Investment Strategy

July 2020

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Graph sources: Bloomberg/BBGI Group

INTRODUCTION

Letter to investors – Investment climate

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The second quarter of 2020 will have been one of the best quarters for equity markets, which, despite the confinement of populations, posted among the best quarterly performances in the last twenty years. The stock market's sharp rebound beginning in April is reminiscent of the Q1 2019 rally following the stock market panic of the last months of 2018. This complete trend reversal occurred extremely quickly and, in some cases, almost completely erased the losses of February and March.

As the global pandemic took hold in February and gained momentum, the expected effects on financial markets began to materialise and quickly led to stock market panic and one of the fastest and most intense bear markets in recent history. A few weeks later, as the pandemic spread across Europe and began to affect the United States and other regions more markedly, the containment measures implemented in most countries were already stoking strong fears regarding the immediate future of global economic growth. And yet, as confined populations observed the effects of the ongoing health crisis in anguish, and as economic statistics began to indicate its dramatic effects on growth, the pandemic had already stopped scaring active investors. This renewed sense of optimism was likely boosted not so much by the hope for a future vaccine or treatment for Covid-19 as by the massive injections of liquidity by central banks. Central banks' rapid reactions were indeed decisive in reassuring financial markets.

We already mentioned in our previous "Investment Strategy" that the strength of their commitment to adopting flexible monetary policies for the long term would be such as to reverse negative investor sentiment. In the meantime, central banks' key interest rate cuts and massive asset purchases, which had already initially led to a flattening of yield curves, have been reinforced, thus providing further visibility on the evolution of monetary policies in 2020 and 2021. On the government side, the various support and economic stimulus plans already announced during the stock market shock were also expanded and will likely provide greater support for the economic recovery expected in the second half of the year.

The Covid-19 crisis will clearly have lasting repercussions on government budgets and fiscal policies. A new paradigm has been established that will support a lasting increase in public spending and its logical consequence, the forced monetisation of the debt issued via central banks' unlimited asset purchases. In this health context marked by an increase in cases and deaths in the world, with official figures now reaching 11.4 million infected people and 533,000 deaths, financial markets very quickly looked far beyond the trough and bet on a solid and rapid economic recovery. In the US in particular, which has recorded close to 2,900,000 cases and more than 130,000 deaths, markets have continuously astonished observers with their lack of reaction to the deterioration of events, both locally and internationally. Indeed, the S&P500 was up +12.8% in April, already posting its best monthly performance since 1987. Since the low point reached in the third week of March, the magnitude of the rebound was even greater, approaching +35% for the S&P500 and +31% for the SPI index.

In six weeks, the March correction was erased, and at the end of June, stocks recorded their best quarter since 1998 with a +20.5% rise for the S&P500, +17.78% for the SX5E index and a +9.86% rebound for the SPI. However, most of the increase occurred at the beginning of the period, since after the strong rally in April, May and June were characterised by low volatility and weak stock market trends for most asset classes. The performance of most equity markets in May and June was thus modest, and it was only thanks to a surge in the last two trading days that they managed to remain positive in June. In rate markets, the performance of Swiss franc bonds (+2.15%) and international bonds (+3.32%) was also modest. Central banks' actions nevertheless still played a stabilising role with regard to yield curves, with the Australian and Canadian dollar markets, followed by emerging markets and high yield, benefiting most from this context at the end of the quarter. Swiss real estate was little affected by the Covid-19 crisis, while international real estate (+9.93%) as well as private equity (+23.4%) and hedge funds (+6.06%) recouped part of their Q1 losses. The rise in the markets and the almost euphoric stock market climate associated with it now stand in very sharp contrast to the still very uncertain health and economic environments that continue to prevail, suggesting a return to a cautious investment strategy. On a macroeconomic level, growth will undoubtedly bottom out in Q2, while hopes of an economic upswing in Q3 are now strengthened by the gradual deconfinement underway in most regions.

Nevertheless, we believe that this economic recovery will remain modest in H2. Hence, the sense of optimism observed at the beginning of the summer already seems excessive to us, especially since, even if 2021 is given a boost by very accommodative budgetary, fiscal and monetary policies, growth over two years (2020-2021) will barely be positive. The same will undoubtedly be true of corporate profits, which in this context will only be able to compensate in 2021 for the losses of 2020. How then can we figure that financial markets, which are now trading at levels close to those prevailing before the Covid-19 crisis, represent an opportunity? After suggesting caution in January, our strategy note at the beginning of April recommended a return to risky assets. However, following the extraordinary rebounds in financial asset prices in recent months, we recommend adopting a slightly more defensive equity strategy once again, due in particular to the fact that valuations have returned to very high levels.

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