HYPOSWISS ADVISORS

Review & Outlook January 2021

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Q4 2020 Review

Covid-19 more important than US elections

The final quarter of 2020 delivered one of the strongest results for equities in years, even ending with a small year-end rally. The MSCI World managed to increase by an astonishing 13.7%, which roughly equals its 2020 performance. Contrary to the rest of 2020, the USA wasn't leading the crowd (S&P500 up 'only' by 10.8%), and the Asian and European markets trended up stronger. In the case of Europe, indices were able to make up some but not all of their underperformance during 2020.

2020 will go down in history books as the COVID-19 year, an unusual year in many ways. The highly infectious coronavirus caused respiratory syndromes triggering a global health crisis, leaving affected people short of oxygen and unfortunately life-threatening consequences. The resulting economic crisis has hit most economies and businesses, leaving major wounds with an unknown end result.

MSCI World Index in USD – 01.01.2020 – 31.12.2020
Source: FIS Market Map

Financial markets were early sensors of the crisis, initially declining heavily and signaling a breakdown in spring 2020. In the **real economies**, one of the greatest pullbacks in global output was following, as governments ordered lockdowns paralyzing the backbone of the economy – the services sector. After the initial panic, policy response got more sophisticated, and scientists learnt about the nature of the pandemic. Medical treatments have advanced, vaccines were developed at breath-taking speed and corporations and individuals alike have learnt to deal with the situation… At least this is everybody's hope and represents the current market consensus!

After an initial March crash, **stock markets** were unimpressed by the economic downturns and managed to recover in a so called V-shaped recovery. By the close of the year, the MSCI World Index was up by 13.2%. US markets, led by its technology giants, outperformed the rest of the world (NASDAQ Comp. +43.2%) and Asian markets were in line and towards year-end even outperforming (MSCI Asia ex. Jap. +15.8%). European markets in 2020 were lagging behind heavily (EURO STOXX 50 -4.3%), which is to a certain extent also a reflection of the different Covid-19 situation in Europe compared to Asia.

US elections would be driving market movements in any normal year, particularly in a situation like 2020 where the candidates could not have been more different in terms of their policies and personas. In 'Covid-19 year' 2020 however, their impact on markets was fairly limited. The end result was approximately in-line with earlier expectations, leaving aside the temporary and quickly disappearing stalemate during the election night. The uncertainty which was hanging over markets for much of 2020 disappeared, as the outcome became clearer day by day. The relief became even stronger when President-elect Joe Biden started to announce his key nominations, which appeared to be market friendly. The selection of Janet Yellen as Treasury secretary in particular is expected to guarantee a strong cooperation between the Treasury and the Federal Reserve. Traders were also betting on a future boost from infrastructure spending and energy transition.

Fixed income markets were as previously dominated by central bank actions, particularly short-term yields which remained at their low levels. The only major yield which is moved by markets rather than by politics, the USD 10yr benchmark Treasury yield, started to increase in October at a slow pace, hovering in the range of 0.60% to 0.95%, approaching but not surpassing the 1% level in 2020.

Fixed Income

Are we already at the turning point to higher long-term rates?

In early January 2021, the yield on the **USD 10yr Treasury bond** within 7 trading days climbed by 20bps to 1.16%, a sudden move unexpected by markets in its magnitude and swiftness. The catalyst of this new uptrend was the election in **Georgia** and the 2 additional seats the Democrats won. They now control the White House, have a 10 seat majority in the House and the upper hand in the Senate, where the new Vice President Harris has the power to break the 50:50 tie.

The rise could also been seen as a sign of confidence in the economic outlook. Estimates for the annual rate of **GDP growth** are being revised up on a broad scale and many predict now a rise of 5%-6%. This move will be further stimulated by pent-up demand from consumers

unable to spend money during the different lockdowns. This higher growth will translate into better employment, a return to inflationary forces and ultimately to lower pressure on the FED to keep refinancing rates artificially low.

In December 2020, the US administration managed to avoid a government shutdown at the very last minute, and was delivering an additional USD 920bn **fiscal support package**, thanks to a multitude of temporary budget extensions. This deal is supportive for growth in the near future, as it contains USD 166bn of direct payments to US households, USD 120bn for the extension of unemployment benefits and an USD 325bn aid for small businesses. With the new constellation in the government, financial markets already are betting on a potentially USD 2 trillion **combined package** in 2021 alone, consisting of a pandemic relief program and budget stimulus.

Client accounts:

The situation of late 2020 remains valid. We have a light underweight for Fixed Income in USD based accounts and even higher underweight in our CHF/EUR based accounts. Despite low returns, we keep this allocation mainly for **capital preservation**, assuming that yields will remain low for the immediate future, and as we hold primarily bonds with maturities below 5 years, no capital losses should occur as the intention is to keep them until maturity.

In the **High Yield (HY)** space, investors hunger for yield have pushed prices up. We avoid low quality debts in structurally challenged sectors as default rates remain elevated in the wake of economic consequences caused by the pandemic. We keep HY bonds to achieve higher returns with reasonable downside risk along our moderate credit risk strategy.

In view of the medium-term inflation risk, we increased in 2020 our position in **TIPS** (Treasury Inflation Protected bonds) as well as in **Convertible Bonds**, as they offer capital protection with a built-in upside potential. During 2021, we might increase our allocation to TIPS even further.

Equity

Limited upside potential left

The solid 2020 equity performance is already history and the counter is set back to zero, as every year. The outlook into the year 2021 seems different from previous years, as the coronavirus is a new phenomenon with an unknown outcome.

The markets are pricing in that the **health crisis** can be contained and countered with continuous policy support. The US is out of a

complete gridlock, China seems to lead while the rest of Asia is following and Europe is trying to catch up. In the political arena, the new US administration meets global partners, while many hotspots remain (Middle East, North Korea etc.).

Global investors face another pain which is that **equity valuations** are becoming expensive. Equity earnings are likely to improve in 2021 and bottom-up analysts expect the S&P500 EPS to grow above 20% to a point that even surpasses their pre-pandemic level. However these improvements are already priced in, leaving hardly any room for positive surprises and limiting the upside potential for equity markets.

The next item on the agenda is the Q4 2020 **earnings season** reporting, which will start as usual with the large US banks. The consensus expects earnings to decline by 9% against the same period last year. So far, company earnings guidance has been positive, with 66% of companies that issued early guidance giving a figure ahead of market expectations (versus a historical average of 33%). For the entire 2021 season, consensus expects an increase of 23%, which is not that impressive considering that the comparison is made to the 2020 crisis-year.

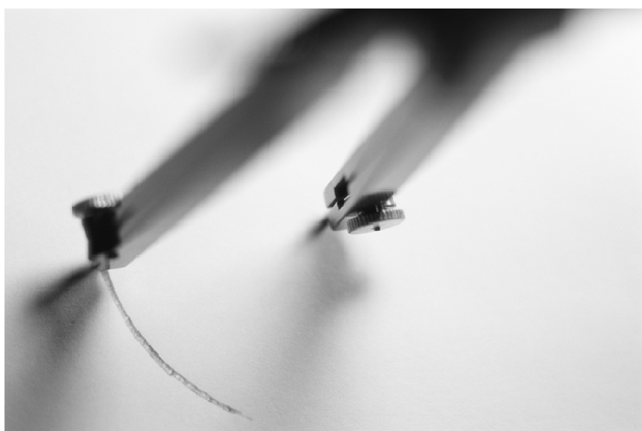
A very significant **regional trend** slowly evolving is that the USA is beginning to underperform to the rest of the world after years of better showings, as its relative performance versus global stocks has broken below its 200-days moving average. China as well as the Eurozone might be the primary beneficiaries of this situation which in the case of Europe might be additionally helped by a renaissance of value stocks versus growth stocks. These new developments however need more time to be confirmed and might not be of long-term character; in particular the case for Europe is not very convincing.

Market participants and news providers are like every year making predictions about the **potential winners** in 2021 and comparing themselves who made the best bets in 2020. When glancing through these lists, the winners of 2020 are in many cases nominated as the 2021 winners again. However, a closer look reveals that the Nasdaq100 winners - who have outperformed the rest of the markets by 14% annually the last 5 years - have peaked in August 2020. This was exactly the time when interest rates bottomed and since then, their outperformance has declined.

It is maybe too early to call an end to the US growth stocks saga, but the previous losers in the field of materials, financials, oils or value stocks in general seem to enjoy a comeback for the time being. We do not intend to play this laggard-picking-game intensively, as in the

long-term, the so called **disruptors** (companies that create, transform and disrupt whole industries, often operating in the field of new global trends) will emerge stronger and will prevail over the old-economy stocks.

Another important factor to watch in the immediate future is the old saying that if markets do well at the **beginning of the year**, they will continue to do so the rest of the year. 2020 seemed to be the exception to this rule – and who in March 2020 would have said otherwise? - however ultimately, the good start into 2020 resulted in a positive yearly performance as the saying goes.



Client accounts:

We had at the outbreak of the coronavirus crisis a neutral to slightly overweight **equity allocation,** depending on the risk category of each client. We did not to sell any stocks during the panic selloff in March for our discretionary mandates and therefore fully participated in the V-shaped recovery. We have increased equity positions modestly in most segments in December 2020.

Within the equity allocation, in 2020 we have reduced positions in Europe by buying ETF's invested in future **'Trend and Thematic Investments'**, some of which we have presented in our past (and current) quarterly letters. Going forward and as always depending on ongoing events, our intention as of today is to reallocate some investments into Asia, particularly China, and to continue our earlier move into the above mentioned ETF's.

Currencies

The greenback still declining – who profits?

The **USD** is weakened by the fact that the broadening global economic recovery raises the growth outlook and increases risk appetite, which undermines safe-haven currencies like the USD. The small rate advantage versus Euro and Yen has declined but not completely disappeared in 2020. Ultimately the superior profitability of US companies will continue to be a magnet for outside capital. The latter fact alone should limit the downside risk of the currency.

The **Euro** has tailwinds in an environment of low inflation, which is a clear indicator of the Euro's strong purchasing power and solid balance–of-payments situation, helped by Europe's large trade surplus. The biggest risk is that the ECB might weaken the currency by increasing its negative interest rate.

The **CHF** was dropping lately towards the Euro because of less market appeal and declining safe-haven demand. As before, the Swiss national Bank is at the mercy of the ECB.

The **CAD** did profit from stronger oil prices and increased risk appetite from investors. This uptrend was further helped by reduced trade uncertainty with the finalization of the USMCA and expected improving relations to the US under a Biden administration. Some negative factors like a high public-sector, a household

debt plus a current–account deficit remain in place, limiting the upward potential.

The **CHN** is benefiting from China's quick and early economic recovery, USD softening and relatively high yields. The ongoing trade war with the USA remains a risk, but currency traders hope on a more predictable and less erratic USA approach in the after-Trump area.

Economics

How to get out of the lockdowns – shock waves?

The coronavirus pandemic was the biggest **exogenous shock** to the economic system of the western world in nearly a century and its impact was and still is huge. The services sector - the backbone of modern economies - did suffer particularly heavily. The lockdowns ordered by all governments to mitigate the spread of the virus forced many businesses to close with enormous impacts in areas such as hospitality, travel and tourism. The fall in employment level was even greater than the fall in output.

The financial markets were rebounding faster than in other crises because the **financial system** today is healthy. The structural damage to the system should therefore be limited and the recovery can start to gain speed as soon as the availability of vaccines increases and economies start to normalize. Economies will still need continued fiscal spending from their governments in order to heal their suffering, but policymakers have different degrees of freedom in this regard and thus the recovery will vary in pace.

2021 began not with an economic shock but with a political ban. The storming of the **US capitol** by Trump supporters attracted the greatest media attention. For financial markets, the unexpected double victory of the democrats in the run-off elections in Georgia was more important. This will create room for maneuver for newly elected President Biden to implement his agenda. This includes high-level fiscal spending among others to support the increasing numbers of unemployed due to the pandemic and programs through direct payments and additional support for housing. These measures will translate into a higher GDP growth rate than previously anticipated.

Commodities

Oil: Short-term picture better than long-term outlook

Oil made headlines with **negative prices** (!) back in March 2020, an event that clearly marked the peak of despair and even panic. This incident revealed the stress the supply chain was exposed too, and was ultimately a result of

certain flows in the future market and some market participants obviously experienced shock waves. However the oil market had negative prices only for one day and only in one of its leading futures, and none of its many physical markets.

Since this historic day for oil traders, the market finds itself in the phase of recovery as the fundamentals inflicted by the crisis heal. Today **inventories** no longer swell at their limits and will soon return to their pre-crisis levels. Three open question will guide the future of oil prices:

What path will the economic recovery and therefore the oil demand take? Will the petro-nations continue to manage their supply deal successfully? Has the US-shale business transitioned its paradigm from growth at all costs to profits?

Oil prices could therefore spike towards or above the **USD 60 level** if economies recover and demand increases as predicted. However behind certain levels, the petro-nation supply deal will be challenged and shale business will enter the field which puts limits to the upside.

Gold: Higher interest rates are poison for the gold price

Gold prices (XAU ounces) in USD – 01.01.2020 – 31.12.2020
Source: FIS Market Map

Supported by a **softer USD**, gold as well as silver had a strong start into 2021, and gold was climbing as high as USD 1959. However this uptick came to an abrupt end when the 10yr Treasury yield surpassed within a few days not only the 1% level but reached 1.16%. Gold dropped within 2 days by more than USD 100 proving the old wisdom that high interest rates are poison for gold. The peak of gold prices in August 2020 above USD 2'000 was exactly at the time when interest rates were bottoming.

Demand for gold as a **safe haven** has not picked up lately, the outlook for economies are improving and expectations for rising real bond yields are increasing. All these factors are bearish for gold. Gold will pick up again if there should be a systemic financial crisis due to an uncontrolled spreading of the coronavirus, an unexpected acceleration of inflation or a longer lasting depreciation of the USD. As always, any unforeseen geopolitical disaster also will push the gold price.

We have during 2020 increased our **allocation** to the precious metal from 5% to 7% to decrease it again back to 5% in our discretionary accounts and intend to keep this 5% allocation for the time being as an insurance for unforeseen events.

Outlook

Coronavirus news will remain the key factor

World economies might reach their pre-crisis levels only in the second half on 2021. China already achieved this stage in late 2020 and one expects the US to follow next this summer, while Europe, Japan and most emerging markets are likely to take longer. We expect therefore that until the health crisis is fully resolved across the globe, which will not be before 2022,

the economic winners will be those western nations which can afford to increase their fiscal spending, plus China.

In equities, global investors face the pain that equity valuations are becoming expensive. History has shown that extended valuation ratios point more to low average returns over a multi-year time horizon than a major selloff the following year. As markets have already priced–in an earnings growth of 23% in 2021, which will be hard to beat, the expected return will be in single digit numbers. However, when relative considerations are put into place, equities by far are still more attractive than bonds. On this basis, equities should outperform bonds again in 2021.

When peeking beyond the long shadow of Covid-19, we see the pandemic irreversibly accelerating trends such as work automation and the digitalization of economies. However, other more profound setbacks brought about by the lockdowns and recession will ultimately prove temporary, including the home-office rules. Assuming a reasonable path for the health situation is found, the scarring effect of permanent job losses is likely to be limited.

We enter 2021 with the assumption that the global economy will continue its recent recovery, but are aware that all hinges critically on the health situation and the battle between the virus and human's effort to staunch it. We keep our positions in fixed income for capital preservation, gold for unforeseen events and allow a modest overweight in our equity allocation, with an increasing bias towards future 'Global Trends and Thematic' investments.

Walter Küng
Senior Portfolio Manager

Asset Allocation

USD Reference – Balanced

Thematic investment idea

Investing in a future megatrend

Gaming and eSports

Video gaming was until recently considered an entertainment product for kids and teenagers. But today, it is experiencing an ongoing and profound transformation, disrupting the traditional media and becoming a major segment of the entertainment industry. The emergence of new technologies and a new generation of players have given raise to new businesses models mainly in the fields of digitalization (mobile gaming) and streaming services (eSports).

An Underestimated Growth Story

By 2020, the total revenues generated by the industry globally is expected to reach $195bn, surpassing the cyber security and robotics industry. With the increased use of smartphones and mobile devices, a new form of playing Mobile Gaming, has emerged. This new platform which did not even exist 15-20 years ago, is now the main revenue source of gaming companies. From 2015 to 2019, this segment has grown 22% annually, compared to 15% for the overall industry.

Gaming and Digitalization

New technologies have been the real catalysts for the industry development. Video games were traditionally played via physical devices and cartridges but is now transitioning toward a more digital form of delivery, allowing related companies to boost and diversify their revenues streams. Publishers are using a new model (Game-as-a-Service), were the concept is to freely deliver a game but still generate revenue through in-game transactions and through subscription-based models. Such transactions are becoming a major source of growth. Instead of making a one-time transaction at the release of a title, publishers can maximize their revenue stream within a much longer time frame.

Online Streaming & eSports

The new generation of consumers is highly connected. Time spent online by 25 - 36 years old individuals has increased tremendously and traditional media channels are being abandoned in favor of online streaming. This has led to the creation of streaming platforms where players can share their experiences with others but still broadcast main events such as eSports competitions.

Long-term catalysts

The industry is strongly supported by long term technological and social shifts. Global consumer demand is moving toward more digitalized services, which includes entertainment. Demographics are also supportive as not only the number of players is growing but also the number of time played by the millennials.

Risks

There are increased concerns from regulators in certain countries which could lead to a change in the regulatory landscape which could affect the industry negatively. The segment is also highly competitive, as barriers to entry have decreased due production ease and low cost.

The COVID-19 pandemic has obviously been positive for the industry with people being at home globally and a return to office-work could be considered as a risk.

Conclusion and how invest in this thematic trend:

In our view, the trend on this long-term thematic is intact and was initiated well before the COVID-19 outbreak. Stocks in this industry have risen already strongly lately but we believe there is a long-term opportunity for investors to participate in this still underestimated and growing industry which successfully identified new trends in our highly connected digital world.

Should you want to know more about this new trend and how to invest, please feel free to contact your Relationship Manager.

"Luck shouldn't be part of your portfolio."

HYPOSWISS
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Expect the expected

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Mission Statement

- Hyposwiss Advisors' mission is to offer **personalized asset management services and financial advice** to high net worth individuals and families based in the **USA** and **Canada** with the overriding objective of **capital preservation** and **asset growth** performance oriented.

- Investments in compliant global assets are used to construct a **diversified balanced portfolio** tailored to the investor's requirements and deposited with **international banks** acting as qualified custodians.

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