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CIO Update

Investment Committee Bank J. Safra Sarasin
7 May 2020

Editorial

Dear reader

The situation in financial markets remains tense. The strong correction in March was followed by a strong recovery in financial markets until the end of April. The coronavirus containment measures successfully implemented in many countries give hope for an economic recovery in the near future. However, while it was quite easy to turn off the economic engine by decree, it will probably not be possible to kick-start it without stuttering. The news flow is therefore likely to remain fragile, and we expect financial markets to continue to be highly volatile. In our multi-asset portfolios, we have now slightly reduced the risks again and are adopting a wait-and-see and risk-neutral stance. Thanks to the generous support of the central banks, the area of high-quality bonds continues to appear particularly attractive to us.

Yours faithfully
Philipp E. Bärtschi, CFA
Chief Investment Officer

Focus

Let's wait and see

Review: Markets in recovery mode

Since their lows in March, equity markets in most regions of the world have risen between 20 and 30%. Fiscal and monetary policy measures on an unprecedented scale have caused equity market valuations to rise significantly and credit spreads to fall. But investors' focus has recently shifted from extensive support measures and massive liquidity injections to the potential economic consequences of the pandemic.

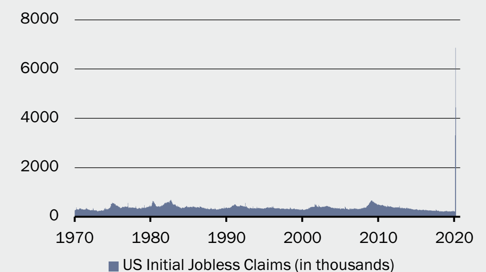
USA: Equity markets recover significantly

Source: Refinitiv, J. Safra Sarasin, 06.05.2020

Macro outlook: On the low point?

The latest macro data already give a first impression of the extent of the crisis. China's economic growth declined by 9.8% in the first quarter. The US economy contracted by 4.8% in the same period. This is the sharpest decline since the Great Recession. Moreover, the real extent of the contraction will only be seen in the data for the second quarter. As a result, 30 million initial jobless claims have been received since the end of March - this matches the number of new jobs created in the past ten years.

USA: Labour market gives warning signals



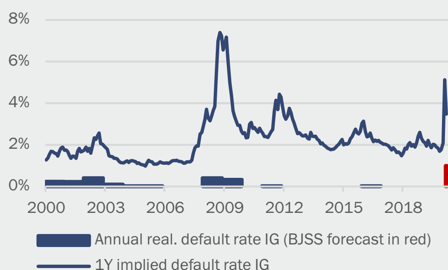
Source: Refinitiv, J. Safra Sarasin, 06.05.2020

The corona pandemic and the economic standstill leave deep scars. There is no question about it. The latest macro data were devastating, and much worse than expected. Nevertheless, there are also rays of hope. The growth rate of new coronavirus-infected people has recently declined in most countries and is now in the low single-digit range in Europe and the US. Governments are becoming more confident about a gradual relaxation of the containment measures. Nevertheless, the return to normality is difficult. Given the sharp decline in consumer confidence, a rapid and strong recovery in consumer spending is rather unlikely. Although monetary and fiscal policy measures can move financial markets very quickly, they cannot directly stimulate economic growth. The example of China shows that it may take several months, if not quarters, before the economy is fully revived. Until then, we must be prepared for further disappointing macro data.

Bonds: Central banks provide direction

Volatility in the fixed income sector has fallen sharply in recent weeks despite the economic uncertainty. Central banks on both sides of the Atlantic have restored calm to the market segment with extensive asset purchase programs. However, idiosyncratic risks remain high, especially in the US high-yield space, where companies have come under massive pressure due to severe distortions on the oil market and oil prices well below production costs. Although both the high-yield sector and emerging market bonds offer attractive return potential in the long term, from a risk-adjusted perspective we currently prefer investment grade bonds. Their corporate balance sheets are much more robust and valuations more attractive.

Attractive IG credit spreads



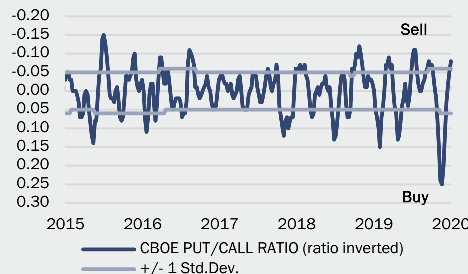
Source: Refinitiv, J. Safra Sarasin, 06.05.2020

This is particularly evident when comparing the current implicit default rates and the effectively realised default rates. We believe that the expected defaults in the investment grade space are more than compensated by the current level of credit spreads. The segment also receives strong support from central banks. A renewed increase in risk premiums is therefore rather unlikely. Even if risk premiums are not expected to narrow significantly in the coming months, the investment grade segment should be given a much higher weighting simply because of the current yield.

Equities: Time for a pause?

In recent weeks, equity markets have priced in the many rate cuts, asset purchase programs and rescue packages. Options markets also suggest that investors attach less probability to downside risks than was the case at the end of March.

Put/Call Ratio deutet auf Optimismus hin



Source: Refinitiv, J. Safra Sarasin, 06.05.2020

This makes sense, as growth rates of new coronavirus infections are steadily declining; and governments are establishing initial strategies to gradually increase economic activity. In addition, the extensive fiscal and monetary policy measures support the market's expectation that the lows on the stock markets are behind us.

However, the recent sharp rises in prices and valuations on the equity markets within a very short time frame make them vulnerable to disappointment at current levels. Not least against the backdrop of the current reporting season and possible reassessments of future corporate earnings expectations. We therefore expect a consolidation phase, which will probably continue to be characterized by elevated volatility.

Asset Allocation: Consolidation phase

Although the potential for further gains in the equity market at current levels is limited, the asset class remains supported from a positioning perspective. This is particularly true for the long term. In the short term, however, equity market volatility remains high. A sustained decline of it is crucial for many investors in order to increase their portfolio risk again. Following the strong rally in April, we have therefore reduced the risks in our multi-asset portfolios and are now again underweight in equities.

We have also reduced our overweight in high-yield bonds following the massive tightening in credit spreads. In the bond space, our focus is on high-quality corporate bonds that offer attractive risk premiums. For an investor it is now again possible to earn more than cash with a relatively small increase in portfolio risk. We therefore expect strong inflows into investment grade bonds in the coming months, not least from central banks. For investors who can tolerate higher volatility and are not dependent on short-term liquidity, high-yield and emerging market bonds also remain interesting.

Overall, we are broadly diversified and risk neutral in our multi-asset portfolios and are adopting a wait-and-see approach. Due to the high volatility in financial markets, it is very likely that further tactical opportunities will arise in the coming weeks, either to increase risk again or to take further profits.

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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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