Für Ihr Vermögen.

FACTUM

Investment Report

July 2021

Factum AG
Current positioning:

Portfolio “balanced”	Neutral	Current	Change*
Liquidity	3%	9%	→
Bonds	37%	29%	→
Equities	45%	47%	→
Alternative investments	15%	15%	→

**Changes since the last Investment Report (02 June 2021) & current assessment.*

Strategy overview

The first and second quarters developed very differently. Due to improved growth prospects, yields on 10-year US government bonds rose significantly and helped value stocks outperform growth stocks by a considerable margin. Gold was one of the worst performing asset classes due to increased real interest rates. The tide turned to a certain extent in the second quarter. Interest rates have fallen, helping established tech stocks and gold to recover from their lows.

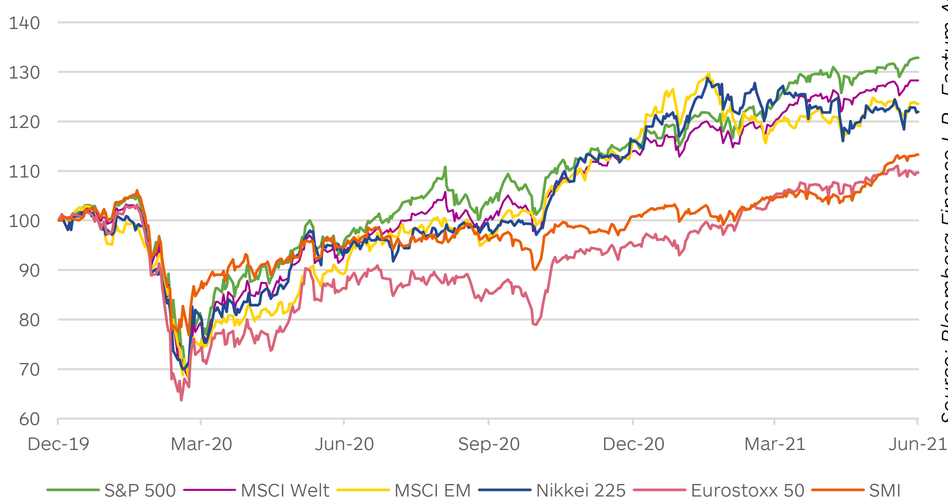
“The first and second quarters developed very differently.”

The latest collection of reference data confirms our assessment that the global economic upswing is continuing, monetary policy remains expansionary – albeit not to the same extent – and the current “overshooting” inflation figures are only temporary in nature. Earnings expectations are being revised significantly upwards by analysts due to the stronger-than-expected recovery. Within this context, we still consider a slight overweight in equities to be justified.

“The global economic recovery is continuing – we take the view that a moderate overweight in equities is justified.”

The coronavirus pandemic continues to dominate day-to-day news, but from an investor's point of view it has receded into the distance, as the following chart shows.

"Equity markets post a fantastic performance."



Since bottoming out in March 2020, global equity indices have recovered significantly. For example, the global equity index MSCI World gained almost 90%. In Switzerland, the upswing was less pronounced, with a gain of almost 50%. This can be attributed to the fact that the local market is more defensively positioned due to the composition of the index and consequently had less ground to lose during the downturn.

In terms of investment policy, it is worth mentioning in respect of the second quarter that we raised the ratio of world equities in our managed mandates. We did this after the setback at the beginning of May. Including the total risk budget, we have raised the ratio to a slight overweight. This was implemented by adding a newly selected global equity fund, the Fidelity Global Focus Fund, with which we also expanded our US dollar exposure. At the same time as the increase, we trimmed the "SRI bias" implemented via ETF (partial sale of iShares MSCI World SRI ETFs). Of course, the Fidelity Fund also places importance on ESG criteria, but the methodology and the weighting of individual stocks is more balanced compared to the ETF.

"World equities ratio lifted."

Following the strong performance of the European equity market – the Eurostoxx 50 in Europe, for example, has risen around 16% this year – we closed our tactical overweight in European equities towards the end of May. After

"European equities reduced."

the sparkling catch-up race, “signs of fatigue” were apparent in our view. This prompted us to pursue profit-taking to benefit the liquidity ratio. However, if the European equity market suffers a setback, we could certainly raise this equity ratio once again.

Gold has not been one of the best-performing asset classes in the 2021 investment year, losing around 12% by the time it bottomed out in March of this year. Last year the yellow precious metal gained around 25%. After testing the low again, the gold price started to recover. The reasons for the price gains were burgeoning inflationary worries and the associated negative real interest rates as well as the renewed weakness of the US dollar. Geopolitical tensions as well as turbulence in cryptocurrencies also helped. We took advantage of the temporary price increase and reduced our tactical overweight to a neutral ratio in the second half of May.

“Reduction in the gold ratio to our neutral ratio.”

Politics

“We have a deal”. With these bold words, US President Joe Biden announced the agreement reached by a bipartisan group of senators at the end of June concerning infrastructure investments worth around USD 600 billion. This huge sum is to be used for new construction and mainly also for the repair of the road network, the expansion of broadband internet, the modernisation of the electricity utilities and for other projects in the USA.

“Biden heralds billions in infrastructure investment.”

This step may be seen as an initial breakthrough in Biden’s efforts to forge a broader compromise when it comes to infrastructure investment. However, caution is advised, because there is still no guarantee that the package will actually be adopted and come into force. Leading Democrats rightly argue that the compromise is only a fraction of the USD 4 trillion economic package that Biden presented earlier. This would entail even higher expenditure, but tax increases as well, which are not to be avoided.

“Democrats call for more.”

Like his predecessor Donald Trump, incumbent President Joe Biden holds his own negotiating skills in high regard. He says the agreement that has been reached reminds him of the days “when much was achieved in the United States Congress”. By this means he is endeavouring to reinforce the sense of change that he is always keen to create.

“Biden is striving to keep the spirit of optimism alive.”

On the other hand, many details of the presented framework have yet to be agreed and still need to be worked out. At the end of the day, the compromise adds an additional burden to the already substantial deficit US budget, even if some of the billions in coronavirus aid that have not yet been called up can be reallocated to other programmes. In overall terms, the Biden administration is planning to spend USD 6 trillion. The spending will not fade away. If big-spending politicians are to be believed, however, the enormous government spending on the never-never will pay off eventually because the economy will grow and later tax revenues will materialise. Unfortunately, this line of argument has an unpleasant after-taste, as the trend in public debt has been consistently upward over the past decades.

"Government debt continues to climb."

Expectations for the meeting between Biden and Putin in Geneva were low. But measured against expectations, the summit can be considered a success. Cautious signs of relaxation can be observed between the two great powers, whose relationship is at a low point. For example, the two heads of state agreed on new arms control talks. Military experts and diplomats from both sides are said to be working on a mechanism that could lead to the control of new and sophisticated weapons. The decisive factor will be how things develop in the coming months. It remains to be seen whether the strategic dialogue on arms control will be crowned with success, whether there will be a breakthrough on the release of prisoners and whether an agreement on cyber security can be reached. America is accusing Russia of being responsible for a massive hacking attack on ministries, authorities and companies in the USA. Unsurprisingly, Putin brushed off these accusations. All in all, the fact that dialogue has been resumed is something to be welcomed. But only time will tell whether agreement can actually be reached. This would undoubtedly benefit the world in terms of global security.

"What did the summit between Biden and Putin bring?"

Economy

The latest macroeconomic data confirms our view that the global economic recovery is gaining strength and breadth and that the economic outlook for the coming quarters remains favourable. On balance, economic data continues to come in ahead of analysts' expectations. A strong and sustainable upswing can be expected, especially in the industrialised countries of the West. In the West, due to the rapidly progressing vaccination campaign, the risk of new coronavirus outbreaks is much lower than it is in emerging economies, where vaccination rates are still modest in many countries.

"The global economic recovery is gaining strength and breadth."

Citi Economic Surprise Index – Eurozone

The positive economic outlook is also reflected by analysts' earnings expectations. For the coming twelve months, they are expecting robust earnings growth in the region of 20% in the US and as much as 27% in the Eurozone. In addition, the majority of earnings expectations in the Eurozone and the US continue to be adjusted upwards. On the other hand, we are well aware that economic momentum will inevitably decline in the coming months, as the high catch-up effects will diminish over time. In addition, investors are likely to be increasingly concerned with the question of how economic development will look in the "post-pandemic world" when states gradually withdraw their stimuli and central banks make their monetary policies somewhat less expansive. Moreover, the question of whether inflation is actually experiencing only a temporarily bounce cannot yet be definitively assessed. While arguments in favour of this are perfectly valid, ultimately future data will have to prove it.

"The US economy is firing on all cylinders."

The US economy is in the midst of a significant recovery, which is likely to have peaked in the second quarter that has just come to an end. A number of key leading indicators are pointing towards this, such as the Markit purchasing managers' indices published at the end of June. The PMI Composite, which tracks overall economic development, fell by no less than 4.8 points in June. However, the activity indicator is still at an exceptionally high level of 63.9 points. However, growth should remain clearly above the potential rate of growth in the coming quarters. The current huge price and cost pressures were also confirmed once again. Both industrial and service companies reported sharply rising costs triggered by supply bottlenecks and rising wages

due to tremendous difficulties when it came to recruiting new staff. As a rule, such higher costs are passed on to customers. The increase in sales prices was the second strongest since data collection began in October 2009.

"Europa is also in fine fettle."

Recent economic indicators from the Eurozone were again upbeat, underpinning the strong upswing we are anticipating. For example, the closely-watched Purchasing Managers' Index for the overall economy (PMI Composite) climbed to its highest level in 15 years. The renewed uptick in growth is due to the services sector, which benefited strongly from the opening steps. Consequently, business activity was as good as last seen before the financial crisis in July 2007. Growth in industry has also remained at a record high (63.1 points). At the country level, momentum in Germany increased surprisingly strongly, while the purchasing managers' indices for France fell somewhat short of the high expectations. Incoming orders in the Eurozone rose sharply again and the business outlook climbed to a record high within a year. Accordingly, job creation was the highest in almost three years. However, because supply cannot keep up with rapidly growing demand, there are enormous supply bottlenecks and inventories are exceptionally low. Input prices therefore increased markedly across the board. In the services sector, higher supplier prices, increased fuel and transport costs and higher wages are also squeezing profit margins. Companies therefore increased sales prices more than at any time since the data began to be collected in 2002. There is no sign of this situation easing in the short term. Overall, however, we consider price and cost pressures to be only temporary.

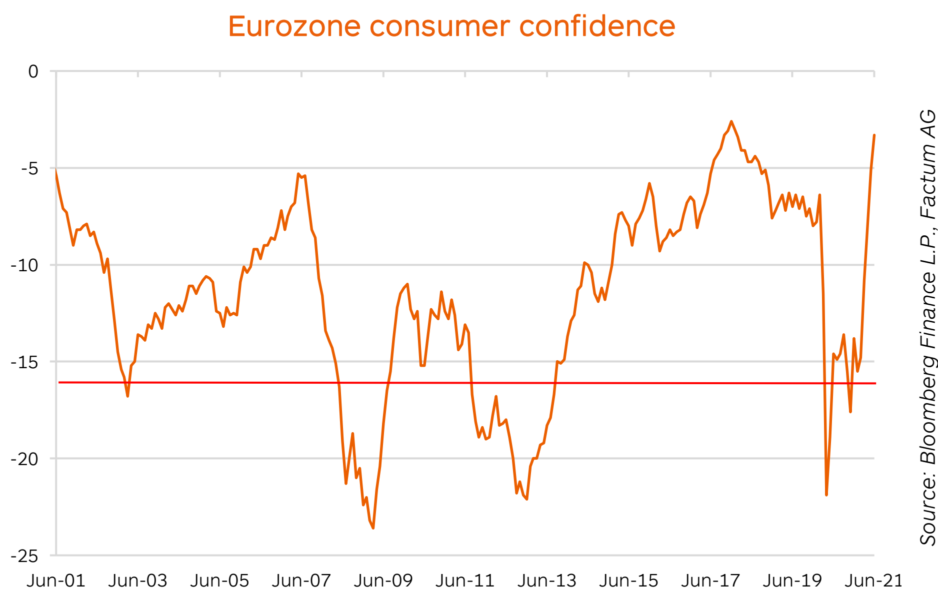
"The German ifo Business Climate Index climbed to its highest level since June 2018.

Good PMI data is also confirmed by national survey results. In June, the German ifo Business Climate Index climbed to its highest level since November 2018. The approximately 9,000 German companies surveyed rated both the current business situation and the outlook for the coming six months considerably better than in the previous month. For the first time since the beginning of the pandemic, the current situation was assessed better than at the beginning of 2020, and the index for business expectations reached its highest value in over a decade. In the view of the ifo Institute, the German economy is increasingly leaving the coronavirus crisis behind. The improvement in sentiment is again broad-based and extends across all economic sectors. In France and Italy, the business climate even reached a 14-year high in June. With the opening up of the economy and the easing of restrictions, the mood within the service sector in particular brightened considerably.

"Consumer confidence in Europe continues to brighten."

In view of falling infection figures, rapid progress when it comes to rolling out vaccines and the gradual easing of restrictions, consumer confidence in the

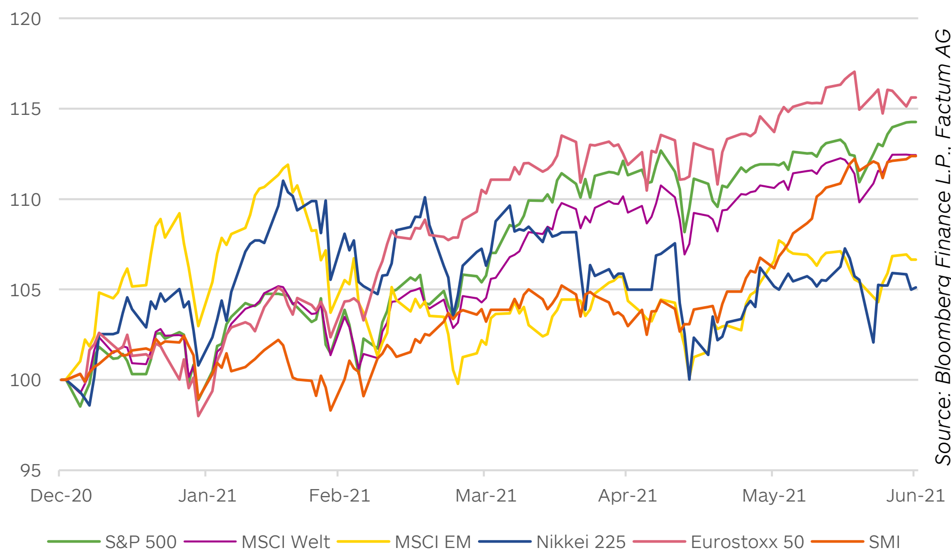
Eurozone also continued to improve in June – for the fifth month in succession. The European Commission's sentiment indicator increased from -5.1 to -3.3 points to reach its highest level in almost three and a half years. Consumer sentiment is now significantly better than it had been before the outbreak of the pandemic, and the indicator is also markedly above the long-term average.



Equity markets

The recovery of economic activity and corporate earnings is progressing apace. This is clearly reflected by quarterly results in the US as well as Europe. In both regions, over 70% of quarterly results were better than analysts' consensus forecasts. The same can be said for sales. In addition, positive corporate earnings surprises were also well above average by historical standards. Underlying effects also meant that European earnings growth was particularly strong compared to America. With share price performance lagging behind the US in 2020, European equities still have catch-up potential this year. Due to the composition of the index, that is to say the stronger weighting of the "value stocks" factor compared to "growth stocks", European indices could provide support this year compared to their American counterparts.

"The recovery in corporate earnings is progressing."



When it comes to emerging markets, we are slightly positive at present. While the valuation is attractive, coronavirus problems are currently weighing on these markets. We are currently neutral on the Swiss equity market, even though the valuation appears attractive compared to the global equity index and the quality and defensive orientation of the index heavyweights is appealing, especially if markets become jittery. We remain convinced that there is still a constructive environment for equities, but with inflation now pointing upwards, it is likely to be only a matter of time before capital market interest rates, which have now paused for a while, start to rise again. There is no doubt that we are no longer in the most favourable "Goldilocks phase", but equities still remain more interesting than bonds, which remain very low-yielding from a historic perspective.

"The Goldilocks phase is probably over, yet equities remain more interesting than bonds."

Bond markets

The US Federal Reserve made "hawkish noises" at its meeting in mid-June. Although the US monetary authorities have not yet given a clear signal for tapering, the discussion has begun. The timing of the taper remains uncertain. The Fed wants more data, especially on the labour market, showing that further substantial progress has been made. US Federal Reserve Chair Powell says that progress has been made, but that it is not yet sufficient to signal a reduction in bond purchases. Powell noted that this progress would be assessed at each of the upcoming meetings. We believe that two or three favourable labour market reports could be enough to give the go-ahead for a

"Hawkish sounds from the Fed meeting."

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reduction in bond purchases in August or September, either at the end of the year or otherwise at the beginning of the new year. Tapering is likely to take about a year after that before the ground is set for an increase in key interest rates.

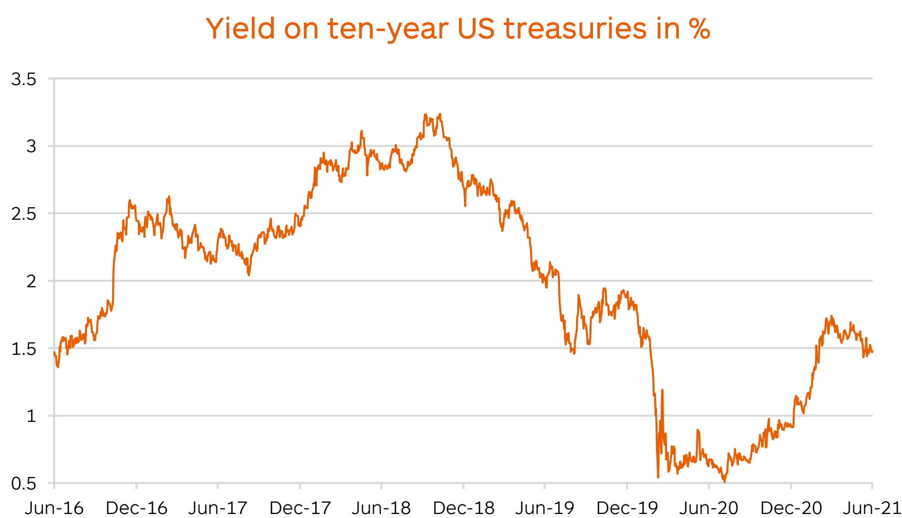
The currently less favourable price environment has nevertheless been reflected in a reassessment of the appropriate policy rate path. The median key interest rate forecasts in the dot plot now envisage two rate hikes of 25 basis points by the end of 2023. In the March projections, the monetary authorities did not expect a first rate hike until 2024. Of the 18 Fed decision makers, 13 expect at least one rate hike by the end of 2023, compared to only 7 in March. For 2022, 7 of the 18 Fed representatives are now expecting at least one interest rate hike (compared with 4 in March). This means that here likewise, only two monetary watchdogs are missing for the median for 2022 to rise and signal an interest rate hike. The US Federal Reserve is clearly looking to tighten the roadmap for interest rate hikes. According to Fed Chair Powell, however, the significance of the dot plot should not be over-interpreted. He explicitly emphasised that the dots are not a great prediction for future interest rate movements. The main message of the projections and dot plot, he said, was simply that many meeting participants were more confident and that progress towards the Fed's targets may come more quickly than had previously been thought. Despite the looming tightening of the timetable for the first rate hike, the Fed remains confident that it can make a slow exit from the ultra-loose monetary policy. This is realistic if it is correct in its assessment that the increase in inflation is mainly being driven by temporary factors and will slip back once again next year. Financial markets clearly take a similar view. There is no other explanation for the continuing low yields. In the months ahead, however, when the one-off effects are no longer relevant, we will see whether this assessment is correct. In overall terms, we see our forecast confirmed that the Fed will start tapering at the end of this year or in early 2022 and will decide on a first rate hike in 2023. For equity markets, we see this as a course of action they can live with, as monetary policy will remain expansionary and support growth for a considerable time to come. This also means the earnings outlook for companies remains excellent. However, risks for stockmarkets increase if the rise in inflation were to prove more persistent, meaning that monetary policies would have to react to this. There are few signs of this at the present time, though. On the other hand, key interest rate hikes in the sense of a normalisation of monetary policy due to the quicker-than-expected hitting of employment targets as well as sustained strong growth prospects are less of a problem

"Of the 18 Fed members, the majority are expecting a rate hike by the end of 2023."

for stockmarkets. Nevertheless, with the looming change in US monetary policy, the path for equity markets is likely to become more unsettled.

Yields on 10-year US government bonds sank last quarter by around 25 basis points to 1.48%, notwithstanding high inflationary pressures. This clearly suggests that the bond market has fully priced in the Fed's view that inflation will only be short-lived and has focused on the negative surprises in the labour market.

"The yield on 10-year US Treasury bonds fell 25 basis points in Q2 to 1.48%."



Source: Bloomberg Finance L.P., Factum AG

Yields on high-quality government bonds are still at historically low levels and not interesting. To generate acceptable returns, we are investing in a mix of government and corporate bonds and inter alia use funds with active duration management. We are currently neutrally weighted in inflation-protected bonds and emerging market bonds. In the latter, we are focussing on hard currency bonds as well as an active manager in Chinese bonds (hard and local currency).

Commodities

Since we reduced gold to neutral in the second half of May, the price of the yellow precious metal has fallen by around USD 120 (-6.5%). Following the Fed meeting in mid-June, the price of gold lost considerable ground. The mix of falling nominal yields and a rising US dollar are the most important reasons for this. However, it is still very likely that the scenario favoured by central banks – of "controlled yield curves and simultaneously for the moment rising inflation, corresponding to negative real interest rates" – will materialise. This would have the effect of boosting demand for gold and other precious metals.

"The gold price has lost about 6.5% in value since we reduced the ratio."

In our view, the current price represents an interesting buying opportunity for an investor with a medium to long-term investment horizon. We also continue to view the shares of gold producers as attractive, as they have done their homework. The major producers have healthy balance sheets after years of consolidation in the industry, have attractive leverage in a strengthening gold price and the dividend outlook is positive. For this reason we are maintaining our tactical overweight in gold mines.

The oil price rose again due to a sharp rise in demand from industrialised countries thanks to the easing of coronavirus restrictions. OPEC+ countries adhere to the previous agreements regarding supply control. For commodities, the development of real interest rates is likely to be of particular relevance in the coming months. Within this context, particular attention should be paid to possible signals concerning more restrictive monetary policies by the most important central banks.

"Signs of a more restrictive monetary policy should be paid greater attention."

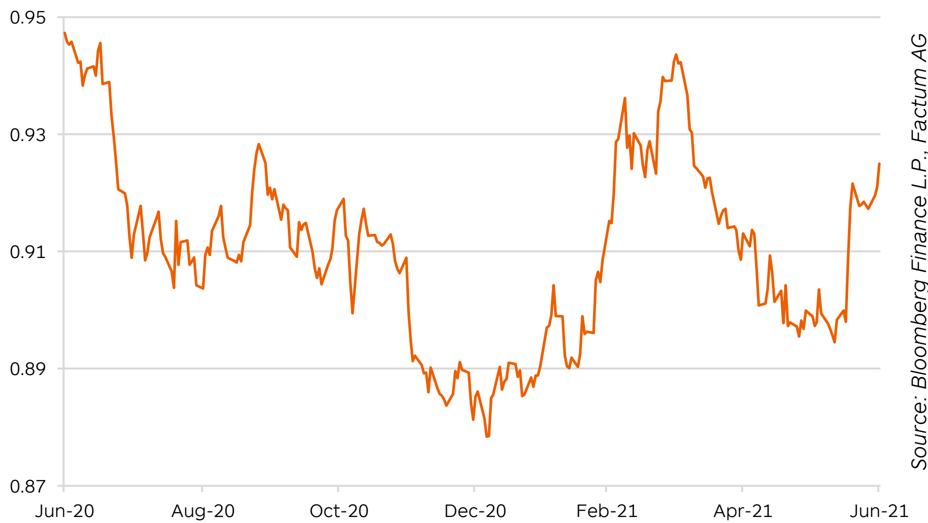
Currencies

The greenback responded promptly to the statements coming out of the FOMC meeting. The flatter yield curve with slightly higher yields at the short end helped the US dollar to a short-term gain of around 2.5%. This would not be anything unusual in itself, but due to the recent extremely low volatility on currency markets in recent months, this development is worth mentioning. The Fed is clearly thinking more intensively about the economic bottlenecks in its own country and about the notable rate of inflation, at least for the moment, than the majority of market watchers thought. As a consequence, it

"Greenback reacts to FOMC meeting."

has become more likely that it will take its foot off the monetary policy accelerator sooner rather than later.

USD/CHF over twelve months



If the Fed ensures that real interest rates on securities and contracts with short maturities rise, this will help the US dollar in the short term. A key takeaway from Fed Chair Powell's press conference was that the Federal Reserve's implicit calendar-based interest rate script was weakening, as he went on record to say that inflationary pressures in the current year could no longer be ignored.

True to our belief that foreign currencies are difficult to forecast and do not generate returns on their own, we had previously hedged most foreign currencies in our global bond and equity positions. Due to the temporary weakness of the USD, we decided to correct our extreme positioning somewhat at the beginning of May and increased the USD ratio in our portfolios with CHF, EUR and GBP as reference currencies. For an asset management mandate with the Balanced strategy, this step corresponds to an increase of 4%. We then invested these US dollars in a global equity fund at the end of May.

"Increase of USD ratio by 4% in our portfolios with reference currency CHF, EUR and GBP."

Market overview 30 June 2021

Equity indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	11,942.72	5.10	14.65
SPI	15,347.05	4.62	15.15
Euro Stoxx 50	4,064.30	0.70	16.59
Dow Jones	34,502.51	0.02	13.79
S&P 500	4,297.50	2.33	15.24
Nasdaq	14,503.95	5.55	12.92
Nikkei 225	28,791.53	-0.15	5.75
MSCI Emerging Countries	1,374.64	0.17	7.43
Commodities			
Gold (USD/fine ounce)	1,770.11	-7.17	-6.76
WTI oil (USD/barrel)	73.47	10.78	51.42
Bond markets			
US Treasury Bonds 10Y (USD)	1.47	-0.13	0.55
Swiss Eidgenossen 10Y (CHF)	-0.22	-0.06	0.33
German Bundesanleihen 10Y (EUR)	-0.21	-0.02	0.36
Currencies			
EUR/CHF	1.10	-0.20	1.45
USD/CHF	0.93	2.90	4.50
EUR/USD	1.19	-3.02	-2.93
GBP/CHF	1.28	0.14	5.76
JPY/CHF	0.83	1.51	-2.82
JPY/USD	0.01	-1.38	-7.02

Author: Christof Wille, Dipl. Private Banking Expert NDS
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