Investment Report

August 2020

Factum AG
Current positioning:

Portfolio balanced	Neutral	Current	Change*
Liquidity	4%	11%	→
Bonds	37%	29%	→
Convertible bonds	4%	0%	→
Shares	41%	43%	→
Alternative investments	14%	17%	→

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

Strategy overview

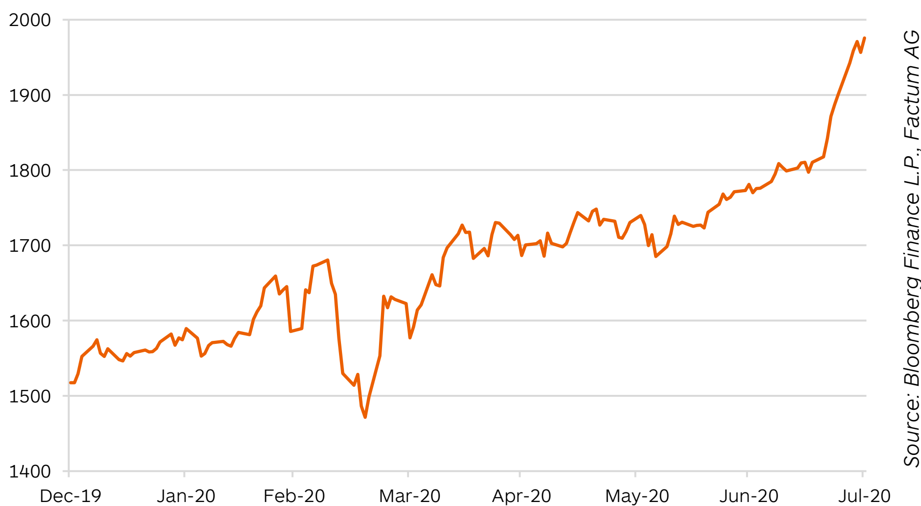
"Rebalancing the equity ratio in July."

Rising SARS-CoV-2 infection rates in the most populous US states, new provocations between America and China as well as rather disappointing US labour market data produced unsettled stockmarkets at the end of July. Our outlook remains constructive, however, as the expansive monetary and fiscal policies of major central banks are set to continue and will consequently support the markets. Bond yields remain at unattractive levels, meaning that a positive return can only be achieved with bonds by accepting higher credit or maturity risks. Due to the positive performance of global equity markets – the MSCI World is currently only about 4% below its all-time high of February 2020 – the ratio in the world equity segment has deviated from the tactical allocation (TAA). Acting anticyclically, we took advantage of the current market strength and reduced our exposure to the defined ratio by selling part of the ETF on Equities World and/or by reducing the gold mining equity fund, which recently outperformed the World Equity Index due to the positive development of the gold price.

We are sticking to the moderate overweighting of the equity ratio. We would consider a significant increase in this in the event of major market disruptions. As a result of the weaker US dollar, lower USD real yields and slightly higher inflation expectations, gold was able to gain a superb 10% to reach USD 1,975 per troy ounce in July. As the main drivers for the yellow precious metal remain intact, we are also maintaining our overweight.

"Gold posted an impressive 10% rise in July."

Gold YtD.



Politics

Tensions between the USA and China reached a new high last month. America ordered the Middle Kingdom to close the consulate in Houston with immediate effect. This was opened in 1979. The US State Department's decision was justified by claims that Beijing has been conducting illegal espionage and manipulation operations in the USA for years. The intellectual property and private information of Americans need protecting.

"Washington orders the surprise closure of the Chinese consulate in Texas."

The number of US soldiers in Germany is to be reduced by almost 12,000 – it had originally been assumed that that about 10,000 of the approximate 36,000 soldiers in Germany would be ordered back to America. The US Administration announced the partial withdrawal of troops in June, justifying it with what it considers to be insufficient defence expenditure. However, the final word has not yet been spoken on the implementation of the partial deduction. There is resistance in Congress from both Republicans and Democrats. During the Cold War, US troops were regarded as a guarantee of security for Germany. At the time, American soldiers in Germany numbered up to 250,000 at the peak. After the Berlin Wall fell, however, the numbers have

"Bigger US troop withdrawal in Germany than forecast."

been successively reduced, as the potential danger had decreased markedly.

"US elections approaching – time to examine certain clichés."

There are just under three months to go until the US presidential elections, which are also slowly but surely attracting media attention. At this point we would like to take a critical look at a number of clichés. It is often claimed, for example, that defence corporations benefit when Republican presidents are in power and IT companies make gains under Democratic presidents. However, there has never been a stock sector that has performed as impressively during the Trump era as IT – above all FAANG stocks. On the other hand, the stocks of the armaments industry are traditionally seen as beneficiaries of Republican presidential years. Unlike his five predecessors, however, Trump has not become embroiled in a single armed conflict. He has even proposed withdrawing troops from Syria as well as from Afghanistan. Despite this, there are persistent patterns that cannot be talked away. The Republican Party tends to block regulations that burden sectors such as oil and gas, chemicals and pharmaceuticals, while advocating more liberal legislation, which also benefits big banks. Democrats, by contrast, often advocate programmes that benefit industries such as construction and infrastructure as well as health insurers. It is also often argued that the Republicans are the more pro-business party. In actual fact, however, on average the S&P 500 posted more gains under a Democratic president than under a Republican one.

"Senate elections also decide whether and to what extent a president will be able to implement his agenda."

In addition to the presidential election, senatorial elections will also be held on 3 November. It is becoming apparent that this will be a neck-and-neck race between the two major parties. This same race will also decide whether and to what extent the president will be able to implement his agenda. In our view, the US elections may create uncertainty, at least in the short term. In the event of a Republican victory, the political scenery is likely to be more predictable. The Biden camp has been signalling that corporate tax could possibly be raised from 21% to 28%. Trump's tax cut in 2017 had a positive effect of around 10% on the profits of S&P 500 companies – Biden's proposal would reverse this.

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Economy

"Initial estimates for GDP figures."

As expected, the coronavirus crisis left deep scars in the second quarter. Following publication of initial GDP estimates during the last week of July, the damage can now be quantified with reasonable assurance. GDP in the Eurozone, for example, contracted 12.1% relative to the previous quarter. As a consequence, the currency zone's economy was pushed back to 2005 levels and 15 years of economic activity was wiped out in just two quarters. The worst hit in Q2 was Spain, whose GDP fell by 18.5% relative to the previous quarter, reflecting its high dependence on tourism and the hotel and hospitality industry. Other important European economies contracted as follows: Portugal (-14.1%), France (-13.8%), Belgium (-12.2%), Austria (-10.7%) and Germany (-10.1%). The US economy fared little better in the second quarter. In annualised terms, GDP fell by 32.9%, which, according to local criteria, corresponds to a GDP decline of 9.5% relative to the previous quarter. The US economy has not previously taken a hit of this magnitude since the Second World War. The fear of contagion and the lockdown led to significant downturns, particularly in investment and private consumption. In the interim, most economies have begun to recover. Initial progress has been encouragingly rapid and shows that the slump in growth was attributable mainly to the lockdowns. Thanks to the easing in many areas, the economy began to recover markedly from June onwards.

"Republicans and Democrats haggle over a further US fiscal package."

In the near future, fiscal and monetary policy support is likely to remain crucial. At the end of July, EU heads of state and government approved a EUR 750 billion reconstruction fund. The European Central Bank is also contributing to the recovery with an extensive bond purchase programme, which is likely to be stepped up again in the autumn. A new aid package is also currently being discussed in the United States. Continued subsidies for unemployment benefits are likely to be particularly important in this respect. At the present time, Republicans and Democrats are haggling over the size of the payout. In addition, according to both parties there is to be a new round of one-off payments made to households. At USD 300 billion, these are expected to be similar in size to those made in April. At that time there was a USD 1,200 payment per adult and USD 500 per child. These measures undoubtedly make good sense, as they will boost consumption and prevent the US economy from falling into another hole. It is expected that an additional fiscal stimulus of USD 1 to 1.5 trillion will be approved, which would correspond to 5-7% of GDP. This is likely to be finalised before Congress takes its summer break. Under normal circumstances, failure would not be an option for the two major parties in an election year.

Equity markets

Corporate earnings estimates for the current year have been revised considerably downwards as a result of the lockdown. The consensus is now looking at a global decline in earnings of up to 25%. In America, more estimates were revised upwards than downwards for the first time last month. However, due to various imponderables, many companies are not venturing to give precise details of the results that are to be expected during the second half of the year. In the USA, around 70% of the index members of the S&P 500 have released their quarterly results. Earnings expectations were exceeded by 85% of companies, well above the historical average of 73%. Despite this, the decline in earnings relative to the second quarter of last year, amounting to 41%, is the most pronounced since the final quarter of 2008. The principal arguments in favour of equities, however, continue to be the flood of liquidity from central banks, the extensive fiscal packages of governments and the concomitantly extremely low bond yields.

"Interest rates, which in our view are set to remain low for a long time to come, are the main reason why an excessively low equity ratio has its risks."

The massive recovery in the USA is mainly due to stocks in the IT and social media sectors. In the interim, the companies Facebook, Microsoft, Apple, Amazon, Netflix and Google account for some 22% of the S&P 500. Without these stocks, the broad US market would have performed far more modestly. We remain positive about these stocks, but also see a certain risk potential. One of the aspects that is currently still unclear is how US policy on regulating the key US technology corporations will turn out – although we are not expecting any significant headwind before the US presidential inauguration in January 2021.

"IT stocks dominate the market."

Bond markets

Bond markets continue to be dominated by central banks. Ever since the Fed began to focus on corporate bonds in its quantitative easing securities purchase programme, the yield gap between corporate and government bonds has steadily narrowed. Yields on first-class government bonds are still at very low levels and are not interesting. To achieve acceptable returns, we are investing in a mix of government and corporate bonds and inter alia use funds with active duration management. We currently have a neutral weighting for inflation-linked bonds. By contrast, we have overweighted emerging market bonds because they offer the most attractive maturity yields. Here we are focusing on hard currency bonds and on a product solution with short duration.

"Bond markets continue to be dominated by central banks."

The US Federal Reserve will also continue to support the economy. At their most recent meeting in July, as had been expected, the currency watchdogs made no adjustments to their monetary policy stance. However, they have made it clear that they will continue to use all monetary policy instruments at their disposal to support the recovery. This means key interest rates are set to remain very low for a very long time to come. Meanwhile, bond purchases are set to continue at least at the current level. In addition, the Fed extended a number of emergency measures, either until the end of the year or until next March. Powell remained pessimistic about the outlook, probably with the intention of keeping yields low.

"The Fed is not even thinking about raising interest rates."

Commodities

In the shadow of the gold rally, silver has also experienced a remarkable upward price trend after a short and sharp slump in March. But the drivers are not the same as those in the gold market.

"Remarkable performance of the silver price."

Silver - 5 years

Under normal circumstances, about half of the global demand for silver comes from industrial corporations that need the metal to produce solar panels or medical and electronic applications, for example. There is a saying that if the economy is running smoothly, the demand for "poor man's gold" increases. In retrospect, the start of the coronavirus crisis was a good time to enter the market, when silver was cheaper than ever before relative to gold. One troy ounce cost a 114th of the same amount of gold. Subsequently, a considerable volume of investor money flowed into silver exchange traded funds (ETF). The physical holdings of the funds has increased by 7,000 tonnes since March. This corresponds to the total production of all silver

mines worldwide over a period of three and a half months. Due to strong investor demand, the gold-silver ratio has returned to pre-crisis levels of over 1 to 80 and the silver price has also recovered since March, from USD 12.27 to just over USD 25, its highest level in seven years.

Currencies

The US dollar certainly has a special status on global financial markets. However, the euro is gaining in popularity because of the largest spending package in the history of the European Union. The European single currency gained around 5% in July to reach USD 1.18. A controversial aspect of the spending package is the fact that for the first time in their history all 27 member states are entering into joint liabilities on a major scale.

"Is the US dollar losing its status as the global reserve currency?"

At the present time, many investors are assuming that considerable amounts of money will flow into the European economy. According to their expectations, this is driving growth and corporate earnings and should have a positive impact on European securities. Only a few months ago – at the start of the coronavirus crisis – US securities and the US dollar were "en vogue". The reasons for this included the fact that America has the most flexible economic system, the most powerful army and, last but not least, the dollar as the global reserve currency. Many international bonds and loans are denominated in US dollars. This means the supply of dollars is regularly constrained when many market players hedge or behave differently than they would under normal circumstances. At present, it seems there is a shift in the relative attractiveness between the euro and the dollar. Irrespective of theoretical valuation models such as purchasing power parity, some investors are expecting capital flows from the US to Europe in future, which should further boost the euro.

"The euro continues its rise against the US dollar."

This means it is likely that the US dollar will continue to lose ground. There are also upsides to this scenario, though. American companies with strong revenues abroad could expect exchange rate gains. A weaker US dollar would undoubtedly also help various emerging markets. On the one hand, their dollar-denominated liabilities would then be easier to bear, and on the other hand, if the dollar weakens, energy and commodity prices tend to rise – and as a result the economies of resource-rich countries would be boosted. Price developments should not be allowed to get out of control, however, otherwise the over-indebted world will find itself in trouble.

"A weaker US dollar would help emerging economies."

Market overview 30 July 2020

Stock indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	10,005.90	-0.37	-2.70
SPI	12,407.39	-0.23	-3.35
Euro Stoxx 50	3,174.32	-1.52	-13.30
Dow Jones	26,428.32	2.51	-6.14
S&P 500	3,271.12	5.64	2.38
Nasdaq	10,745.27	6.85	20.46
Nikkei 225	21,710.00	-2.59	-7.17
MSCI Emerging Countries	1,078.92	9.01	-1.53
Commodities			
Gold (USD/fine ounce)	1,975.86	10.94	30.22
WTI oil (USD/barrel)	40.27	2.55	-34.05
Bond markets			
US Treasury Bonds 10Y (USD)	0.53	-0.13	-1.39
Swiss Eidgenossen 10Y (CHF)	-0.54	-0.10	-0.07
German Bundesanleihen 10Y (EUR)	-0.52	-0.07	-0.34
Currencies			
EUR/CHF	1.08	1.09	-0.90
USD/CHF	0.91	-3.63	-5.56
EUR/USD	1.18	4.84	5.04
GBP/CHF	1.19	1.71	-6.86
JPY/CHF	0.86	-1.70	-3.14
JPY/USD	0.01	1.96	2.63

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