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FACTUM

Investment Report

October 2020

Factum AG
Current positioning:

Portfolio balanced	Neutral	Current	Change*
Liquidity	4%	7%	↘
Bonds	37%	29%	→
Convertible bonds	4%	0%	→
Shares	41%	47%	↗
Alternative investments	14%	17%	↗

**Changes since the last Investment Report (03 September 2020) & current assessment.*

Strategy overview

September saw the long-awaited 12% correction in the US technology stock-market. This aspect is almost irrelevant, however, as the Nasdaq Composite rose 75% between 23 March and 2 September of this year. It has risen 25% in value since the start of the year. In addition, an increase in Covid-19 cases in Europe, the Middle East and some emerging markets and more moderate economic activity undermined markets at times over the past month. Despite this, the past quarter was a successful one – for example, the broad MSCI World Stock Index gained 8%, as the following chart shows.

"Successful Q3 – the broad MSCI Global market Index gained 8% in value."

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MSCI World Index over 1 year

In contrast to the situation last spring, European governments have refrained from ordering nationwide lockdowns. The authorities in certain cities, such as Madrid, have however imposed severe restrictions. We remain firmly convinced that politicians will not reimpose nationwide lockdowns, especially since the increase in case numbers in some parts are due to greater testing and hospitalisations remain significantly below the level at the start of the year.

"When it comes to Covid-19, we are not expecting any nationwide lockdowns in Europe."

In the United States, Congress was unable to agree on an extension of the support measures in September. Deep party-political rifts are likely to increase as the US election campaign progresses. It may be assumed that President Trump will not accept a narrow defeat, in view of his negative attitude when it comes to postal voting. This would trigger chaos immediately after election day on 3 November, from which there is no easy legal or political way out. The analyst Josh Mendelsohn describes this scenario as the "red mirage" – an entirely plausible outcome. On election night, there might be a putative landslide Trump victory with almost exclusively red states, since Republicans go to the polls in person in far greater numbers than Democrats. On election night only about fifteen percent of the votes cast by mail are likely to have been counted. On the whole, significantly more Democrats tend to vote by mail than Republicans. As the remaining postal votes are counted over the course of the following days, the Republican lead would therefore melt away like snow in the sun until, once all these votes were counted, the Democrat Joe Biden would finally be declared the winner. It does not take much imagination to assume that President Trump is likely to

"When postal voters determine the result."

declare himself the winner on election night. Trump supporters, who comprise about a third of the electorate, would probably be convinced by this, encouraged by misleading information from social and alternative media. If they were led to believe that Trump's election victory had been "stolen", the situation could get out of hand.

"We took advantage of the volatility and increased our equity exposure."

We took advantage of the volatility in September to make adjustments to our portfolios. Stockmarkets corrected at the beginning of September – starting with US tech stocks. We still have conditional capital protection at the bottom and limited participation at the top through the bonus certificate. We made the most of the opportunity to increase our equity ratio (+4% in a balanced mandate). We did this through a global mid-cap investment fund that has an excellent track record and whose performance is less driven by the omnipresent large-caps Facebook, Apple, Amazon, Microsoft and Google.

"Raising the physical gold ratio."

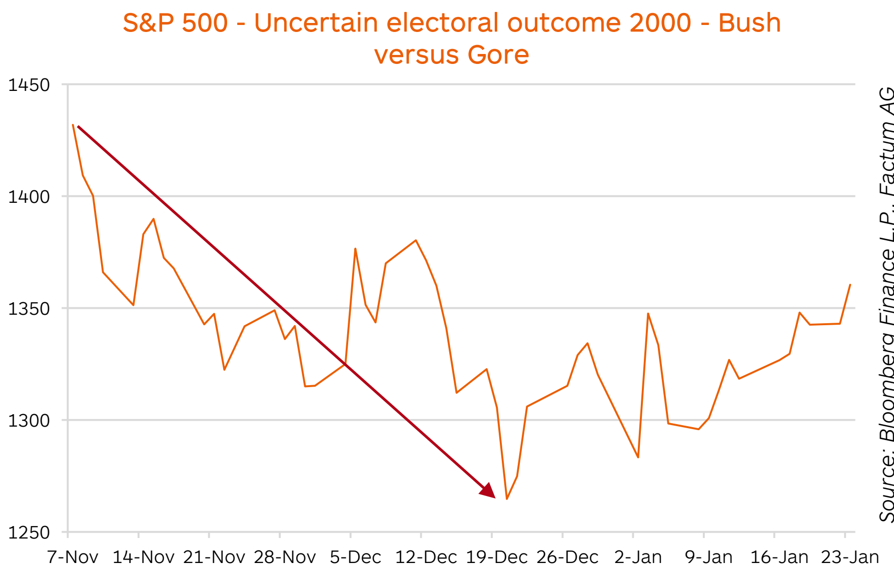
In our view, the price of gold is very well-supported from a fundamental perspective: Arguments for this include negative real interest rates, especially in US dollars, higher inflation rates that are being tolerated for the present by the FED and a latent US dollar weakness due to twin deficits and a dwindling interest rate advantage. Moreover, the alternatives when it comes to "traditional" risk-free investments in portfolio structures (namely government bonds) have become very expensive from a relative point of view and promise little protection in the event of a renewed phase of heightened risk aversion. Having taken the sharp rise in prices at the beginning of August as an opportunity to "rebalance" (partial disposal), we are using the current price slide to raise the ratio by up to 5% of the portfolio. Our current positioning is shown on Page 1 – at the asset class level. We continue to overweight liquidity. This enables us to benefit quickly from lower entry level prices in the event of market downturns.

Politics

"Unclear election results in 2000 put pressure on the stockmarket."

What recently caused additional jitters amongst financial market players is the forthcoming US presidential election due on 3 November. There are growing concerns that the outcome of the election might be contentious and that it will take time for a definitive election result to be announced. For the first time in US history, postal voting will become hugely important as a consequence of the Covid-19 pandemic. Recounts and potential legal proceedings could cause weeks of delays and even undermine the orderly transfer of power. This is reminiscent of the 2000 election, when George W. Bush ran against Al Gore and the result remained disputed for a considerable time.

The 2000 presidential election was ultimately decided in Florida, where the two candidates were very closely matched. Initially, the Republican Bush was in the lead, but after a recount in one electoral district, his lead narrowed. Gore went to the courts to push for further recounts. In the end, the Supreme Court ruled by a narrow majority of 5:4 votes that a recount in accordance with the constitution could not be guaranteed by the end of the statutory deadline, and therefore stopped the recounts. At the time, Bush was in the lead by 537 votes, gained the 29 members of the electoral college in Florida and thus won the US presidential election. On stockmarkets, the uncertain outcome of the election caused prices to tumble well into December, see graph below. The S&P 500, for example, lost around 12% of its value between election day on 7 November 2000 and mid-December.



The febrile atmosphere during the current election campaign could mean that neither of the two candidates acknowledges an election defeat. President Trump is adding fuel to the fire when, as occurred last week, he is unwilling to guarantee a peaceful transfer of power from today's perspective. Within this context, we are expecting a period of increased equity market volatility up until the US presidential elections and beyond. Once the race has been decided, however, fundamental factors are likely to prevail again. In our view, these still speak for equities.

"Increased volatility can be expected in the coming months."

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Economy

"Encouraging data from China."

The Chinese Purchasing Managers' Index for the manufacturing sector, which is compiled by the private polling agency Caixin, rose from 52.8 to reach 53.1 points in August. Production in particular was increased again. New orders also increased, with export orders growing again for the first time this year. August was the eighth consecutive month of job losses, but this time the drop was only marginal.

"At 52.0 points, the Indian Purchasing Managers' Index is above the growth threshold of 50 points."

At 52.0 points, India's Purchasing Managers' Index for the manufacturing sector climbed above the 50 point growth threshold in August for the first time since March. This means the Indian industrial sector has probably bottomed out. Further easing of the lockdown measures, which are extremely strict by global standards, enabled production to resume. After four months of contraction, new orders also posted a significant increase for the first time, driven primarily by the revival of domestic demand. Export demand, by contrast, declined once again. The government has now approved a further major easing of lockdown measures, despite high case numbers. For this reason, we are expecting a stronger resumption of economic activity over the weeks ahead. The Indian industrial sector will also benefit from this. Despite this, there is still a long way to go before pre-crisis levels are reached once again.

"Brazilian Purchasing Managers' Index records sharp rise."

Brazil's Purchasing Managers' Index for the manufacturing sector jumped from 58.2 to reach 64.7 points in August. This represents the third consecutive increase and the highest index value since the data began to be collated in 2006. Sub-indices for production, new orders and purchasing power also hit new highs. The strongest increase in employment since 2010 was also recorded. As a result, the industrial sector recovery is continuing to gain momentum.

"US data suggest that the recovery is set to continue."

Measured in terms of the provisional results of the Purchasing Managers' Survey in September, the economic recovery is continuing at a pace that is similar to that in August. The PMI for the manufacturing sector rose slightly from 53.1 to reach 53.5 points, marking its highest level since January 2019. By contrast, the Purchasing Managers' Index for the service sector fell slightly from 55.0 to 54.6 points. Nevertheless, it is still well above the growth threshold of 50 points, and represents the second strongest increase since March 2019. There was also a sharp rise in new orders, which reached the highest level seen in 18 months. As a consequence, employment growth continued at an encouraging pace, albeit at a slightly lower rate than in August. The overall index (PMI Composite), which combines the industrial and

service sectors, also fell slightly from 54.6 to 54.4 points due to the significantly higher weighting of the service sector. Despite this, it still points to continued attractive growth.

Economic growth in the Eurozone came to an unexpected halt in September, according to the monthly survey conducted by IHS Markit of around 5,000 representative firms. The Purchasing Managers' Index for the overall economy, the PMI Composite, fell sharply for the second consecutive month and at 50.1 points was only marginally above the growth threshold of 50 points. As had been the case in August, the renewed slowdown is exclusively attributable to the services sector, while the recovery on the industrial side gained momentum with unexpected vigour. PMI Services fell from 50.5 to reach 47.6 points, signalling that business activity amongst service providers has contracted for the first time since June. The recent rise in the number of new infections and a renewed tightening of lockdown measures in various countries are having a particularly serious impact on consumer-related service sectors. Order backlogs continued to shrink, while the pace of job losses slowed. Despite the difficult ongoing situation, the business outlook for companies is now as optimistic as it was last February, the final month before the outbreak of the Covid-19 pandemic in Europe.

"In the Eurozone, the PMI Composite declined for the second straight month."

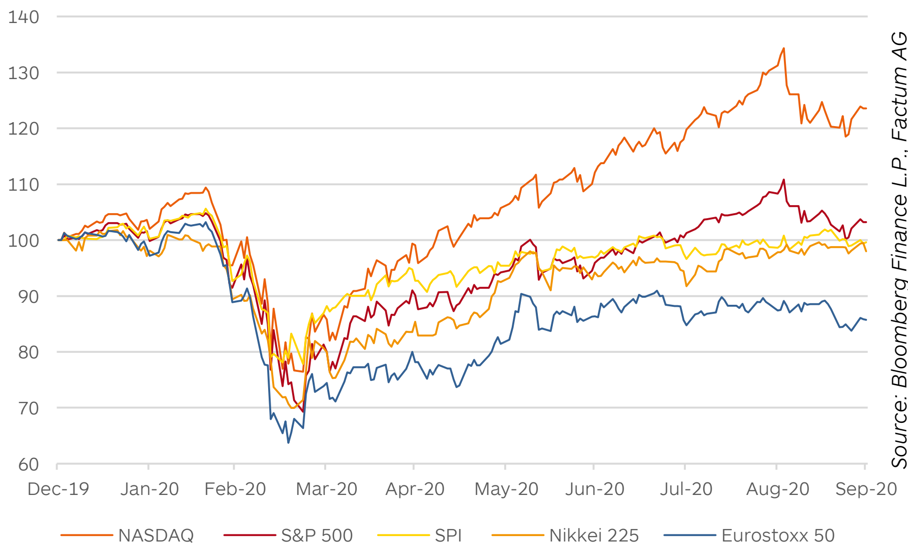
Different countries are performing differently, though. While growth remained strong in Germany, the French economy contracted for the first time in four months. In the other countries covered by the survey, business activity slowed even more than in the previous month. Firstly, purchasing managers' indices show that the recovery came to an almost complete standstill in September. Secondly, it is becoming clear that developments at the sector and country levels are increasingly out of sync. Countries with large service sectors and strict lockdown measures, such as France and Spain, are faring much worse than those with sizeable industrial sectors and lower infection rates, such as Germany and the Netherlands. Thirdly, the weak survey results confirm the view that the recovery will be weak and bumpy.

"Mixed picture at the country level in Europe."

Equity markets

Once again, the performance of global stockmarkets has been mixed. US indices have dominated, first and foremost the Nasdaq. This is illustrated by the following chart, showing the performance since the start of the year:

"The beginning of the end, or just a dip?"



Led by the major IT companies, the US technology exchange Nasdaq hit repeated new highs. For example, the relative market capitalisation of the five biggest IT companies rose briefly to account for 25% of the S&P 500, having been less than 20% at the start of the year. Valuations also rose to record levels, indicating that the market was overheating. Out of the blue, the fastest 10% correction of all time occurred in September. Since then, however, prices have recovered slightly. In our view, this represents a healthy and necessary consolidation of recent extremely rapid price gains, and does not point to a crash. We have currently given the IT sector a moderate overweighting, as we believe that topics such as social networks, automation, robotics, artificial intelligence etc. will dominate in the coming years.

Presidential candidate Biden has proposed a four-year USD 2 trillion plan to invest in infrastructure and clean energy. The programmes could result in an investment volume of over USD 4 trillion. Renewable energy would be a major beneficiary. In 2019, annual US energy consumption from renewable sources overtook coal consumption for the first time. Wind and solar energy could be given a strong boost under Biden. Fracking businesses would undoubtedly be amongst the biggest losers.

"Possible investment in infrastructure and clean energy in the USA."

Bond markets

"FED signalising zero interest rates for at least three years."

At its monetary policy meeting in September, the US Federal Reserve (FED) declared unequivocally that key US interest rates are set to remain close to zero for a very considerable period of time. It aims to maintain the target range at this level until labour market conditions have come into line with the currency watchdog's assessment of full employment, and until inflation has risen to 2% and is on course to edge above 2% for a protracted period. This is in line with the new strategy defined at the end of August, which set an average inflation target of 2%. The new performance-based forward guidance therefore sets the criteria for an interest rate increase in such a way that the conditions will not even be met by the end of 2023. According to the Fed's economic forecasts, PCE core inflation is not expected significantly to exceed 2% before the end of 2023. The message is also underscored by the Fed's Dot Plot analysis. The dot forecasts of individual Fed members for key interest rates up to the end of 2023 show practically no deviation from the current key interest rate level. Only one of the seventeen currency watchdogs expect interest rates to rise in 2022, and four out of seventeen in 2023.

"BoE could introduce negative interest rates if Brexit proves chaotic."

The monetary policy strategy pursued by the US Federal Reserve sets the stage for all other central banks. This means they too have considerable scope to continue their ultra-expansive monetary policies for a long time to come, or even to strengthen these. Financial markets, for example, are expecting both the ECB and the BoE to expand their quantitative easing policies still further. The BoE is even thinking about introducing negative interest rates, if there is a chaotic Brexit at the end of the year. Under Japan's new Prime Minister Suga, we are expecting similarly close cooperation between the BoJ and the government, meaning that the Bank of Japan is also set to remain ultra-expansive for the foreseeable future. At any rate, these monetary policy strategies pursued by central banks provide stockmarkets with welcome and lasting support. The popular saying: "Don't fight the FED" (or other central banks) remains as true today as it has always been, and remains an important driver of stockmarket sentiment.

Commodities

"We remain of the view that gold should be seen an established portfolio component."

As mentioned at the beginning of the Investment Report, we took advantage of the weaker gold price in September to increase our exposure. In addition to well-known factors of influence such as real interest rates, the US dollar or market jitters, supply and demand also play an important role. In particular, there has been no let-up in demand. This criterion is coming to the fore in an environment of slightly declining production, as mining statistics corroborate. Demand for jewellery almost halved to 570 tonnes in the first half of the

year. Here too, coronavirus is likely to have been a factor. However, the decline was almost entirely offset by central banks and financial instruments. We remain of the view that gold should be an established component of a managed portfolio.

Currencies

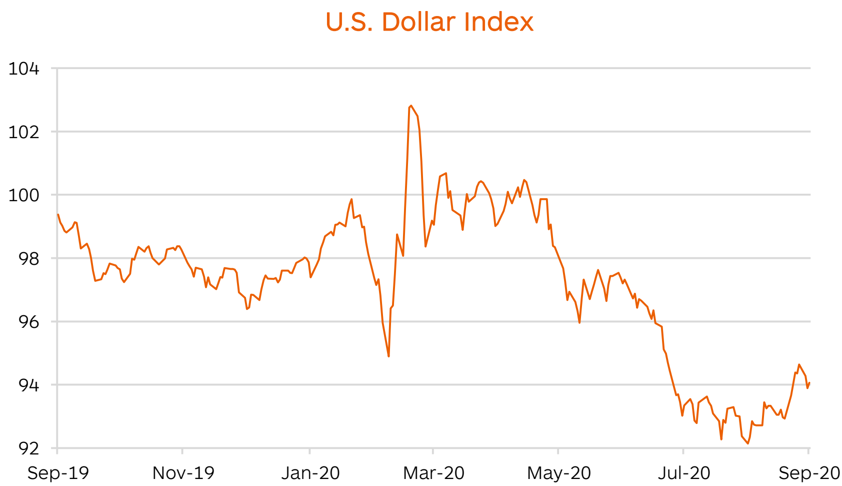
The value of the greenback eased 2% against the euro in September. Compared to the Eurozone, the United States has not been able slow the spread of coronavirus significantly. This aspect is having a detrimental impact on economic activity. The US dollar has lost some of its appeal, on account of the interest rate cuts pushed through by the FED. The Federal Reserve's expansionary approach is evidenced by the increased purchases of securities. Financial support was provided to tackle the coronavirus crisis, but this will significantly increase government debt. Although the unemployment rate has fallen, thanks to the partial lifting of lockdown restrictions, it remains high. In this environment, the FED will be keen to ensure favourable financing conditions for an extended period of time. A quick turnaround in US monetary policy is therefore not in sight. The FED will not consider normalising interest rates until the unemployment rate has fallen below 5%. Within this context, the US dollar is unlikely to strengthen significantly in the coming months. It is therefore very likely to settle down around the USD 1.20 per euro level.

"Weak US currency."

"The dollar is our currency, but your problem." In 1971, John Connally, US Treasury Secretary under President Richard Nixon, used this famous saying to point out the painful consequences of a weak dollar for other countries.

"At 62%, the US dollar still accounts for by far the largest share of global currency reserves."

Some fifty years later, the matter is as topical as ever. The dollar index – a barometer that compares the value of the US currency against a basket of international currencies – has dropped almost 10% since 20 March. At the same time, however, the US dollar has lost none of its special status as a global reserve currency. According to the International Monetary Fund, the dollar still accounts for by far the largest share of global currency reserves at 62%, followed by the euro at around 20%.



Source: Bloomberg Finance L.P., Factum AG

Market overview 30 September 2020

Stock indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	10,187.00	0.56	-0.89
SPI	12,724.65	0.52	-0.88
Euro Stoxx 50	3,193.61	-2.30	-12.58
Dow Jones	27,781.70	-2.18	-0.91
S&P 500	3,363.00	-3.80	5.57
Nasdaq	11,167.51	-5.11	25.40
Nikkei 225	23,182.12	0.67	-0.36
MSCI Emerging Countries	1,082.00	-1.62	-0.96
Commodities			
Gold (USD/fine ounce)	1,885.82	-4.17	24.28
WTI oil (USD/barrel)	40.22	-5.61	-36.19
Bond markets			
US Treasury Bonds 10Y (USD)	0.68	-0.02	-1.27
Swiss Eidgenossen 10Y (CHF)	-0.49	-0.09	-0.03
German Bundesanleihen 10Y (EUR)	-0.52	-0.14	-0.36
Currencies			
EUR/CHF	1.08	0.07	-0.55
USD/CHF	0.92	1.90	-4.63
EUR/USD	1.17	-1.80	4.45
GBP/CHF	1.19	-1.51	-7.78
JPY/CHF	0.87	2.31	-2.11
JPY/USD	0.01	0.43	2.76

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