HYPOSWISS
ADVISORS

Review & Outlook
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Review and Outlook

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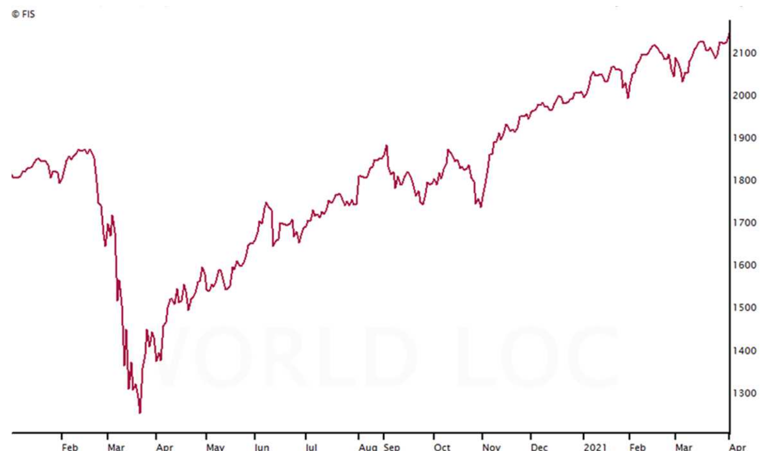
Q1 2021 Review

Equities continue long-term uptrend despite rate increases

The **US economy** grew much faster than anticipated in Q1 (GDP +4.8%) and now enters what is set to become the strongest quarter in post-war history, thanks to gradual re-opening of the services sector to meet **pent-up demand** from consumers. Helped by this background and historically low interest rates, equity markets ignored any bad news from the health front and continued their long-term uptrend, which has started in March 2009, and was only briefly broken – coming as unforeseen as decisively - by the Covid-19 related crash in March 2020.

The Q1 equity-run was at certain trading days interrupted by the stubborn increase of the USD **10-year Treasury rate.** This increase was unexpected by most market participants and in particular its magnitude and swiftness came somewhat as a surprise.

The overall picture given during the first quarter was signaling no clear trend until the last few trading days, but by March 31, the MSCI World was at +4.28% YTD. The S&P500 was approaching the 4'000 level which meant new all-time highs (+5.39% YTD).



MSCI World Index in USD – 01.01.2020 – 31.03.2021
Source: FIS Market Map

The NASDAQ, contrary to the last years, is lagging so far in 2021 (+1.22% YTD). At the same time, volatility on the Index dropped below the major support at 25 and is now trading at a new 52-weeks low.

The bigger question for investors is if the Technology Index will return to its outperformance of the last few years or if the **revival of value and cyclical stocks** will prevail. For now, the stage is set for some of the lagging big names to make up some of their lost ground of the past years (Dow Jones +8.04% YTD).

A look at **individual regions** reveals that Europe is suddenly doing better than the rest of the world after years of underperformance (EURO STOXX50 +10.52% YTD). Germany (+9.40% YTD) and France are leading, the UK is behind (only +4.82%YTD), and Switzerland is lingering even more (3.90% YTD), as it 3 main stocks are trading sideways despite being value stocks.

Surprisingly and against most predictions, Asia is underperforming so far in 2021 (MSCI Asia Ex-Japan +2.55% YTD), as formerly leading China is even in negative territory in 2021 (Shanghai Comp. -1.00% YTD).

Fixed Income

Long-term interest rates have their highest jump since 1994

Longer-term bond yields started to increase from their historically low levels and the **USD 10-year Treasury** went as high as 1.77%, reaching its highest level since January 2020. During Q1 of 2021, this rate has according to Bloomberg gone up by 0.79%, an increase which equals the highest number since 1994. Ironically, this sharp rise occurred almost a year after the markets panic low of yields below 0.50%. The next higher point of interest will be the 2020 high of 1.91%, which will be another barrier on the uptrend towards 2%.

However, considering the latest statements by the **US Federal Reserve**, fundamental valuations and some technical readings, the odds are high that the rate increase may be in for a breather. The FED is maintaining its loose monetary policy stance for now, even though a strong economic recovery is expected and also despite the debate on the potentially too large Biden stimulus package causing a growth overshoot.

The new US administration just presented the second of its **3 fiscal packages.** The first *American Rescue Plan Act* will be fully financed with higher debt and serves only to promote short-term consumption. The second *American Job Plan* presented late March will boost spending for infrastructure in the first seven years, before higher corporate tax revenue will kick in the following years. The third and missing

part, the *American Families Plan,* to be unveiled sometime in May, is supposed to be fully financed with higher income taxes and environment levies.

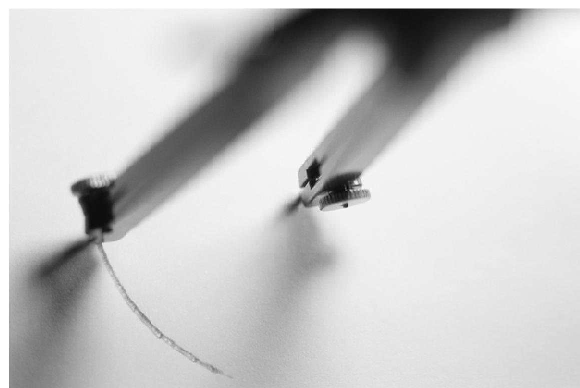
The outlook for higher taxes is very supportive for bonds and a fundamental change from the Trump Administration's deficit-only financing, with chronically higher deficits year-by-year. This tax debate will help the treasury market to better digest the ongoing hunger for fresh capital and one could argue that "h**igher taxes are the bonds best friends".** However this 'tax-euphoria ' might not last forever, as historically, every government was better in pushing through higher spending than opting for and financing it by (voter-unfriendly) higher revenues.

Client accounts:

We have reduced our allocation to Fixed Income in USD based accounts by approximately 5% in Q1, thereby increasing our underweight in this unattractive asset class and have an even higher underweight in our CHF/EUR based accounts. Despite expected low returns, we keep a certain allocation mainly for **capital preservation**, assuming that yields will remain low for the immediate future, and as we hold primarily bonds with maturities usually below 8 years, no capital losses should occur as the intention is to keep them until maturity.

In the **High Yield (HY)** space, we tend to avoid low quality debts in structurally challenged sectors and 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 have a fairly high position in **TIPS** (Treasury Inflation Protected Securities) 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

Value stocks outperforming growth stocks

Currently we are in the midst of one of the most broad-based upturns in **global growth** of recent decades. The strength and breadth of the recovery supports positive earnings, which in return will lift equity prices. The **earnings season** will kick off mid-April and based on consensus expectations, the market is looking for earnings to rise 24.5% against the same period last year, which would be the strongest growth rate since Q3 2018 (+26%). Based on leading indicators like early reporters (81% beats), Q1 2021 could actually be even stronger and there might also be positive earnings revisions for the next quarters, as the macroeconomic momentum is picking up.

Another important impact on future valuations of US equities will be the potential impact of **higher corporate taxes.** President Biden proposed during his election campaign to raise the statutory corporate tax rate on domestic income from 21% to 28%, which would partially reverse the tax cut passed in the 2017 *Tax Cuts and Jobs Acts* by the Trump

Administration. The full implementation of the planned tax cuts would reduce 2022 earnings for S&P500 companies by approx. 9%. All else being equal, this could translate into a 9% drop of the Index. It is an open question if this tax increase is already priced into market assessment. On the other hand, a partial implementation only or higher infrastructure spending could lower the final impact.

There will be **winners** from tax hikes too. Cyclical sectors will benefit from infrastructure spending. Should the spending boost growth and lead to a steeper yield curve, financial stocks should be profiteers and do better. Furthermore higher US taxes will lead to a shift away from the US to international markets like Europe or Asia. In contrast, tech companies outside the clean energy sector will underperform, especially if the bill introduces a minimum corporate tax on book-income and raises taxes on overseas profits.

Many investors are concerned about **rising bond yields** (highest quarterly increase since 1994) and their implication on equity valuations. History shows that rising bond yields have been positively correlated to equity markets since the 1990s, whereas before (particularly in the 1970s), they were negatively correlated. Taking a closer look, one finds that rising bond yields below the 4% level are positive for equities and above 4 % are a negative factor. One underlying reason for this phenomena is that rising rates from low levels (like now) tend to be an indication of accelerating growth, whereas in an environment of rising rates above 4%, inflation concerns are becoming the dominant element. On top, with yields above 4%, Fixed Income is an easy and less risky alternative to Equities.

Client accounts:

We hold a minor overweight in our **equity allocation,** depending on the risk category of each client, as we did increase equity positions modestly in most segments in late 2020. Within the equity allocation, in 2020 we were buying ETFs 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 modestly increase our positions in **value and cyclical** stocks. We wait for new allocations into Emerging Markets, including China, until the situation there becomes more constructive, but have in the long-term the objective to increase these regions and to continue our earlier move into the before mentioned ETFs.

Currencies

The USD surprise comeback

The **USD** was climbing strongly in Q1 2021, gaining 4.16% versus the Euro and 6.69% versus the CHF. One reason was the rise of USD long-term interest rates and therefore the recovery of the USD interest rate advantage, the other the strong economic growth and the successful vaccination narrative.

The budget deficits prints at levels of around 16% of GDP, together with the current account deficit of soon 5% equate to a twin deficit in the region of above 20%. The size of this suggests that the USD will struggle to appreciate over the long-term as previous instances of surging twin deficits resulted in aggressive USD weakness, albeit with a lag.

The **Euro** is held up by the frustratingly slow pace of vaccination which will prevent a rapid growth rebound until early Q3. Additionally, the European central Bank's (ECB) plan to increase the pace of its PEPP (*Pandemic Emergency Purchase Program*) will suppress Eurozone yields, meaning the EU-US yield spread will remain high.

The **CHF** was dropping further in Q1 towards the Euro (-2.26%) amid 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 was the only currency climbing against the USD in Q1 (+0.79%). The Bank of Canada vowed to keep its expansionary monetary policy on hold for a prolonged period with rates of 0.25% for the next two years. It might profit from reduced trade uncertainty and a relaxation of relations to the new Biden administration.

The **CNH** is supported by several factors like China's swift return to pre-crisis growth, a record trade surplus, increasing foreign demand for Chinese bonds and a renewed expected onset of USD weakness once the global economy accelerates. However, rising USD rates reduce the yield premium and authorities' interventions to slow the CNH's appreciation curb the uptrend potential.

Economics

The US leads global growth

The global economy is expected to rebound from the pandemic over the remainder of the year. So far, it has been a two-speed recovery. Whereas the Bloomberg consensus has US real GDP growing by 4.8% in Q1, analysts expect the economies in the Euro area, UK and Japan to contract by 3.6%, 13.3%, and 5.5% respectively. Two things explain US outperformance. First the successful launch of the US **vaccination campaign** has allowed state government to

begin dismantling lockdown measures. Currently, the US has a vaccination (not fully) per capita rate approaching 40%, whereas parts of Continental Europe are still battling a new wave of Covid-19 infections, prompting policy makers to further tighten social distancing rules.

Second, the US **fiscal policy** has been more stimulative than elsewhere. The 1.9 trillion *American Rescue Plan Act* provides direct payments to lower-class households, extends unemployment benefits and offers aid to local governments.

Growth leadership is expected to shift from the US to the rest of the world only in the second half of 2021. The EU will benefit from a cyclical recovery later this year as the vaccination campaigns pick up steam. Surveys indicate that **European** households have accumulated significant excess savings which will lead into pent-up demand to drive consumption over the rest of the year. The latest European PMI data also show that the services sector may have turned the corner.

The **UK** was hit hard by the emergence of a new, more contagious strain of virus. Thanks to the speedy vaccination campaign, the government is able to lift the "stay at home" rules earlier than in Europe and the economy is expected to improve already over the coming months.

The question is out there if the **US economy might overheat**? Open table measures of restaurants occupancy is progressing back to pre-pandemic levels, airlines and cruise line companies report a surge in bookings. At the same time, the supply side of the economy could face a temporary constraint and a shortage of labor supply at a time when firms are trying to step up the pace of hiring.

Commodities

Oil prices above USD70 are likely but long-term outlook remains bearish

Oil prices are moving sharply just below the USD65 (Brent, per barrel) level, pausing from the past months fast paced Covid-19 recovery rally. The **current consolidation** is more a change in mood than fundamentally driven. Global fiscal stimulus and successful vaccinations will likely cause oil demand bounce towards the summer months. Currently oil demand is already at 95% of pre-crisis levels and a full recovery seems possible until late 2021, which might push the oil prices well beyond the USD70 levels, under the assumption that the petro-nations are willing to over-constrain supplies. This near-term uptrend will be fueled by western world leisure and travel activity resuming to pre-Covid-19 volumes and thereby lifting oil consumption and additionally by further Chinese demand.

The **medium-term picture** however still looks different as vast volumes on the sidelines stand in the way of a further uptrend. Elevated oil prices will trigger feedback loops and erode petro-nations cohesion, particularly between Saudi Arabia and Russia, and it would raise the appetite to circumvent sanctions on Iranian and Venezuelan oil. Furthermore oil prices well above USD70 will reawaken the shale business, where privately held companies are still operating regardless of costs but the big listed oil companies would come back and ramp up drilling because with such prices they can generate profits.

Looking even **more long-term**, the fact remains that Venezuela and Iran will return to the market which will result in an immediate period of surplus supplies. Demand on the other hand is set to decline towards 2030 with the acceleration of electric mobility, and lower prices are almost inevitable.

Gold has lost its upside momentum

Gold was declining by 11.8% YTD to as low as USD1'680 and by this decline **lost all momentum** of its Covid-19 related uptrend. The cause of the decline was the rise in USD 10-year rate to levels of above 1.70%, as higher yields remain the main enemy of Gold. Sentiment has become more bearish on Gold in recent weeks, the buoyant equity market has taken in all attention and investors have reduced their net-long gold positions to the lowest levels since 2019, which can also been seen by the outflows in Gold ETFs.

On June 21 this year, **Basel II regulations** will kick in for Gold, meaning that Gold will be classified as tier-1 instead of a tier-3 asset. Banks that hold gold will be able, in theory, to lend more and to increase profits. This development has been well flagged and banks had ample time to adjust, but there might be last minute changes pushing gold prices up.

Gold prices (XAU ounces) in USD – 01.01.2020 – 31.03.2021
Source: FIS Market Map

Outlook

Reopening optimism

The world is about to leave **a recession behind**; as pent-up demand, restocking of depleted inventories, easy credit conditions and people going back to work should all act in concert to bring the economy roaring back to life. Such a period usually features the fastest GDP growth rates and the acceleration could last for several successive quarters. On top, government globally have committed to more stimulus, relief packages or large infrastructure initiatives.

Corporate earnings and **stock prices** follow the economic growth and the stock market typically overdoes it in both directions, falling further than earnings decline in the recession and then rising more steeply and sooner than earnings recover. This is exactly happening now as markets are pricing in much of an improved outlook, particularly in the USA, where the

S&P500 sits at a P/E ratio of 22x consensus earnings.

The momentum provided by the re-openings, the anticipation of future GDP growth and the lack of any recession in sight will be positive for equities. **Two main risks** however remain. The **pandemic** has in recent months shown that the virus remains capable of tossing nasty curveballs, among others challenging variants or vaccine shortcomings. **Inflation** increases are another concern. Petrol prices are surging as are many industrial and agriculture commodities, which will lead to higher prices on finished goods and consumer products. Such inflation expectations could in return lead to higher bond yields which at these low levels are mainly an issue for Fixed Income holdings.

We are confident about our modest overweight in our equity allocation but are aware the stocks trade at all-time highs and command high valuations. We keep certain positions in Fixed Income for capital preservation, gold for unforeseen events and with an eye on the long-term horizon, we will continue our bias towards future "*Global Trends and Thematic*" investments.

Walter Küng
Senior Portfolio Manager

Remark:

"Client Accounts" refers to a generic description of general investments for managed accounts under discretionary mandates. Each account and portfolio could be materially different from this description and could invest or not in substantially different securities or products, based on individual risks and objectives. The descriptions above are not meant to reflect exact holdings by all accounts. Non-discretionary mandates could also be managed in a manner materially different than the description above.

For any question or doubt, please contact your Relationship Manager that will review or account and provide personalized comments and information.

Asset Allocation

USD Reference – Balanced

Thematic investment idea

Investing in a future megatrend

Semiconductors

The semiconductor market is experiencing expanding demand thanks to Covid-19 related issues such as online-shopping or work from home. However there exist normal underlying trends which will persist long after the pandemic is over and which are related to the ongoing digitization and growing dependency on the Internet.

Such long-term trends include the increasing utilization of chips in electronic components of traditional and electrical vehicles, the deployment of 5G technology in the next-generation wireless revolution, the digitization of healthcare, the growing favor for video gaming and the needed wearables including VR (virtual reality headsets) and AR (augmented reality or smart glasses) devices, the surge of digital payments, the crypto-currency euphoria, drones and other items in the field of military equipment, and many more.

Another driver of demand is the ongoing data-center boom where operators are increasing their capacities to meet the surging need of cloud providers, including Amazon Web Services, Microsoft Azure, Google Cloud, IBM or Oracle.

While all this demand will continue to grow, the chip supply is not quite as fluid. While other products can see input costs rise amid periods of high demand, semiconductors are not just becoming more expensive, the material supply just does not exist to adequately meet the demand. One key reason is that only two companies – Samsung and TSMC – can create the highest specification semiconductors and the factories needed to build these components cost billions of dollars to build.

The effect of these dynamic is the subject of several worrying headlines, including a number of factory closures (Ford, GM). Realizing the strategic importance of these components, President Biden has signed an order that mandates a review of critical supply chains and US manufactures are lobbying the government to subsidize the semiconductor production.

According to the World Semiconductor Trade Statistics (WSTS) data, the global Semiconductor market is now projected to rise 8.4% in 2021, higher than the previously projected growth of 6.2%. The long-term growth rates will remain elevated given all the mentioned underlying trends (AI Artificial Intelligence being another future element).

Conclusion and how invest in this thematic trend:

In our view, the trend on this long-term thematic is intact and not only related to 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 growing industry in our highly connected digital world. Should you want to know more about this accelerating trend and how to invest, please feel free to contact your Relationship Manager.

“Luck shouldn’t be part of your portfolio.”

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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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