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CIO Update

Investment Committee Bank J. Safra Sarasin
9 July 2020

Editorial

Dear reader

During the lockdown phase, our full attention was focused on daily statistics regarding new COVID-19 infections and their growth rates. These data were soon joined by daily mobility figures, which serve as an indicator of economic recovery. However, the high frequency and fluctuation of these data should not prevent us from paying attention to the medium-term conditions for financial markets. With their generous supply of liquidity, central banks have created the foundation for further increases of asset prices. Investors must learn to surf cautiously on this liquidity wave and not to be too confused by the daily news flow. A risk-neutral portfolio seems to us to be the best way to get through the summer months with tranquility.

Yours faithfully
Philipp E. Bärtschi, CFA
Chief Investment Officer

Focus

Surfing the wave carefully

Review: Gold heading for record level
The past few weeks have been dominated by normalisation. People have returned to their workplaces and borders have gradually reopened. Macroeconomic data have recovered significantly from their lows of recent months and market sentiment has improved. However, the return to normality has led to an increase in COVID-19 infections. Although this should not come as a surprise, it has nevertheless led to increased uncertainty among investors. Volatility in equity markets has risen again, at least temporarily, and gold once again has proven to be a safe haven.

Gold at a 9-year high

Source: Refinitiv, J. Safra Sarasin, 08.07.2020

Macro outlook: An uneven path to the top
Just as people are getting ready to live with the virus for a longer period of time, investors seem to be accepting that after the first wave, more waves will follow. Nevertheless, there is a certain amount of confidence, as a renewed lockdown is very unlikely. The world has become better prepared for the pandemic in recent months and governments can take much more targeted measures. The strategy of limiting outbreaks at the local level has proven successful in many Asian countries and should also be successful in Europe. In the southern states of the US, on the other hand, the rapid increase in infections is alarming. However, the delay of some easing measures is likely to slow down the recovery, but not stop it. As long as the economic recovery continues, COVID-19-related setbacks in financial markets are likely to be short-lived.

Global PMI: Low point passed in 2Q

Source: Refinitiv, J. Safra Sarasin, 08.07.2020

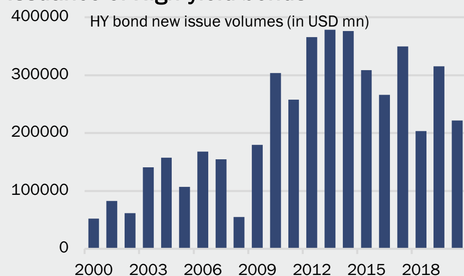
Sentiment indicators have recently improved significantly and the expectations components in particular paint a thoroughly optimistic picture. The latest purchasing managers' indices confirm that the low point was passed in the second quarter. In our baseline scenario, we expect the recovery to continue in the third quarter and to continue to surprise positively. Some banks have raised their economic forecasts again. Nevertheless, dents cannot be ruled out. Due to the high uncertainty regarding the development of COVID-

19, it is also likely to be dampened if another wave of infection occurs in the fall. The worst seems to be over, but the path to the top is uneven.

Bonds: Attractive as ever

Central banks will therefore remain ready to take action and maintain their already ultra-expansive monetary policy. Although the central banks' wave of liquidity primarily targets high-quality bonds, demand is spilling over to other market segments. At least the US Federal Reserve is now also buying bonds from companies that were investment grade before the Corona crisis but have since been downgraded to junk by the rating agencies.

Issuance of High-yield bonds



Source: Refinitiv, J. Safra Sarasin, 08.07.2020

Thanks to high demand from both public and private investors, companies have been taking full advantage of the positive market environment and have been issuing bonds as if there were no tomorrow. Issuing of high-yield and convertible bonds reached a historic high in June. At the end of the month, Austria issued a 100-year government bond with a yield of less than one percent. What was once unthinkable is now reality. What was even more surprising was that the bond was ten times oversubscribed. Although bonds, depending on the rating segment and region, have in some cases offset more than two thirds of the widening of credit spreads between the end of February and the end of March, they are still trading at a higher level by their own historical comparison. In addition, they remain attractive compared to equities from a risk/return perspective due to the explicit support of central banks. High-yield and emerging market bonds are attractively valued, especially with a longer-term investment horizon, even if they are not protected to the same extent and are more strongly correlated to equity markets.

Equities: Consolidation phase

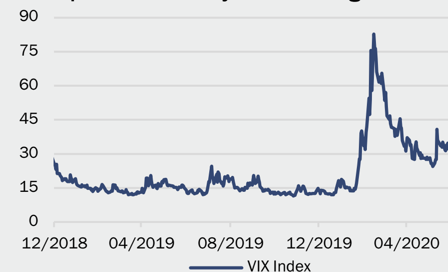
The central banks' wave of liquidity has also affected equity markets. Following the dramatic slump in the first quarter, the second quarter saw a no less impressive recovery. In particular, growth stocks from the technology and healthcare sectors, which were relatively mildly affected by the corona crisis, benefited strongly and achieved new record valuations. In the medium term, valuations in equity markets are likely to continue to rise due to the persistently low interest rates. In the short term, however, consolidation seems more likely after the strong rally.

Asset Allocation: Cautiously optimistic

Investors currently have to weigh up extensive monetary and fiscal policy measures against the increased uncertainty resulting from a potential second wave of infection. In addition, there are increasing geopolitical tensions between the US and China, as well as trade policy disputes with Europe. Not to forget the US presidential election in November.

The risks are therefore manifold. Against this backdrop, the vulnerability of equity markets is high. This can be seen not least in equity market volatility, which, despite increasing prices, remains at an elevated level. The risk/reward ratio for equities is suboptimal in the short-term due to the sharp increase in prices in recent months and uncertainty about profit expectations. We therefore remain underweight, but are prepared to take advantage of buying opportunities.

US-Equities: Volatility remains high



Source: Refinitiv, J. Safra Sarasin, 08.07.2020

From a valuation perspective, however, we continue to focus our risk budget on the credit sector. Despite already sharp declines in credit spreads, we remain overweight in investment grade, emerging market and high yield bonds. Valuations in these segments continue to be more attractive than in equities. In addition, the potential for setbacks is limited due to the extensive asset purchase programs of central banks. The central banks' willingness to intervene should prevent a liquidity shock even in the event of a renewed rise in risk aversion. We therefore expect credit risk premiums to remain at least stable in the coming months, which means that bonds still offer an attractive yield. Although equity markets should also benefit from the available liquidity, they could still come under even greater pressure. We therefore believe that a slight underweight in equities is more than justified at the current price level.

We are maintaining our overweight in gold, primarily as a diversifying element within our multi-asset portfolios. The precious metal is one of the few asset classes that made a positive contribution to diversification during the crisis.

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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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