TELOMERE | Capital

# Outlook 2020 – Q4

Our investment views

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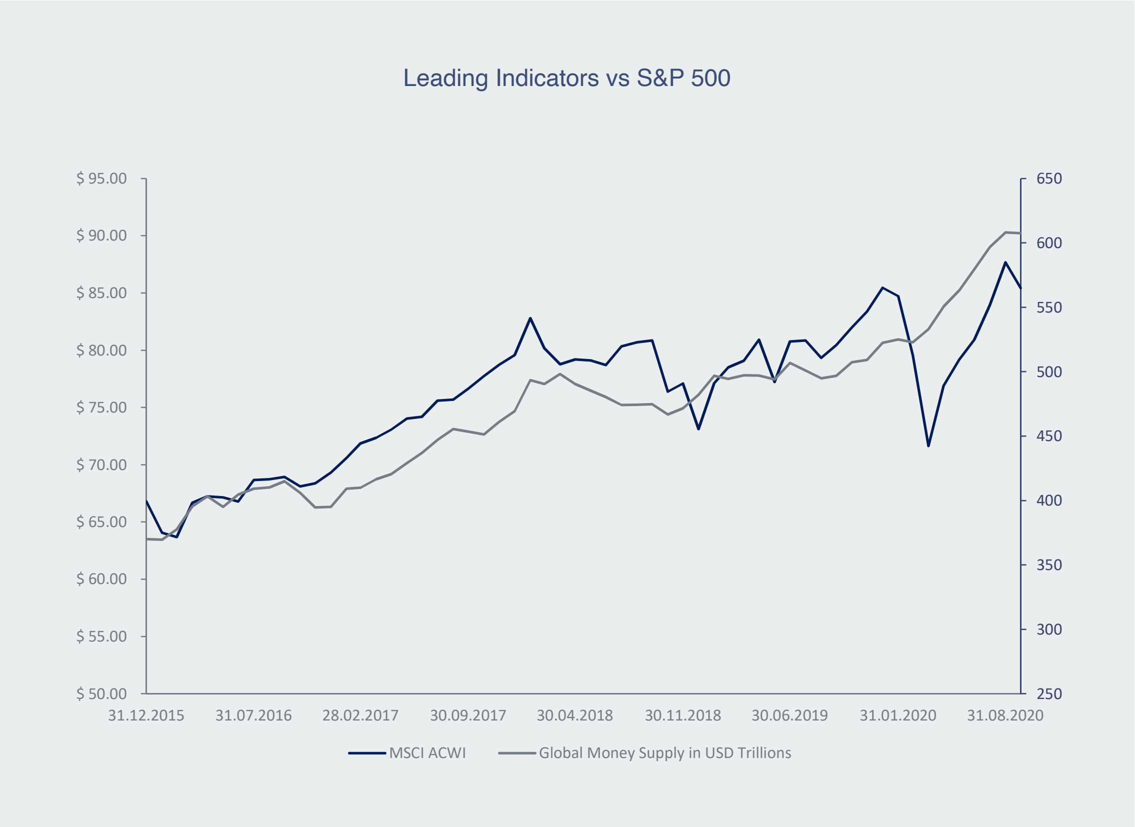



With this document, we are pleased to share with you our views and investment recommendations for the fourth quarter of 2020.

Quarters go by but the COVID-19 pandemic remains our major concern. Indeed, the new increase in cases in Europe shows that the epidemic episode is not over and seems with us for a long time to come.

With this particular context as a backdrop, in this publication, we will deal with our expectations regarding the virus and its impact on the economic recovery, but also with the results of companies and the American elections.

# We are in the second wave

We have been talking about the risk of a second wave for several months and trying to assess the potential consequences. As we explained in our previous publications, the second wave that hit the United States from June showed a sharp rise in cases with a stable death toll, if not lower than in the spring. This is now confirmed.

The announcement of new daily cases peaked on 16 July and then slowed down until mid-September, dropping from 78,389 to 25,000. For the number of deaths, the peak was reached in August with 1,842 deaths recorded in a single day. In the first wave, the United States recorded 2,584 deaths per day at the height of the pandemic, i.e. 1.5 times higher.

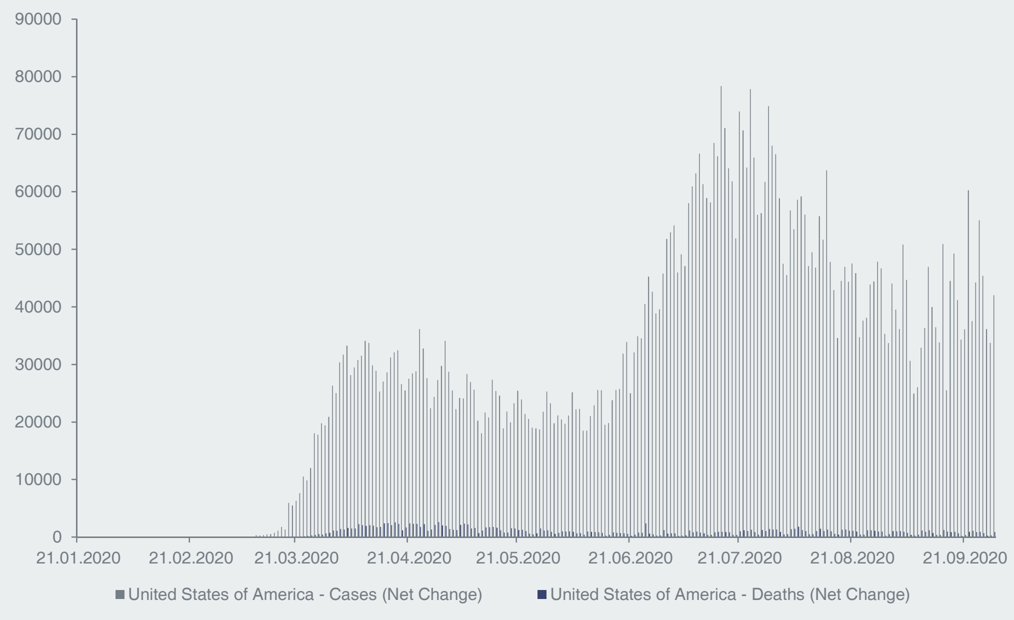
The decrease in the number of victims that we see today seems to be due to two main factors: first, better preparation and management of serious cases by the hospitals; secondly, a lower total number of contaminations even if the figure is not verifiable, because the test policy is less sustained during the second wave than during the first.

While this finding is encouraging from a health perspective, it is not enough to rule out any risk of local or generalised confinement, the impact of which can be significant for economic activity as well as for market volatility.

However, the main cause of the establishment of confinement is directly linked to the occupancy rate of intensive and resuscitation units by patients suffering from COVID-19. Governments in several countries have said this over and over again.

However, it is almost impossible to frequently retrieve this data, so we cannot rely on it to anticipate the establishment of a new confinement.

Evolution of daily net new cases and related deaths to Covid 19 in the USA



# A vaccine for the recovery?

Care should therefore be taken with the variability in the hospital occupancy rate, because if it increases rapidly, new uncertainties could emerge.

At the same time, many experts believe that the arrival of a vaccine will allay concerns. However, many people are worried about the side effects it might cause. So things are not that simple. All the more if the vaccine in question is being developed at an accelerated rate, with the pressure and the challenges that we know. Either way, we believe the arrival of a vaccine could bring a short-term easing in the markets.

But tensions and uncertainties could arise, especially in the event of low mobilisation of the population during the vaccination phase. States will therefore have to decide whether to make vaccination compulsory or optional; a decision that will be motivated by the resilience or not of their respective economies.

# Recovering indicators

In any case, the economic indicators published during the third quarter confirm the V-shape of the economic recovery. Even if this one remains incomplete, we are not in an L-shaped scenario.

Most of the guiding purchase indices have climbed above 50, whether in China, the United States or the eurozone.

The aggregation of leading indicators in the United States also confirms this V-shaped recovery. However, for the moment, it is impossible to tell how long this rebound will continue for.

The release of corporate results this next quarter will in any case give us a clearer picture of the situation.

# Earnings season results

As with the GDP figures, business results for the second quarter were better than expected by analysts. Despite the spectacular decline observed for the tourism and air traffic sector, the fall was relatively cushioned thanks to the technology, health care and consumer discretionary sectors.

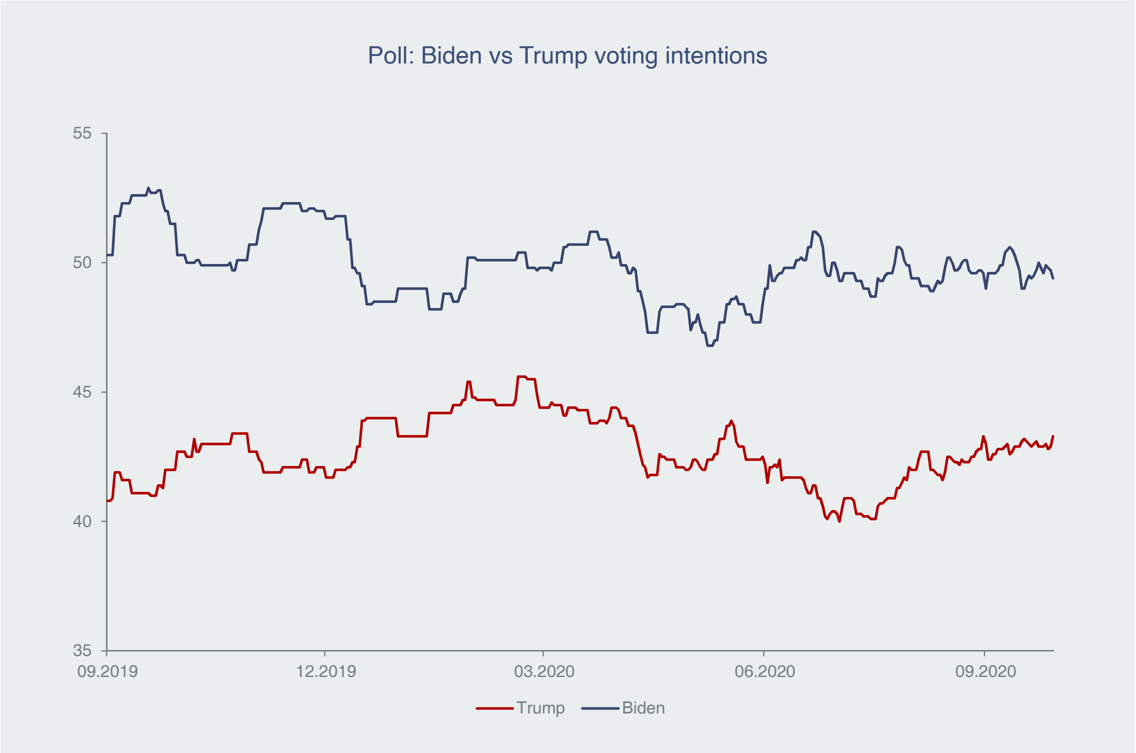
Their good performances made it possible to slow down the overall decline. This is why these stocks, which investors rushed to buy in early April, are now exceeding their pre-COVID peak.

We are now awaiting the third quarter's releases for which analysts have gradually raised their expectations. The momentum should therefore show a reversal, at least a stabilisation, for the markets to continue their advance or consolidate their levels.

In this context, it will be necessary to monitor the consumer discretionary and technology sectors very closely to see whether the first signs of slowing down are emerging or whether the momentum of recovery continues. In the first scenario, it is highly likely that governments will launch new fiscal stimulus programmes, especially in the United States.

It is also a safe bet that Donald Trump will do everything possible to find an agreement with Congress on the matter before the elections.

# Who will be the 46th President of the United States?




The presidential election in the United States is simmering in a very tense social context. Since the death of George Floyd, numerous and violent demonstrations have taken place, suggesting here and there scenes worthy of a civil war.

The growing divide between American citizens is also amplified by the positions of the two candidates who favour division and not unity. The COVID-19 crisis, which had already created a divide between pro and anti-masks, politicises the debates all the more, as they are continuously fuelled by the irresponsibility and inaction of Donald Trump. Despite this, the vote remains uncertain. If Joe Biden seemed, a quarter ago, to have reversed the trend in the polls to completely dominate Donald Trump, the 45th President of the United States has now bridged the gap with the Democratic candidate, to the surprise of all observers, to the point of suggesting a close vote. However, this scenario does not seem to be taken into account by the market.

Regardless of the winner, there is a high probability that the result will not be known by the morning of 4 November. If that was the case, we would have to take several factors into account. The first is Donald Trump's unpredictability and his failure to abide by the codes and rules of the US constitution and diplomacy. Asked by a journalist about a possible peaceful transfer of power in the event of defeat, he replied: «we're going to have to see what happens».

This reflection outraged the American political class, but it is not innocent. It aims to discredit postal voting, which he believes would promote fraud. Knowing that about 80% of these votes are Democrats, it is easy to understand Donald Trump's interest in refusing to include them in the ballot. The current President remains concerned, as the results are likely to be close. It is also possible that we will relive the situation of 2000 when George W. Bush won against Al Gore where the result was only known on 12 December, more than a month after the vote.

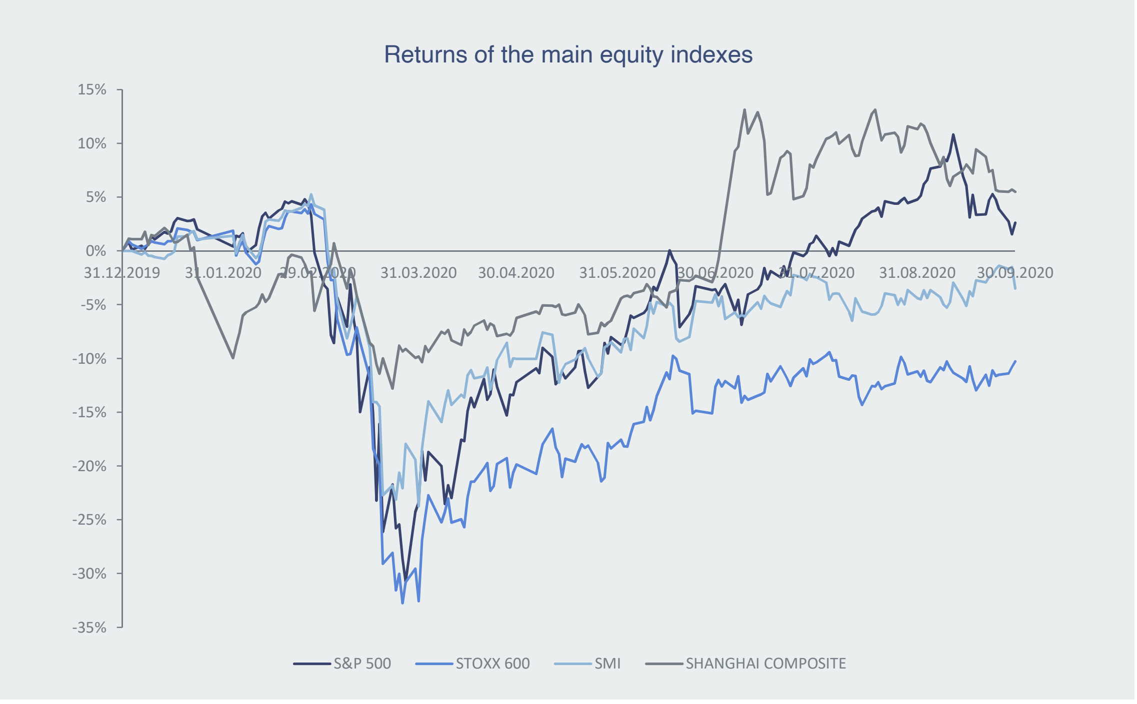
However, a strong lead from either candidate in pivotal states like Florida could prevent this from happening again. That way, we would not have to wait for a Supreme Court ruling on postal votes.

On the market side, the major risk therefore lies more in the uncertainty of the results than in the victory of one or the other of the candidates. Indeed, the programmes of both camps do not pose a danger to the short-term asset markets. Planned budgetary spending diverges, however, and sectors will not react in the same way depending on the outcome. While Donald Trump defends fossil fuels and an infrastructure plan that is a little vague, but based on the renovation of roads and bridges, Joe Biden proposes an environmental plan with impact reduction targets. In the first instance, the cyclical and relatively "value" sectors would be favoured while in the second instance, it would be growth stocks oriented towards energy transition that would benefit.

Before concluding, we must not forget thaton 3 November, elections will also be held to partially renew the Congress. As a reminder, Congress is made up of the Senate, controlled by the Republicans (53 seats against 47), and the House of Representatives, controlled by the Democrats. Note that for the first chamber, the upper chamber, a third of the seats will be «at stake», namely 35 seats including 12 Democrats and 23 Republicans. If the Democrats seem to have a mathematical advantage, the states brought into play on the side of the Grand Old Party are historically Republicans. A switch of the Senate to the side of the Democrats therefore seems unlikely. As for the lower chamber, there is uncertainty. Even if Joe Biden becomes the 46th President of the United States, it is highly likely that Congress will remain divided. This scenario risks leading to deadlock that would generate a lot of doubts for the markets and the economy at a time when it will be essential to act quickly and efficiently.

# Equities

Despite the correction that began in early September, the equity markets posted a positive performance in the third quarter until 28 September. Following on from the second quarter, the S&P 500 performed better during this period than the STOXX 600 and the SMI. The reason is the same as that mentioned in our previous publication: the champions of



the technology sector are American. With a total performance of 8.54% over the period versus 1.36% and 2.70% respectively for the European index and the Swiss index, the S&P 500 is doing well. As for China - which is a strong conviction in our portfolios it has outperformed the American market, namely + 9.02% over the period for the Shanghai Composite.

The world's second-largest economy has absorbed the shock of the coronavirus better from an economic point of view. In addition, equity market valuations are more attractive than anywhere else. To be convinced, note that the S&P 500 is currently worth 25 times earnings, compared to 18 times for the Shanghai Composite, which explains the better resistance of Chinese equities during the correction observed in September.

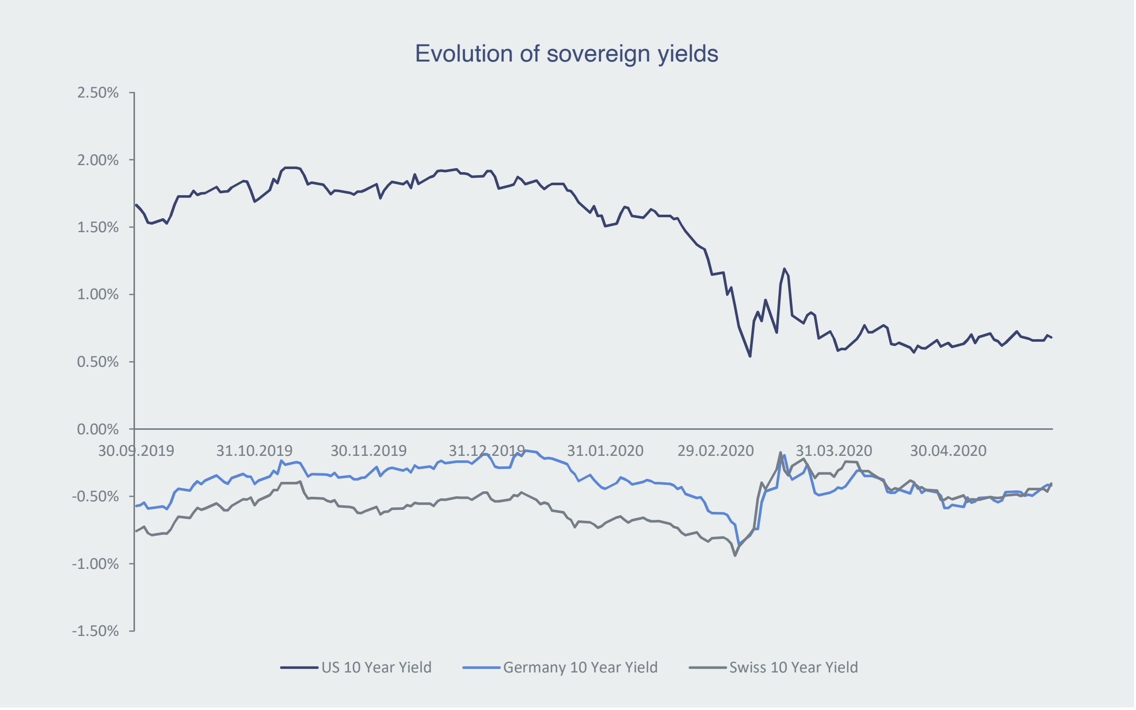
In this context, we changed our equity allocation from "neutral" to "overweight". This movement includes the addition of new positions in companies that seem promising in the long term such as Ali Baba, Nike, Uber, Ericsson or Volkswagen. We believe that the correction in September is an opportunity to return to interesting levels on quality names that show stable growth.

# Bonds

Corporate bonds in USD, EUR and CHF had a strong quarter with widespread compression of credit spreads between sovereign bonds and credit. However, the EUR and CHF pockets held up better. They were stable at the end of the quarter against the USD, which suffered a little more sharply from the correction in September.

This context enabled us to continue our arbitrations. Furthermore, we took profits on a lot of positions to get attractive returns. However, we remain slightly "underweight" in bonds in order to allow greater exposure to equities and alternative investments.

Based on announcements from major central banks and announcements of new fiscal stimulus plans, we will need to continue to monitor developments in long rates. We will also pay particular attention to investor interest in bonds to finance projects aimed at reducing the negative impact of companies on the environment. Demand seems high and we are thinking of devoting a pocket to this theme in the portfolios.



# Alternative investments

The allocation to alternative investments increased during the quarter, notably with the taking of a tactical position in silver. We note that the decline in the USD as well as the decline in US real rates have a carry effect on precious metals.

Gold and silver should further benefit from this buoyant environment. Regarding funds, we are happy to add a very good Long / Short fund on European equities. This is the Pictet Agora, which has an excellent investment process, allowing it in particular to benefit from mergers and acquisitions.

It also deploys a strategy comprising low volatility, a low maximum decline and a strong decorrelation. In addition, this fund has not experienced a year with a negative calendar performance since 2012, which shows a solid and rigorous investment process.

# Conclusion

The next quarter will be subject to the pandemic evolution, the release of corporate results and the presidential election. It is therefore a turning point.

This is all the more true as the outcome of the American elections could bring substantial movements in several sectors. It will also be necessary to carefully observe the various announcements that could be made by central banks and governments in relation to potential future support plans.

In this context, the announcement effects could support the dynamics in place on risky assets, such as creating a period of uncertainty. We will therefore monitor these developments closely and remain cautious in our investment strategy.

However, this will not prevent us from taking advantage of the current context, which is favourable for risky assets while keeping in mind the advent of new waves of volatility. To maintain the strength of the portfolios, we favour strong diversification and will do everything possible to optimise and reduce the impact of market movements.

Of course, we remain at your entire disposal to assist you in this complex, but promising, period.


**Dominique De Riaz**
*Chief Executive Officer*

**Hugo Derny**
*Investment Strategist*

# Asset allocation

| | UNDERWEIGHT | SLIGHTLY UNDERWEIGHT | NEUTRAL | SLIGHTLY OVERWEIGHT | OVERWEIGHT |
|---|---|---|---|---|---|
| **EQUITY** | ○ | ○ | ○ | → | ● |
| World Equities | ○ | ● | ○ | ○ | ○ |
| US Equities | ○ | ○ | ○ | ● | ○ |
| European Equities | ○ | ● | ○ | ○ | ○ |
| Swiss Equities | ○ | ● | ○ | ○ | ○ |
| Emerging Equities | ○ | ○ | ○ | ● | ○ |
| **FIXED INCOME** | ○ | ● | ← | ○ | ○ |
| Investment Grade | ○ | ○ | ● ← | ○ | ○ |
| High Yield | ○ | ○ | ○ | ● | ○ |
| Emerging Markets | ○ | ○ | ○ | → ● | ○ |
| Government Bonds | ● | ○ | ○ | ○ | ○ |
| **ALTERNATIVE INVESTMENTS** | ○ | ○ | ● | ○ | ○ |
| Metals | ○ | ○ | ○ | → ● | ○ |
| Alternative Funds | ○ | ○ | ● | ○ | ○ |
| **CASH** | ● ← | ○ | ○ | ○ | ○ |

Based on 12-month forecasts

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