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CIO Update

Investment Committee Bank J. Safra Sarasin

6 November 2020

Editorial

Dear reader

In October, a number of key factors came to the fore, which created uncertainty and moved the financial markets. On the one hand, there was the upcoming US presidential election, which was the focus of attention in the USA. On the other hand, the rising COVID-19 case numbers in Europe, which led to one country after another imposing new lockdowns. As soon as the results of the US elections are clear and the growth of COVID-19 cases is slowed down, there is nothing to stop the volatility on the financial markets from decreasing significantly. We expect that risk appetite among investors will increase again in the coming weeks and that the environment for risk assets will brighten significantly by the end of the year.

Yours faithfully

Philipp E. Bärtschi, CFA

Chief Investment Officer

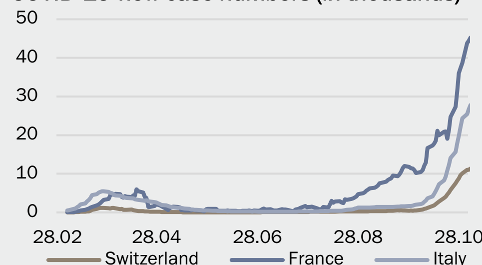
Focus

Uncertainty will be reduced

Review: Financial markets under pressure

Financial markets have come under heavy pressure in recent weeks. The breakdown of negotiations between Democrats and Republicans on much-needed fiscal measures and the pending outcome of the US presidential election contributed significantly to investor uncertainty. On top of that comes the sharp rise in corona cases throughout Central Europe. Also in countries that had come through the pandemic relatively well in the spring, including Germany and Switzerland.

COVID-19-new case numbers (in thousands)

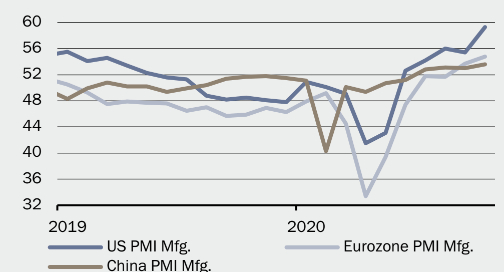


Source: Refinitiv, J. Safra Sarasin, 7-day average until 2.11.2020

Macro outlook - A rocky path

The new lockdown measures are currently weighing on the economic outlook - at least in Europe. Once again, it is the US economy that is proving more resilient in this environment. US consumer confidence has remained stable despite rising COVID-19 case numbers and the latest purchasing managers' indices suggest that the economy has made a strong start to the fourth quarter. The services sector in particular showed its strength. This contrasts sharply with Europe, where this component has again fallen below the contraction thresh-old. The business outlook has also recently improved in the US. This is mainly due to renewed hopes of a fiscal policy package following the US presidential elections, as well as a more predictable political environment.

Purchasing Manager Indices: Manufacturing



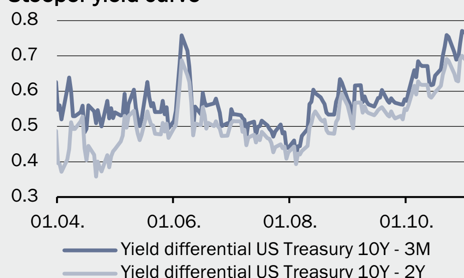
Source: Refinitiv, J. Safra Sarasin, 02.11.2020

The economic environment in Asia has been surprisingly robust since the outbreak of the coronavirus. In China, whose economy was the first to go into lockdown, the Purchasing Managers' Index for the manufacturing sector rose to 53.6 points in October from 53.0 the previous month. The economic barometer thus reached its highest level since January 2011, reflecting the strong rise in industrial production and exports. China is the only country among the major economies to have already returned to pre-corona activity levels.

Bonds: Solid environment

Credit spreads on corporate bonds have risen slightly recently. Although investors remain cautious, the environment is still positive. The prospect of further fiscal policy measures and expansionary central banks are the decisive factors. In the euro area in particular, the European Central Bank is likely to respond to the economic slowdown during the winter months by aiming for an increase in monetary aggregates. This will particularly support investment grade bonds. In anticipation of monetary policy easing, long-term interest rates in Europe have also fallen. This contrasts with long-term US bonds, which came under pressure from the expected fiscal stimulus programmes.

Steeper yield curve



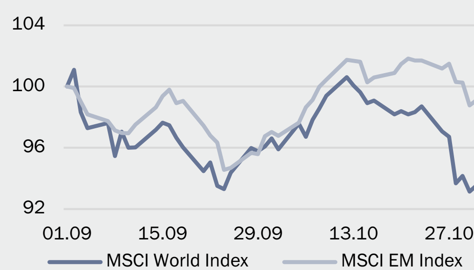
Source: Refinitiv, J. Safra Sarasin, 02.11.2020

The significant outflows from long-term US government bonds have led to a significant steepening of the US yield curve over the past few months. In the short term, this movement seems somewhat exaggerated, as the positioning among investors is only very one-sided. Should the US fiscal stimulus turn out to be less than expected due to the election outcome, the yield curve is likely to flatten again somewhat. However, we expect interest rates to rise slightly in the medium term. Against this background, high-yield and emerging market bonds offer a certain risk buffer due to their attractive credit risk premium. Bonds from emerging markets in local currency also offer considerable yield potential for next year.

Equities: Earnings outlook mixed

The third quarter earnings season has so far been surprisingly positive in both Europe and the US. However, these earnings reports have not been reflected in rising equity prices. The outlook for the fourth quarter has become less clear. And that is the crucial point. Companies must reassure investors of their business expectations for the coming quarters. But the uncertainty in this regard is very high. And so the demand for high quality and growth stocks with predictable and stable earnings is rising again. Although a rotation towards cyclical value equities has not been cancelled, it is likely to be delayed even further due to the growth dip in Europe.

Emerging Markets with better performance



Source: Refinitiv, J. Safra Sarasin, 02.11.2020

Emerging markets have outperformed in recent months, led by China. In China, the corona pandemic seems to be under control and growth indicators are pointing upwards. Based on these positive fundamentals, we remain overweight in emerging markets in our portfolios.

Asset Allocation: Balanced

Although the danger of a second wave of coronavirus had been looming since the summer, the vehemence with which the number of cases shot up in recent weeks was nevertheless surprising. The partial lockdowns in Europe should not miss their effect and soon lead to a turning point in the COVID-19 infection figures. This will reassure investors that this second wave will also pass. Therefore, the level of uncertainty should decrease significantly in the near future. This will have a positive impact on all risky assets.

Our current positioning in equities is fairly balanced. We plan to increase our equity exposure in the coming weeks, as the expected return is now higher after the sharp rise in risk aversion in October. Short-term concerns should soon fade and the positive medium-term scenario of a sustained economic recovery will prevail.

We remain underweight in government bonds. As the recent correction in the equity markets has shown, the asset class offers little protection at this yield level. At the same time, they bear the risk of price losses if interest rates rise slightly. Investment grade corporate bonds are more attractive due to stable risk premiums. We remain overweight in emerging market and high yield bonds, as these are likely to benefit most from a further economic recovery. Overall, our multi-asset portfolios are very balanced and broadly diversified. This has helped us this year and will continue to be a crucial factor in the coming months.

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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 =	Gold +

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