price for crude oil further coupled with increased production. This “war” between the two countries led to a historic collapse of oil prices, which currently trade below USD 30 per barrel.

Current Topic:
COVID-19: the coronavirus

Current Topic 1:

Total return (net) in CHF

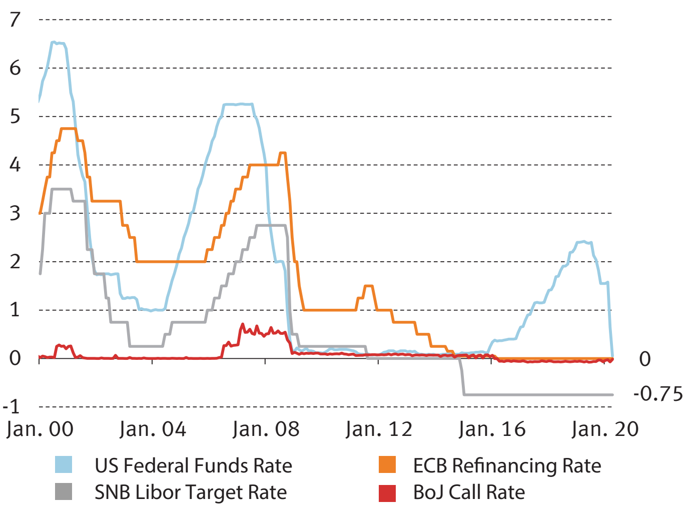


COVID-19: an exogenous shock

The novel coronavirus, labelled COVID-19, is a significant exogenous shock for the world economy. Until mid-February financial market participants mostly underestimated the economic consequences associated with this new virus. As the virus erupted in northern Italy during the weekend of 22nd February, markets started to digest that the virus will infect demand and supply globally. Panic erupted across all asset classes, while investors fled to safe havens, leading to the most rapid sell-off in financial history. The otherwise immune gold and US-treasuries were also affected and experienced significant downward price pressure.

Current Topic 2:

Key interest rate in % p. a.

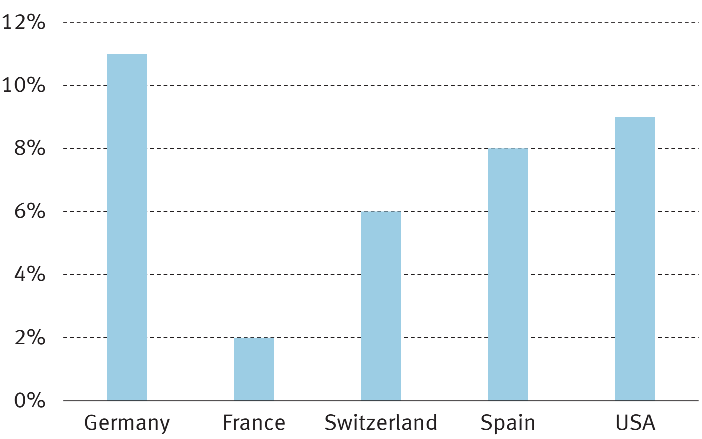


Central bankers extract bazooka from policy arsenal

The immediate response taken by major central banks worldwide is symptomatic of the concerns about the dramatic economic consequences of lockdowns. The primary objective of central banks was to ensure that markets do not run out of liquidity and that banks can continue to lend to all those hit by lockdowns. Leading central banks therefore slashed interest rates, increased asset purchasing programmes a.k.a. QE and expanded their repo markets activities to ensure an abundance of liquidity is guaranteed. More importantly however, central banks have become again the lender of last resort in financial markets.

Current Topic 3:

Stimulus packages as % of gross domestic product (GDP)



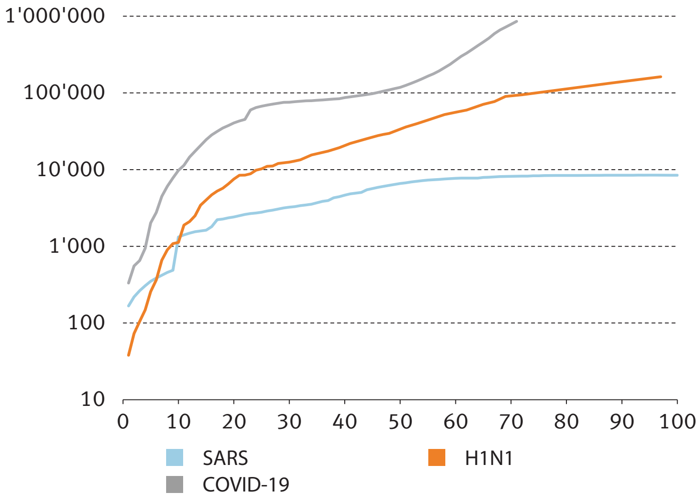
Fiscal stimulus beyond the imaginable

To support the economy, governments followed in the footsteps of central banks by pledging to do "whatever it takes" to sustain their economies through this unprecedented crisis. Germany committed to provide 550 bln EUR through state-owned KfW banks. France also took aggressive steps by providing immediate support with 45 bln EUR and 300 bln EUR guarantees for business loans. While Spain also provided fiscal stimulus for above 200 bln EUR, the USA presented its largest ever stimulus package reaching 2 trln USD. Canada followed suit and is supporting business with 82 bln CAD. More will likely be needed as governments embark on a quest to save their economies. Unfortunately, we believe that these measures will not avoid a recession, but assuming no further lockdowns are needed, the foundations for a recovery in the second half of the year are being laid.

Knowledge & Experience:
During a global financial storm - gold is a safe harbour

Knowledge & Experience 1:

Pandemics: Course of infection numbers in the first 100 days

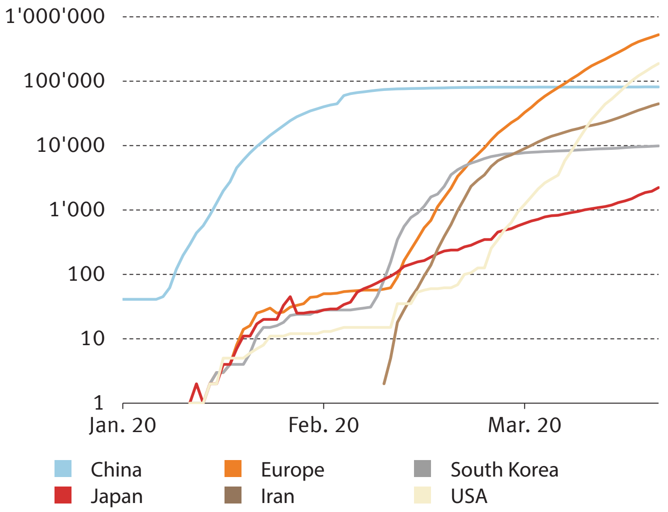


Epidemics and pandemics of the 21st centrury

A pandemic is a global epidemic and the 21st century has already experienced multiple such events. In 2002/03 the world looked to Asia as SARS led to local lockdowns and the world discovered a new deadly coronavirus. Shortly after, in 2009/10 the H1N1, a virus with similar characteristics to the spanish flu (often referred to as "swine flu") infected people globally. However, the speed and efficiency with which COVID-19 spread globally is unprecedented. Globalisation and the increased reliance on China of most supply chains fuelled the spread of this new Coronavirus.

Knowledge & Experience 2:

Spread of COVID-19

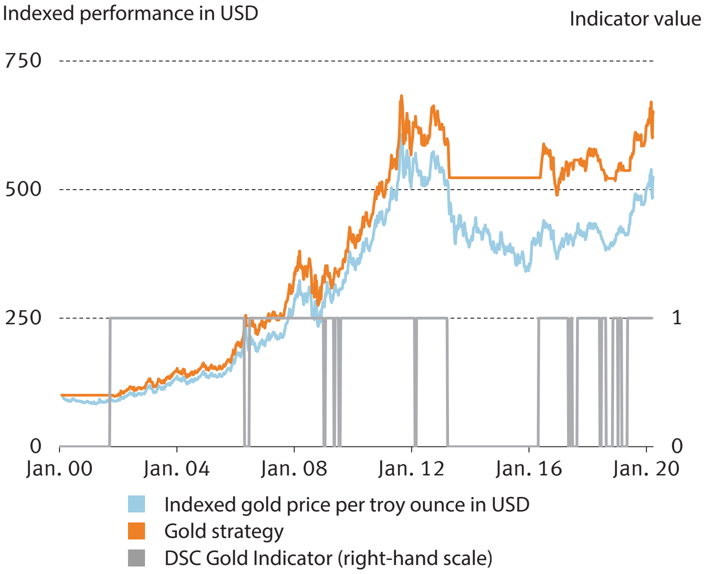


A virus takes our breath away

The novel coronavirus SARS-COV-2 and resulting illness COVID-19 is presenting our world with new challenges. While China, according to official data, is returning to normality and new infections are isolated quickly, the rest of the world is still fighting against the virus. Three billion people roughly were locked down by the end of March to "flatten the curve" and relieve health systems. The economic consequences of such measures are difficult to quantify, but the damage is expected to be significant. We do not expect governments to ease the lockdowns until new infections are controlled and hence it is unlikely that economic recovery can be re-ignited until the amount of new infections fall substantially. The longer an engine is idle, the more complex is a re-ignition.

Knowledge & Experience 3:

Indexed performance in USD



Gold, a safe harbour

Yet another pandemic, but this time the global economic consequences are dire. Investors woke up to the possibility of a global recession and dumped securities leading to a USD liquidity squeeze in financial markets. This squeeze drove up real interest rates in the USA significantly and inflation expectations fell. These two factors pushed the price of gold initially down 13%. Central banks responded in a coordinated fashion with expansive monetary policy and, among other actions taken, dropped interest rates. Governments flung their treasure chests wide open and provided further stimulus though fiscal expansion. These measures drove the price of Gold upwards again and as of today Gold remains the best performing asset class of the new decade. Our Gold price indicator, at 1 (its maximum), signals that their is rooms for further upside.

The prices used in our analysis are end-of-period prices. The figures used for our valuation model are estimates referring to dates and therefore carry a risk. These are liable to change without notice. The usage of valuation models does not rule out the risk that fair valuations over a specific investment period cannot be attained. A complex multitude of factors influences price developments. Unforeseeable changes could, for instance, arise from technological innovations, general economic activities, exchange-rate fluctuations or changes in social values. This discussion of valuation methods makes no claim to be complete.

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