Review & Outlook
July 2021

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Hyposwiss Advisors SA

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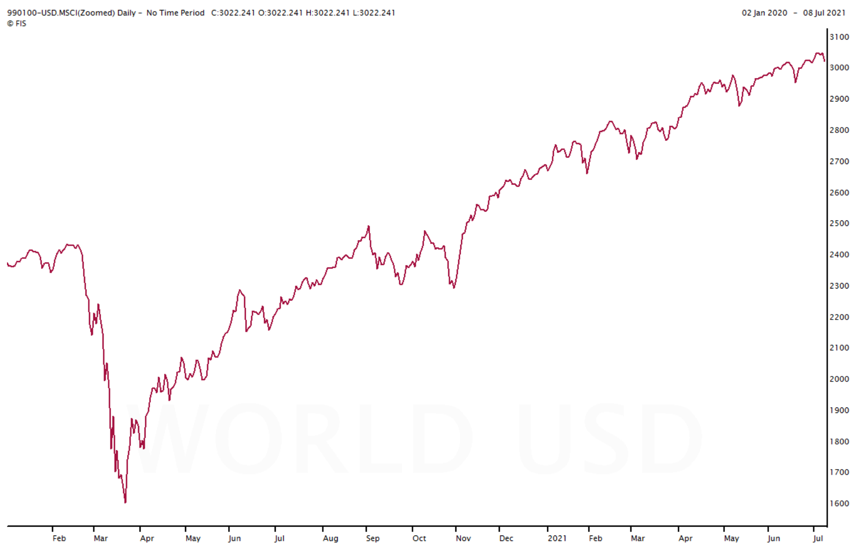
Q2 2021 Review

Equities have green light and continue their run

Global equity markets closed out the first half of 2021 at **record highs** amid **mixed sentiment**, as strong economic data vied with concerns over rising stock valuations and new Covid-19-Delta cases globally. A temporary increase of long-term USD interest rates resurfaced the ongoing debate and uneasiness about future inflation.

By June 30th, 2021, the MSCI World was up by 12.2% YTD. The **S&P500** has taken the lead again (+14.4%) – after lagging the first few months of 2021 – and managed to register its **fifth straight month of gains.** The NASDAQ Comp (+12.5%) was producing its seventh positive month in the last eight, despite the fact that technology stocks were lagging cyclical/value stocks for most of the first part of 2021.



MSCI World Index in USD – 01.01.2020 – 08.07.2021
Source: FIS Market Map

Europe is continuing to perform better than the rest of the world (EURO STOXX50 +14.4%), with the exception of the UK, which despite successes on its vaccination campaign is still behind (FTSE100 only +8.9%). **Asia** is to the surprise of many market observers continuing to underperform in 2021 (MSCI Asia ex Japan +4.0%), particularly because **China**'s markets are suffering from a tight credit situation and government interventions, and cannot make any grounds in 2021 (Shanghai Comp. +3.7%).

Equity markets saw **strong rotation**, mainly driven by interest rates increases, which typically are poison for the highly valued growth stocks and big-tech names. The best sector returns were achieved by the underperformers of 2020, for example cyclicals like oil & gas stocks, which rose 46.1% and financials which advanced by 25.3%. Laggards were defensive stocks such as consumer defensives (+3.2%) and utilities (+2.1%).

In a June survey of US investors conducted by Investing.com, 63% of respondents chose **Tesla CEO Elon Musk** to be the most influential personality in financial markets. Elsewhere, in the widely observed field of tech regulation, the US DOJ dropped its antitrust case against **Facebook** at the end of June. These are two completely different examples, however both are indicators that the 2021-underperformance of technology stocks versus value / cyclicals stocks is not meant for the long-term, as the future is bright for so called disruptor companies.

Otherwise, in the first half of the year, US Treasury bonds are down 3.9% and gold has fallen by 6.6%. On the other hand, oil is up 51.9% (crude oil WTI) and most industrial metals are also up strongly (Aluminum +27.3%). This **increase of commodity prices** was the result of a widely held discussion in financial circles about the dangers of higher inflation.

The news so far on the all-important **pandemic front** remained inconclusive. Outbreaks and renewed contingency measures were counterbalanced by positive news about vaccinations and their efficacy. This story is not finished yet.

Equity

New all-time-highs almost weekly – what or who will stop the bulls?

After the calendar transition from June to July, investors will shift their focus from the recent inflation and Fed policy debates to the **Q2 2021 earnings season,** which will start in mid-July. Consensus expectations have already risen from 54% year-on-year in April to now 64%. While some view this perhaps already overly optimistic and ripe for potential disappointment, it is worth noting that the actual consensus earnings expectations for Q2 2021 sit well below what companies have already delivered in Q1. This suggests that even with the upgrades to date, upside surprises remain likely once reporting begins.

With positive earnings surprises offsetting PE-compression in the first two reporting seasons of 2021, the announced earnings have delivered 5%-6% gains in the S&P500. A similar outcome in the 6 weeks (the usual time frame of the reporting season) following July 12 should not be discounted, despite the fact that US equity markets have moved to **new all-time highs** almost every week. However, all-time highs are from a technical analysis point of view – and contrary to what many anxious investors perceive - per se a positive fact as they indicate a favorable underlying trend, give a bullish signal and typically lead to further all-time highs, or as the French say: "La hausse amène la hausse" [Highs bring more highs].

Otherwise, looking at **historical performances** for guidance, gains in the excess of 10% in the first half of a year tend to have led to better returns in the second half of the same year. In the upcoming summer months, as every year, many investors take holidays and volumes dry up. As USD long-term interest rates are no longer trending up, but even declining, and assuming that the upcoming earnings season does not produce disappointments on a large scale, equities are set to remain in their uptrend channel, unless a yet unknown negative event is to occur.

Client managed accounts:

We increased our **equity allocation** in the first half of 2021 in all categories and now stand at the highest allocation at Hyposwiss Advisors during the last two years. By these moves, our clients did participate in the latest upticks.

Within the regional allocation, we have strengthened our allocation to Europe in Q2 by buying 2% of UK stocks, but see no need to go further. Our positions in **Asia (and particularly China)** were underperforming in 2021 along with those markets. However we like the long-term growth story of these regions and do not want to reduce it despite their currently lagging performance. Regarding China, we are concerned about the fact that the tech sector (which is highly vulnerable to regulation tightening in China and the US) represents 40% of the MSCI China Index. For this matter we also invest in China A-shares which are domestic stocks with less technology involved.

We still appreciate our positions in **"Trend and Thematic Investments"**, some of which we have presented in our past (and current) quarterly letters. We are of the opinion that it is becoming more and more important to be invested in **promising future trends** rather than to choose the correct regional allocation, as most successful companies are operating globally anyway. Therefore, going forward and as always depending on ongoing events, our intention is to continue our earlier move into the above mentioned instruments.

Fixed Income

Credit risk (HY and EM) remain the only source of income

In the USA, the discussion about a reduction of the **central bank's monthly purchases** of treasury bonds is heating up for different reasons. Firstly the **job market** healing is making a solid progress, confirmed by recent consumer confidence data, where 54.4% of the respondents in a survey said that jobs are plentiful, a 21-year high!

Secondly, the treasury's **refinancing need** is falling. On July 31st, the suspension of the statutory debt ceiling ends and the FED is no longer allowed to increase its outstanding debt afterwards, if a last-minute political solutions is not passed. But already before this deadline, the treasury has to lower its liquidity to a "normal" level, meaning a net reduction of USD 600bn by the end of July, resulting in a reduction of the amount of outstanding Treasury Bills. This leads to the question as to why the FED should continue to buy USD 80bn of Treasury debt per month at a time the treasury does not need the money.

And thirdly, one has seen another very strong gain in **US house prices**, which rose at an annual rate of 14.6% in April, up from 13.3% in March and 4.5% in March 2020. House prices have been rising throughout the pandemic-crisis, resulting in impressive long-term increases. On a 10-year horizon, they are up at a compound annual rate of 5.9%, compared to 3.7% nominal gross domestic product growth during the same period.

The **tapering – yes/no – debate** is thus intensifying by the day, as the outcome will be crucial for the future direction of interest rates and therefore of financial markets.

Client managed accounts:

Fixed Income remains an **unattractive asset class.** After the recent decline of USD rates, even USD Treasury bonds are no longer producing real (inflation adjusted) returns. In order to generate some income, investors have to accept credit risk, meaning to hold either High Yield (HY) or Emerging Markets (EM) bonds, albeit and along with higher risks.

We have an underweight for Fixed Income in USD based accounts and an even higher underweight in our CHF/EUR based accounts. We did lower our allocation to bonds already twice this year and might reduce it even more going forward. However, despite low returns, we keep a certain portion mainly for **capital preservation**, assuming that yields will remain low for the immediate future. As we hold primarily bonds with duration around 5 years, no capital losses should occur, as we have the intention to keep securities until their final maturity.

In the **HY** space, we avoid low quality debts in structurally challenged sectors. We take into account the fact that USD high-yield spreads compared to government bonds are down to 230bps, which is at 30-year historical lows and leaves not much room to the upside.

We also find certain **EM** bonds attractive, which we typically cover through diversified ETFs. There are some EM regions which we find attractive (Asia, some Middle East countries), while others (like Argentina and Turkey) are at the present time relatively risky. The fundamentals for EM debt have improved massively the last few weeks as vaccination rates finally are picking up and infection rates are falling.

Currencies

The outlook of the USD is deteriorating

The **USD** might face three problems: **Firstly**, the USD is a countercyclical currency and typically does poorly when global growth is strong. This might be the case soon as most economists predict that the US economy will transition from being the leader (current situation) to a laggard over the coming months, which could be dollar bearish. **Secondly**, a reason to hold USD was its large interest rate differentials, which is declining after the recent drop of USD long-term rates. A **third point** is the balance of payments situation which has worsened significantly over the past year, particularly the US trade deficit. This was offset by equity inflows which were helping to finance the trade deficit. However, stronger growth outside the US might cause international equity flows to move out of the USA. To summarize, the outlook of the USD is deteriorating.

The **Euro** long-term outlook remains constructive, as fiscal policy support offsets the economic pain caused by the Covid-19 and the recovery proceeds thanks to an accelerated pace of vaccination. A lack of inflation pressure enables the European Central Bank (ECB) to remain dovish for longer as others and particularly the US FED may enter its tapering debate soon, therefore the short-term EUR downside seems limited. The EUR **purchasing power** remains strong and Europe offers a solid **balance of payments** situation, contrary to the USA.

The **CHF** is set to trade sideways as the strong cyclical economic recovery reduces the appreciation pressure on the CHF, which traditionally serves as a **safe-haven currency.** Readiness to act is the credible mantra of the Swiss National Bank (SNB) and its famous currency interventions continue to be a headwind offsetting support from reduced risk appetite.

The **CAD** as an **oil currency** was profiting from the surge in oil prices. In reaction to rising inflation and soaring house prices, the Bank of Canada (BoC) has tapered its bond purchases (CAD 3bn / week) and hinted at a lift-off of rates in the second half of 2022.

The **CHN** remains supported by **China's solid growth outlook** and attractive yields against developed markets that are generally less correlated with global bond yields, but the advantages are narrowing. Capital inflow will continue but new domestic outflow channels provide counterweight. Smaller aggregate balance of payments inflows provide reasons to expect some more moderate CHN gains going forward.

Economics

How long will global economies continue their uptrend?

When talking about **macro-economics**, the focus is still on the pandemic. It all began 18 months ago and by now, the global economy is on the mend. In its latest forecast, the OECD projects that it will expand globally by 5.8% this year, higher than its previous projection of 5.6%.

After a rough start, **the vaccination campaign** is progressing well in most advanced countries. The US and the UK were the first major economies to roll out the vaccines, but now, the EU is following quickly. Some countries are still struggling to secure enough vaccine, but fortunately, this issue should abate over the next 12 months. The Global Health Innovation Center at Duke University estimates that pharmaceutical companies are on track to produce more than 10bn vaccine doses this year. While this perhaps is not enough to inoculate everyone globally, it will suffice in providing protection to the most vulnerable members of society, the elderly and those with pre-existing medical problems.

However novel strains of the virus remain a concern. The so called **"Delta variant"**, first identified in India, is spreading around the world. It is highly likely that the Delta variant will produce another wave of cases. **Vaccine hesitancy** is another key element. It is however likely to diminish as the evidence of their effectiveness continues to mount. According to an analysis by the Associated Press using CDC data, fully vaccinated people accounted for less than 1% of the 18'000 Covid-19 deaths in the USA in May. A study out of the UK showed that the Pfizer-BioNTech vaccine was 96% effective against hospitalization from the new Delta-variant.

Therefore while another wave of the pandemic might curb growth this summer, the economic impact will be far smaller than in the past. Today, the **initial terror of the pandemic** has faded and politically, it will be more difficult to justify lockdown in countries such as the USA or the UK, where almost everyone who wants a vaccine has already been able to get one.

After the latest **FOMC meeting** in June, which markets interpreted in a hawkish light, the 5 year yields jumped by 10 basis points (bp), whereas the long dated bonds fell by 19 bp. The key to the future FED policy will be how long it takes the US economy to return to full employment and what happens to inflation in the interim and beyond.

Commodities

Oil: All eyes are on the petro-nations

The oil market for the time being looks fundamentally strong. **Global storage levels** are largely back at their pre-crisis or normal quantities and even seem to tighten, which supports prices. Demand has returned to 2019 volumes on the back of the recovery, re-openings and a noticeable leisure activity bounce, which is particularly visible in North America and Europe.

However, oil supplies are politically tight - not for structural reasons - which creates an environment with specific but unstable dynamics, especially at the current USD75 per barrel (Brent and WTI) prices. **Petro-nations**, the alliance between the petroleum producing countries (OPEC) and other key producers such as Russia continue to constrain supplies and their tapering has even been on the cautious side. Their production - excluding Iran and Venezuela - remains approximately 5mio barrels below pre-crisis levels, which equals around 5% of total supplies.

Surprisingly, the **US-shale production** response to the rising prices was muted so far. It can be explained by capital discipline, investor pressure to curb climate emissions and particularly the lack of conviction in the current oil rally knowing about the vast volumes waiting on the sidelines. **Fuel inflation** has become another item and an economic pain in some emerging markets. If prices continue to rise, this factor which can no longer be neglected will put pressure on petro-nations to increase production.

For the time being, oil prices could overshoot to the upside, but given the **long-term unfavorable** dynamics of the commodity, this uptrend is not sustainable. Transportation accounts for about 60% of global oil consumption and the ongoing shift to electric vehicles will undermine this key source of oil demand.

Gold: Higher prices need some disappointing data or a negative event

The gold market still seems to be shocked by the potentially earlier-than-expected interest rate increases in the USA, and prices are not getting off the ground, lingering sideways around the **USD 1800 level**. As long as the outlook for world economies remains robust, gold has no value for safe-haven investors, resulting in a fading demand, which could lead to even lower prices.

Presently, gold seems to be in an similar environment as a few years ago when short-term swings were primarily driven by shifts in the **market mood**, which brightened and darkened based on the signals the Federal Reserve was sending in regard to its future monetary policy. Expectations of an interest rate increase put pressure on gold prices, while a returning restraint of the central bankers lifted them, even though not convincingly.

The **catalyst for higher gold prices** could be a financial crisis following the Covid-19 shock or an unexpected acceleration of inflation following the massive government stimulus measures, paired with a much weaker USD. Should global economies continue their growth path of the last few months, gold prices have little room to the upside.

Client managed accounts:

We have maintained **a gold allocation of 5%** in our managed accounts as an insurance against any unforeseen negative events.

Gold prices (XAU ounces) in USD – 01.01.2020 – 09.07.2021
Source: FIS Market Map

Outlook

Equities still more attractive (despite lofty valuations) than bonds

Historically, **bear markets** rarely occur outside of recessions. With both fiscal and monetary policy still supportive, and households in many countries sitting on plenty of dry powder, the odds that the global economy will experience a major downturn in the foreseeable future are low.

In light of these facts we remain constructive on stocks as long as growth is likely to remain strong. However we acknowledge that the **risk–reward profile** for equities has deteriorated since the start of the year. Global stocks have risen by 12% YTD, implying that investors have already priced in an increased optimistic economic outlook.

Even years that feature above-average stock markets returns typically contain within them **rocky periods of corrections**, something which did not (yet) happen so far in 2021. There is a long list of possible reasons for such a correction to occur anytime: Inflation worries, the pandemic, geopolitics, profit-taking by investors sitting on large gains, even severe weather. The problem remains the same as in the past, namely that corrections rarely announce their arrival (or conclusion) in a timely enough manner for any investor to get out without taking losses.

Another item to be followed is that Democrats in Congress will likely use the reconciliation process to **raise corporate taxes**. While this may be a non-event for the economy as a whole, it will have negative implications on stocks as most analysts have not yet adjusted their earnings estimates to such higher taxes.

While stocks are getting expensive, **government bonds** are even more costly and **real yields** are even negative in most G10 economies. A persistently high inflation is not an imminent threat, but it is a long-term risk that bond valuations have not yet discounted properly.

We **enter the second half of 2021** with the assumption that global economies will continue their recent recovery and we follow the developments on the health situation and the vaccination campaigns. We maintain positions in Fixed Income for capital preservation, HY/EM bonds to generate income, 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

Remark:

"Client managed 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 your account and provide personalized comments and information.

Asset Allocation

USD Reference – Balanced

Thematic investment idea

Investing in a future megatrend

Hydrogen

What is Hydrogen and why it has come under focus

Is Hydrogen the missing part or even the holy grail in our **desire to decarbonize**? Simply put, Hydrogen is the first chemical element in the periodic table, and the lightest and most abundant atom in the universe. You make hydrogen by passing an electrical current through water (H_2O). When doing that, you split the two components of water, Hydrogen (H) and Oxygen (O). This process is known as electrolysis.

As **environmental policies** around the world are creating a need for more sustainable and efficient sources of both storage and transportation of energy, Hydrogen appears to be the missing link and has become one of the most promising ways to meet governments decarbonization objectives. Indeed, none of the existing alternatives, such as wind or solar, can provide sufficient and consistent supply in a cost-effective manner.

The scope of use for Hydrogen is growing. From grid management, energy creation including heating, to aerospace, shipping or transportation of fuel, **many applications** are being explored or developed. Hydrogen is already being tested to run commercial fleets such as trucks or public transports and by now, buses in China and Europe are being deployed. It can also power industrial equipment in manufacturing, function in data centers or storage facilities. One example is that Amazon is presently using hydrogen to power its forklifts.

The big advantage or supremacy of Hydrogen Fuel-Cells-Electric-Vehicles (FCEVs) over classic battery electric vehicles (EVs) is that they are able to **charge faster, drive longer and have a higher payload.**

Current situation

Even though the technology needed in the extraction process of hydrogen exists for a while now, **high production costs** were a drag for its mass adoption. But the costs of renewable energies and of electrolysers used to produce green hydrogen is falling. Estimates are that costs have already declined by 50% over the last five years and are expected to decrease further, which should generate demand for additional sectors. The positive momentum is not only affecting production, but is also positively influencing the whole value chain. This continuing improvement in the Hydrogen ecosystem will not only help this clean energy source in **going mainstream**, but will also place it as a major player in the energy transition.

Conclusion and how to invest in this Thematic Trend

We believe Hydrogen is set to become more important in the future, thanks to improving infrastructures and decreasing costs. As mentioned, applications for Hydrogen are multiples, and we expect its usage to increase significantly into the future. According to a research report from Bank of America, **25% of energy needs** could be met with Hydrogen by 2050. Global environment and sustainability policies (ESG investing) are also favoring such investments and innovation, which should favor global adoption of Hydrogen.

Pure-play stocks in this industry have skyrocket the last few months already, but besides, there exist traditional companies which are also operating in this field. We believe there is a **long-term opportunity** for investors to participate in this still underestimated and fast growing thematic. 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."

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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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