CIO Update

Investment Committee Bank J. Safra Sarasin

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Editorial

Dear reader

The exponential spread of coronavirus cases outside China has led to great uncertainty in financial markets in recent weeks. It remains difficult to exactly estimate the extent of the damage to the global economy. The rapid intervention by the US Federal Reserve signals the determination and the necessity to take rapid countermeasures. However, as interest rate cuts are not an immediate cure for the coronavirus, the flow of news about the epidemic and its effects will be decisive for the further course of the financial markets. In view of the extraordinarily high degree of forecasting uncertainty, a cautious stance in the portfolios is advisable.

Yours faithfully
Philipp E. Bärtschi, CFA
Chief Investment Officer

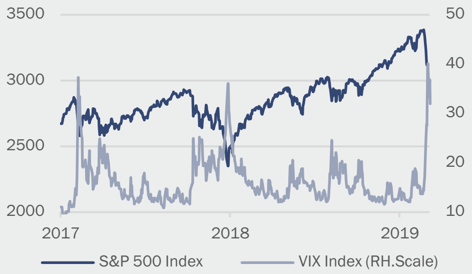
Focus

Cautious stance

Review: Exceptional times

The rapid spread of the coronavirus led to panic in the global financial markets at the end of February. The VIX index, which is regarded as a barometer of investors' risk aversion, jumped to its highest level since February 2018. Equity markets corrected by 10 to 15% from their highs.

US: High uncertainty among investors



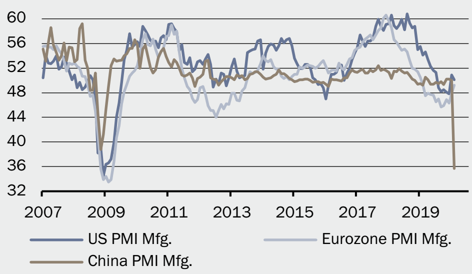
Source: Datastream, J. Safra Sarasin, 06.03.2020

The US Federal Reserve recognised the seriousness of the situation and, for the first time since 2008, cut key interest rates by 50 basis points in an extraordinary meeting. Further monetary and fiscal measures are likely to follow globally in order to avoid a stronger and longer-lasting dent in growth.

Macro outlook – Temporary weakness?

After first signs of an economic turnaround in recent months, expectations for economic growth for the first quarter of this year have fallen significantly due to the coronavirus. The effects of the epidemic, particularly on subsequent quarters, are highly uncertain at this time and the risk of underestimating them is quite high. China's strong integration in global supply chains and the high share of global gross value added certainly urge caution. Reliable economic data for the Chinese economy after the outbreak of the epidemic are still pending. However, the Chinese purchasing managers' index has already fallen to a record low in February. In the meantime the government in Beijing has also taken first fiscal and monetary policy measures to limit the effects on the economy and the capital markets.

Coronavirus weighs on PMIs



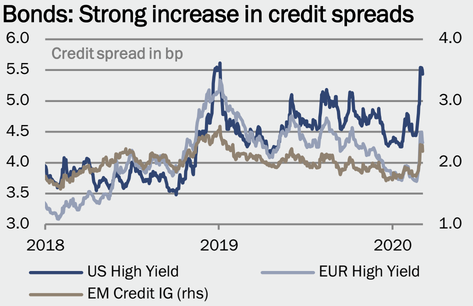
Source: Datastream, J. Safra Sarasin, 06.03.2020

As a result of Europe's intensive economic integration with the emerging markets, and China in particular, the region will continue to be strongly affected, as it has been by the trade war last year. In particular, the economic outlook for Germany, the largest economy in the euro zone, appears fragile. According to the Centre for European Economic Research, the potentially negative effects of the coronavirus are particularly weighing on the outlook for export-intensive sectors. German Finance Minister Scholz has already promised an economic stimulus package should there be severe economic turmoil. In Italy, the government has already announced an aid package for the troubled economy. In the USA, on the other hand, the macroeconomic data were mostly better than expected. Consumption remains stable and provides a solid foundation for economic development. Nevertheless, the coronavirus could also here lead to a slowdown in growth.

Bonds: Yields at record lows

Due to the increasing risks to growth, the US Federal Reserve cut key interest rates by 50 basis points surprisingly quickly at the beginning of March. Further interest rate cuts by other central banks are likely to follow. Even before the recent rise in uncertainty in financial markets, yields fell significantly in almost all regions due to the increasing growth risks emanating from China. In the course of the recent turbulence, investors fled to safe havens, which led to a massive rise in the price of US government bonds. Yields on both 10-year and 30-year bonds reached new record lows. On the other hand, credit spreads have risen significantly in recent weeks.

Bonds: Strong increase in credit spreads



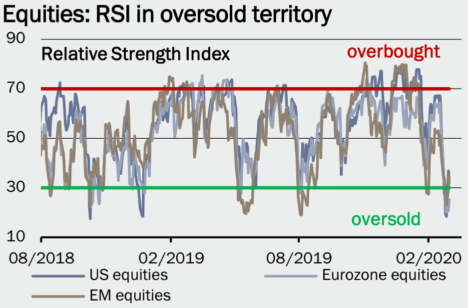
Source: Datastream, J. Safra Sarasin, 06.03.2020

Even if a further increase in risk premiums is possible in the short term, the current level seems attractive in the medium term. We remain overweight in both high-yield bonds and emerging market bonds, for which a similar statement applies. Emerging market bonds in local currencies have had a difficult time of late due to the strong US dollar and the recent spike in risk aversion. However, a renewed cycle of interest rate cuts by the US Federal Reserve could lead to a sustained weakness of the dollar and support the asset class.

Equities: Rapid change of mood

Investors' complacency regarding the economic impact of the coronavirus led to extremely high valuation levels for global equity markets in February. The fact that the spread of the virus is not limited to China led to severe distortions. Cyclical sectors in particular were affected. The extraordinary element about this correction was its speed. US equity markets, as well as equity markets in Europe, fell by around 15% from their peak within only six trading days. Thus, some tactical indicators such as the Relative Strength Indices (RSI) showed oversold levels.

Equities: RSI in oversold territory



Source: Datastream, J. Safra Sarasin, 06.03.2020

Nevertheless corrections usually do not happen in one day but last for a couple of weeks until a bottom is found. Given the high market valuation at the start of this correction it may take longer for the selling pressure to end.

Asset Allocation: Waiting for a clearer picture

Although an abrupt slowdown in growth seems inevitable in the first and second quarter, we expect the global economy to recover significantly in the second half of the year. First monetary and fiscal policy measures in developed and emerging countries have already been implemented or are in prospect. The question is therefore not whether such measures will be implemented, but how effective they will be in view of the nature of the supply/demand disruptions. The sharp increase in further coronavirus cases will continue to create a difficult environment for risky assets in the short term, with the risk of increased volatility and further setbacks.

We have had a more or less neutral risk positioning in our portfolios since the beginning of the year. In February, we realised gains on some equity positions in order to slightly reduce the portfolio risk. Owing to the high degree of uncertainty, the downside risks seem to slightly outweigh the upside potential in equities, so that we remain slightly underweight. We are waiting either for a clearer picture of future economic developments or for more favourable prices that offer adequate compensation for the increased risk. In the meantime, we have increased our cash ratio in order to adjust our equity allocation opportunistically and flexibly. Until then, we are well positioned with a rather cautious approach.

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Attractiveness of individual investments

Asset class	Weighting	Relative attractiveness within the categories			
Equities	=/–	Industrial countries =	Emerging markets =	Large caps =	Small caps =
Bonds	–	Government bonds –	Corporate bonds –	High-yield bonds +	Emerging markets +
Alternative assets	+	Money market =	Convertible bonds =	Other alternatives +	Commodities/gold =/+

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