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IMT GROUP

INVESTMENT OUTLOOK 07.2020

4 July 2020

While the corona virus continues to spread globally, unprecedented monetary and fiscal stimulus measures have cushioned the economic impact. The development of the pandemic differs hugely between countries and regions, depending on the policy response and socio-economic factors. Due to lockdown measures taken, most economic indicators fell drastically in April and May but have improved somewhat recently as the measures were eased.

Despite a global recession and a very clouded outlook, equity markets rallied strongly, pushing equity valuations to record highs. At the same time, bond yields remain at historic lows, with large parts of the global bond market in negative-yield territory.

In our view, this warrants a cautious stance, as risks are clearly skewed to the downside.

In order to track the developments in relation to Covid-19 we have added some charts on page 10 which we hope you will find interesting.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

STIMULUS VS PANDEMIC

Financial markets

Equity markets achieved a V-shaped recovery, implying that expectations are for a swift healing of the economy. The Chinese CSI 300 index has even gone up by 7.9% since the beginning of the year. In general, emerging equity markets underperformed developed markets. Among developed markets, Swiss and US equities performed best. The equity sectors which suffered most are energy, financials, real estate, and industrials. Health, technology, and US consumer staples, however, performed positively this year.

In June government-bond yields fell slightly. Bond markets remained very well supported by sizeable central-bank buying, which also included corporate bonds. This, together with a rising investors' risk appetite, led to significant credit-spread tightening. Break-even inflation rates rose from very depressed levels, which led to an outperformance of inflation-linked bonds.

Volatility in the currency markets rose strongly. The EUR/USD exchange rate underwent unusually wide fluctuations. The EUR strengthened in June against most major currencies. Many analysts expect the USD to weaken in the second half of 2020, since it looks expensive and the US interest-rate advantage diminished sharply on the back of huge liquidity injections by the US Fed. Safe-haven currencies, like the CHF and the JPY remained on the strong side.

Gold continues to rally. It surged another 3% in June, reaching almost USD 1,800 per ounce. The price of oil recovered from the devastating sell-off in February and March. The price for industrial metals was supported by a more optimistic growth outlook. REITS, however, have come under selling pressure and have lost more than 20% since the beginning of the year. The reason lies in concerns about tenants' ability to pay their rents and uncertainties on how the pandemic may have changed demand, especially for commercial and retail real estate.

Covid-19

We reached a level of almost 11.5 m corona cases worldwide with about 200,000 new cases each day, and the number of new cases continues to rise. While the number of new Covid cases has dropped significantly in Europe and Asia, the virus continues to spread viciously in the US and some emerging markets. Some countries have relaxed social distancing rules in recent weeks. As a result, the number of new cases has increased somewhat. It remains to be seen whether the increase will be large enough to classify it as a second wave.

So far the recession has not led to a strong increase in the US bankruptcy index, since fiscal measures have kept many companies afloat. Likewise, the record decline in US personal income has largely been compensated by state transfer payments.

The amount of monetary and fiscal stimulus has been unprecedented. For example, the US Fed almost doubled its balance sheet since the start of the corona outbreak. Many countries decided on fiscal measures which often come close to or exceed 5% of GDP. The US fiscal program even exceeds 10% of GDP and the Japanese program 20%.

Macroeconomics

After many leading indicators dropped to historic lows in April, we saw a clear recovery in June. The US

ISM index rose as high as 52.6, thus climbing above the growth threshold of 50. The European manufacturing PMI also rose significantly, while the Japanese PMI remained depressed.

The US labor-market report showed that the US economy added 4.8 m jobs in June. However, the new, late-June lockdown measures are not yet reflected in the data. Despite recent job creations, the US unemployment rate remains at a record high 11.1%.

Inflation fell in almost all countries, which reflects the deflationary effects of the recession. As a result, US core inflation, which excludes food and energy, fell to 1% after 1.8% in February. The decline of US headline inflation is even more dramatic, with a fall to 0.1% after 2.3% in February. The headline inflation also reflects the dramatic fall of energy prices. If, as we expect, oil prices stabilize or even rise from current levels, next year's headline inflation will go up simply because energy prices will exceed this year's levels.

Geopolitics

Geopolitical tensions, especially between the US and China, intensified in recent months. China approved a plan to impose national security laws on Hong Kong. If this law should be enacted, the independence of Hong Kong and the future of its financial center would be seriously undermined. Serious complaints were voiced by the US administration, together with the UK, Australia, and Canada. In addition, the US senate unanimously voted for a bill which would impose sanctions on Chinese officials who undermine Hong Kong's status.

Furthermore, the US sent two aircraft carriers into the South China sea as a reaction to Chinese military exercises in the contested area around the Parcel Islands.

Monetary policy

At its meeting on 9-10 June the US Fed kept its benchmark interest rate close to zero. The Fed moreover confirmed that it would buy USD 80 bn of government bonds and USD 40 bn of mortgage-backed securities per month. The Fed also reiterated its commitment to keep rates low until the economy is back on track for full employment.

On 4 June the ECB's governing council decided to increase the pandemic emergency purchase program (PEPP) by EUR 600 bn to EUR 1,350 bn. The PEPP will be extended to at least the end of June 2021.

On 16 June the Bank of Japan raised its coronavirus lending program to USD 1 tn (JPY 110 tn). The lending program provides zero-interest loans to banks if they increase lending to companies. This comes on top of the Bank of Japan's bond-buying program, intended to keep 10-year yields at zero, and its corporate bond and commercial bond buying of USD 188 bn (JPY 20 tn).

We also refer to Fig. 35, which shows the balance sheet expansion of major central banks.

Outlook

We recently increased our exposure to corporate bonds, which benefit from central-bank buying, and we introduced an overweight of crude oil.

Overall we remain cautiously positioned, with a clear underweight of equities and government bonds. We believe this is prudent since equity valuations have risen sharply as the earnings outlook has worsened and equity prices have spiked. Elevated equity valuations are in sharp contrast to a clouded outlook and a number of major risks for financial markets.

First, the pandemic is far from over. On a global basis we are still in the first wave. US data show that new cases in Florida, Arizona, and Texas have sharply risen after lockdown measures were eased. Furthermore, it is very unlikely that a vaccine will be found, tested, approved, and produced before next year. Even this would be an outstanding and unprecedented achievement since the development of a vaccine usually takes many years. In Europe and Asia we do not expect a full second wave since politicians and the health systems have learned and will take early measures to fight sporadic regional outbreaks.

Second, the impact on the economy remains uncertain. While the monetary and fiscal measures have worked so far, there is doubt as to whether the impact of a longer economic slowdown can be cushioned by governments. Furthermore, second-round effects are possible if more companies go into bankruptcy, with repercussions on banks and other creditors. Similarly, some emerging markets look very vulnerable.

Third, we are concerned about geopolitical risks. In our view, President Trump has come under significant pressure domestically, due to the "black lives matter" movement and the handling of the corona crisis. As US elections approach on 3 November, Trump may try to please his voters by showing a strong hand against China and potentially against Europe. At the same time, it seems that China itself has been pursuing a more aggressive foreign policy in recent months.

ECONOMICS

After many leading indicators dropped to historic lows in April, we saw a clear recovery in June. The US ISM index even rose to 52.6, thus climbing above the growth threshold of 50. The European manufacturing PMI also rose significantly, while the Japanese PMI remained depressed. The US labor-market report showed that the US economy added 4.8 m jobs in June. However, the new, late-June lockdown measures are not yet reflected in the data. Despite recent job creations, the US unemployment rate remains at a record high 11.1%.

Fig. 1: PMIs

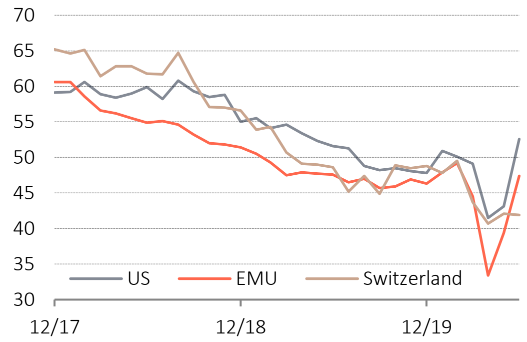


Fig. 2: PMIs

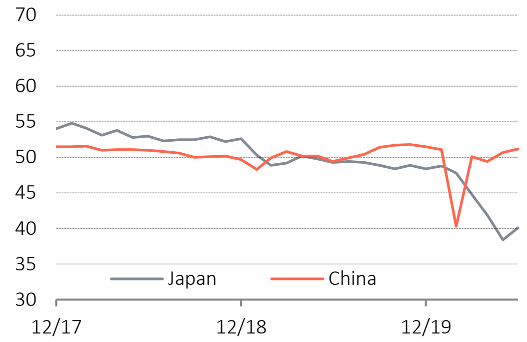


Fig 3: Consumer price inflation, in % YoY

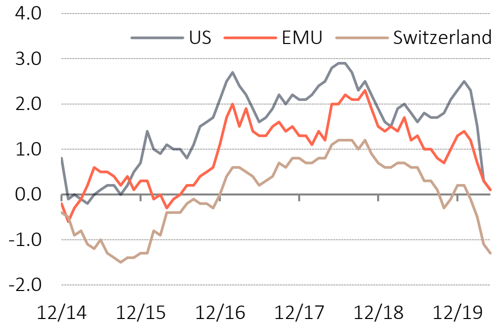


Fig. 4: Consumer price inflation, in % YoY

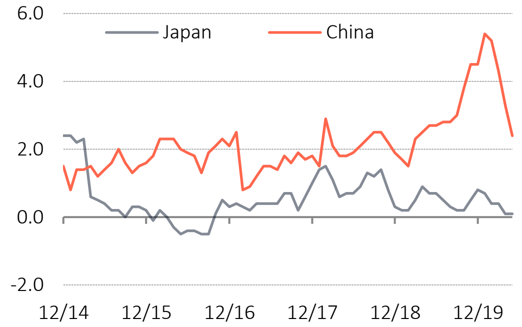


Fig 5: Unemployment rates, in %

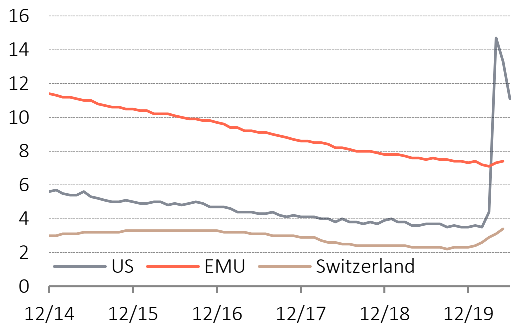
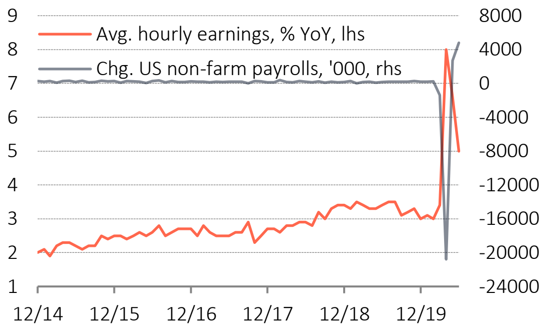


Fig 6: US labor market



FIXED INCOME

In June government bond yields fell slightly. Bond markets remained very well supported by sizeable central-bank buying, which also includes corporate bonds. This, together with a rising investors' risk appetite, led to a significant credit-spread tightening. Break-even inflation rates rose from very depressed levels, which led to an outperformance of inflation-linked bonds.

Fig.7: 2Y government bond yields

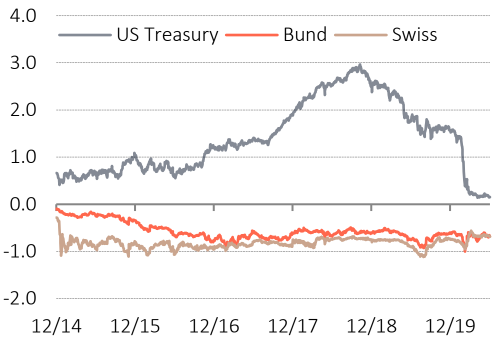


Fig. 8: 10Y government bond yields

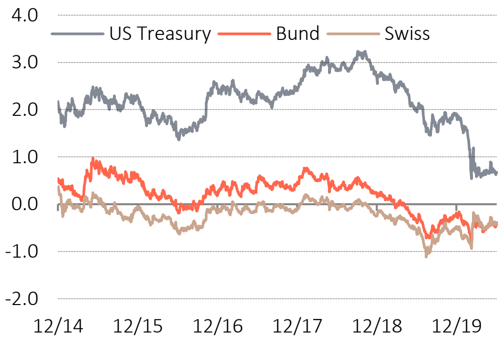


Fig 9: 10Y break-even inflation

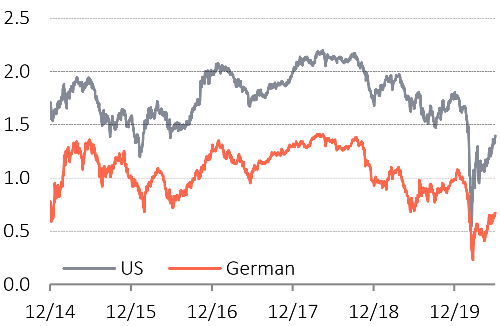


Fig. 10: Credit spreads, 5Y credit default swaps

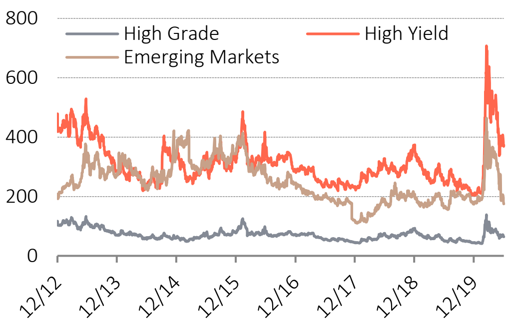


Fig 11: Money market spreads (3M-2Y)

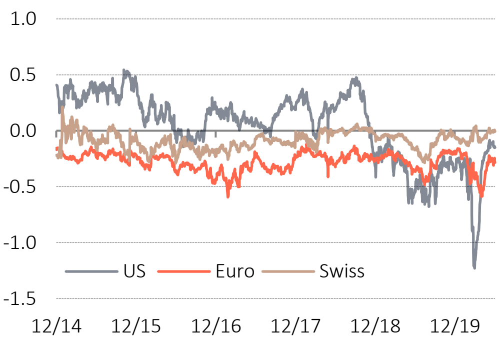
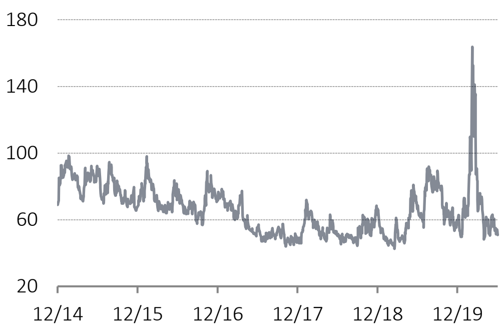


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

Equity markets achieved a V-shaped recovery, implying that expectations are for a swift healing of the economy. The Chinese CSI 300 index has even gone up by 7.9% since the beginning of the year. In general, emerging equity markets underperformed developed markets. Among developed markets Swiss and US equities performed best. The equity sectors which suffered most are energy, financials, real estate, and industrials. Health, technology, and US consumer staples, however, performed positively this year.

Fig. 13: MSCI equity indices – major regions

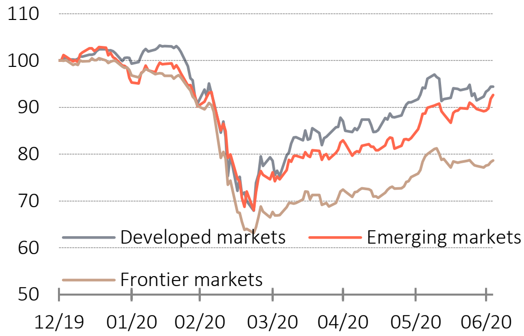


Fig.14: Equity indices – major developed markets

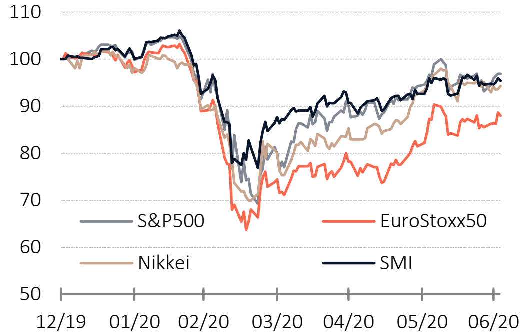


Fig 15: Equity indices – major emerging markets

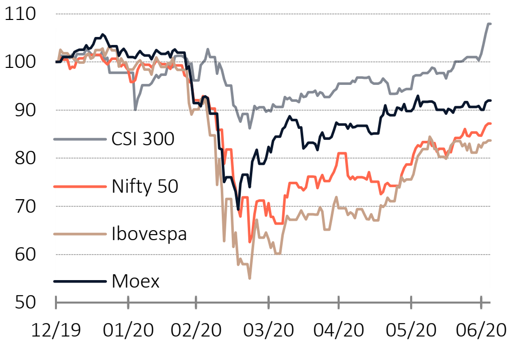


Fig. 16: Sector performance, MSCI Europe, 2018

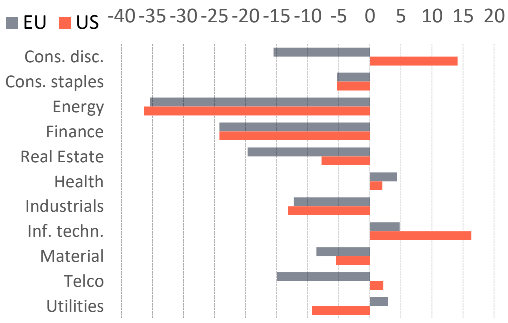


Fig 17: Price-earnings ratios

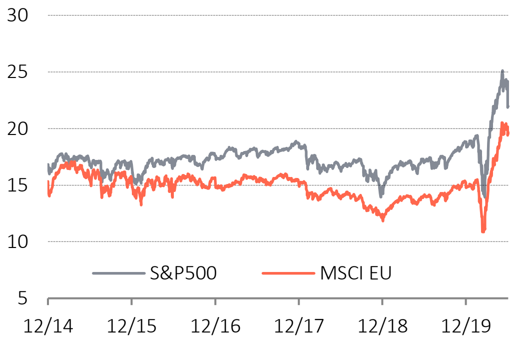
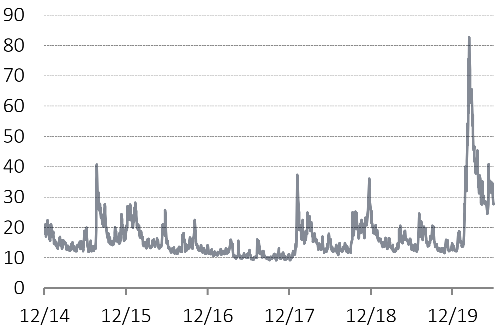


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

Gold continues to rally. It surged another 3% in June, reaching almost USD 1,800 per ounce. The price of oil recovered from the devastating sell-off in February and March. The price for industrial metals was supported by a more optimistic growth outlook. REITS, however, have come under selling pressure and have lost more than 20% since the beginning of the year. The reason lies in concerns about tenants' ability to pay their rents and uncertainties on how the pandemic may have changed demand, especially for commercial and retail real estate.

Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

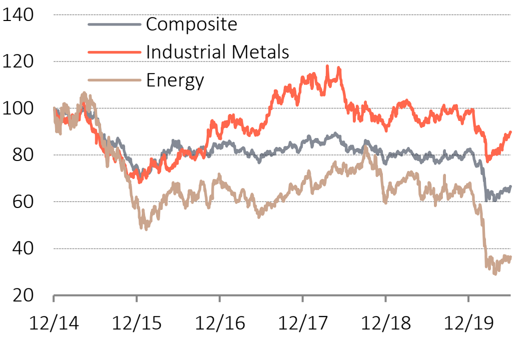


Fig. 22: HFRU hedge fund indices

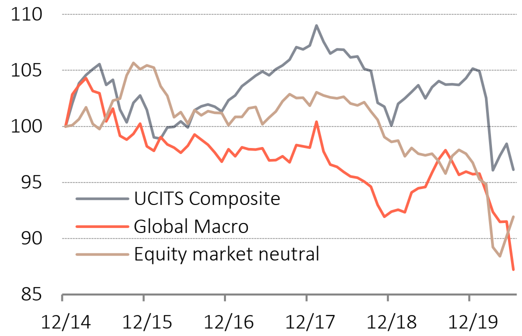


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: LPX global listed private equity

CURRENCIES

Volatility in the currency markets intensified strongly. The EUR/USD exchange rate underwent unusually wide fluctuations. The EUR strengthened in June against most major currencies. Many analysts expect the USD to weaken in the second half of 2020, since it looks expensive and the US interest-rate advantage declined sharply on the back of huge liquidity injections by the US Fed. Safe-haven currencies, like the CHF and the JPY, remained on the strong side.

Fig. 25: EUR-USD exchange rate

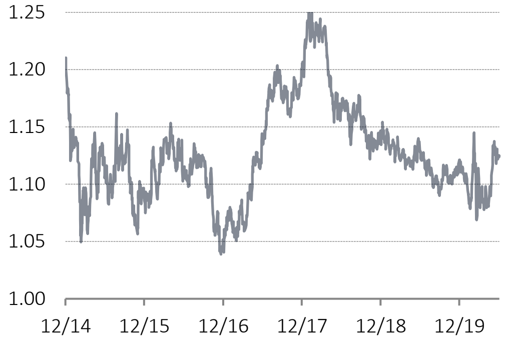


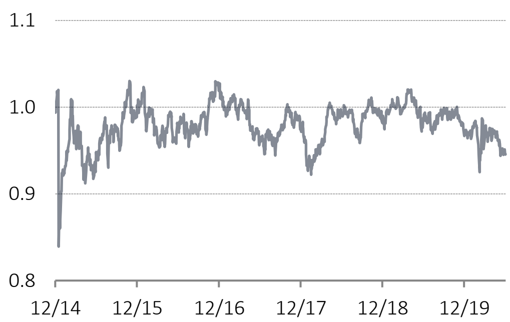
Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

Fig 30: USD-CHF exchange rate



COVID-19

While the number of new cases dropped significantly in Europe and Asia, the virus continues to spread viciously in the US and many emerging countries. Some countries have relaxed social distancing rules recently, which led to a higher number of new cases. It remains to be seen whether the increase will be large enough to classify it as a second wave. So far the recession has not led to a strong increase in the US bankruptcy index since fiscal measures have kept many companies afloat. Likewise, the record decline in US personal income has largely been compensated by state transfer payments.

Fig. 31: Total Covid-19 cases

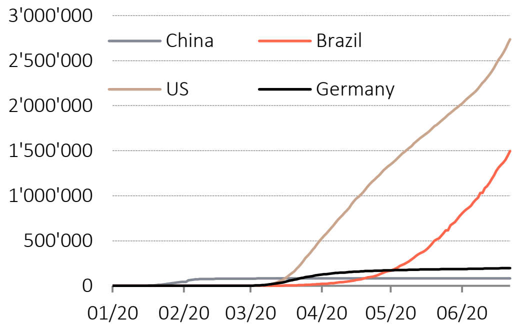


Fig. 32: New cases per day (7-day average)

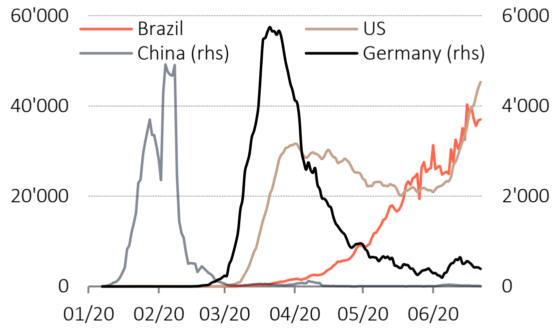


Fig 33: US bankruptcy index

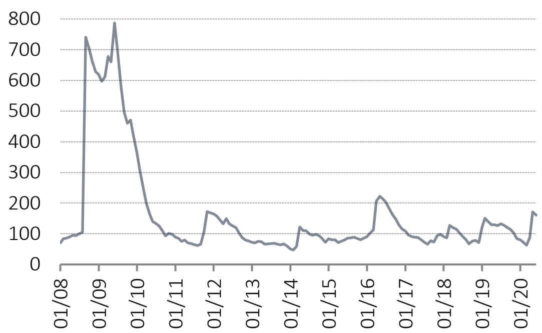


Fig.34: US personal income, excl. transfers (USD bn, 2012 prices)

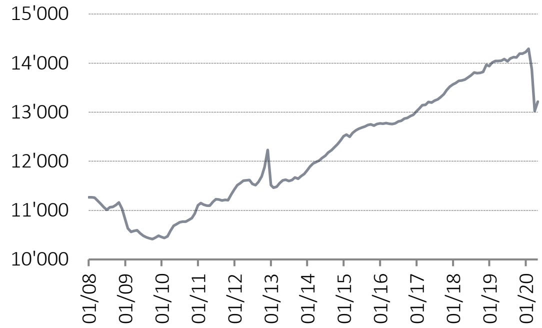


Fig 35: Central bank total assets, indexed

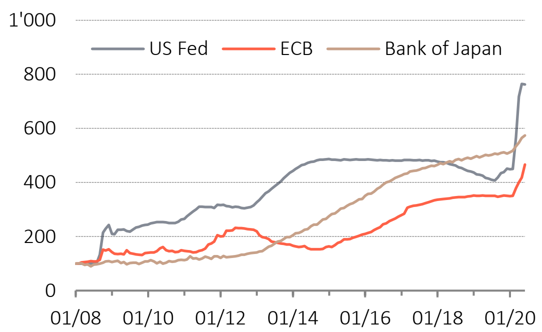
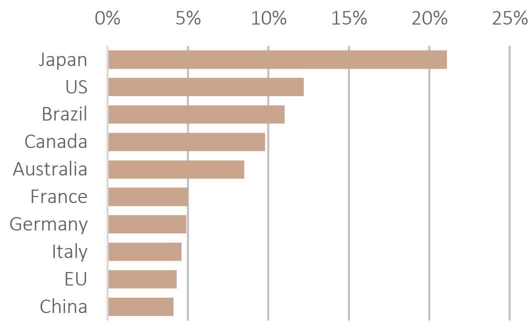


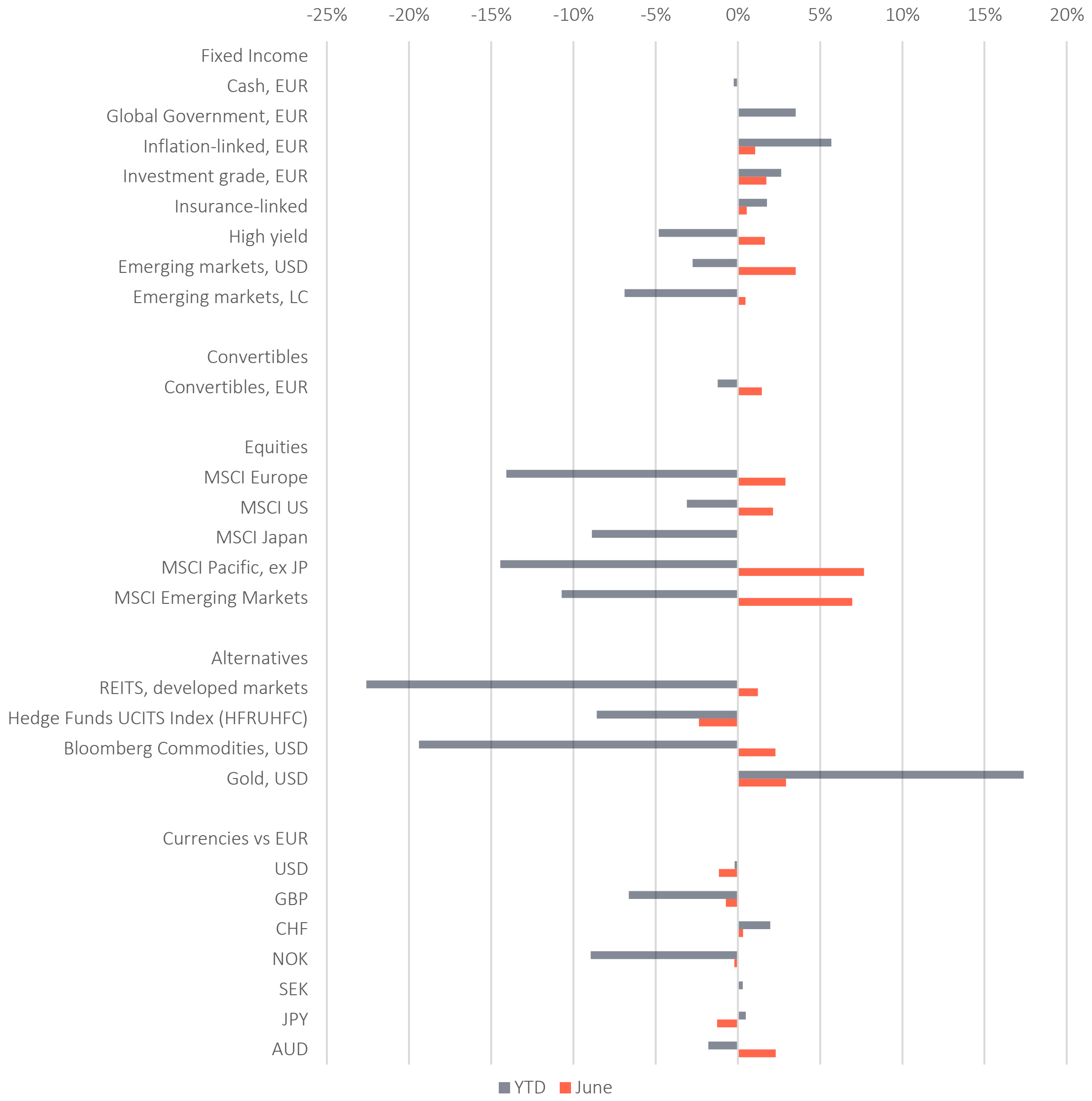
Fig 36: COVID-19 fiscal stimulus as of June 2020, % of GDP (Source: Statista)



ASSET ALLOCATION

In June most asset classes performed positively. Especially equities and bonds from emerging markets had a good month. Gold continued its rally and is by far the best performing asset class this year. Commodities in general rebounded, driven by strong price movements for industrial metals and crude oil. The EUR strengthened vs. most currencies, except for the CHF and the AUD.

Fig. 37: Performance of major asset classes, based on our EUR portfolio strategy

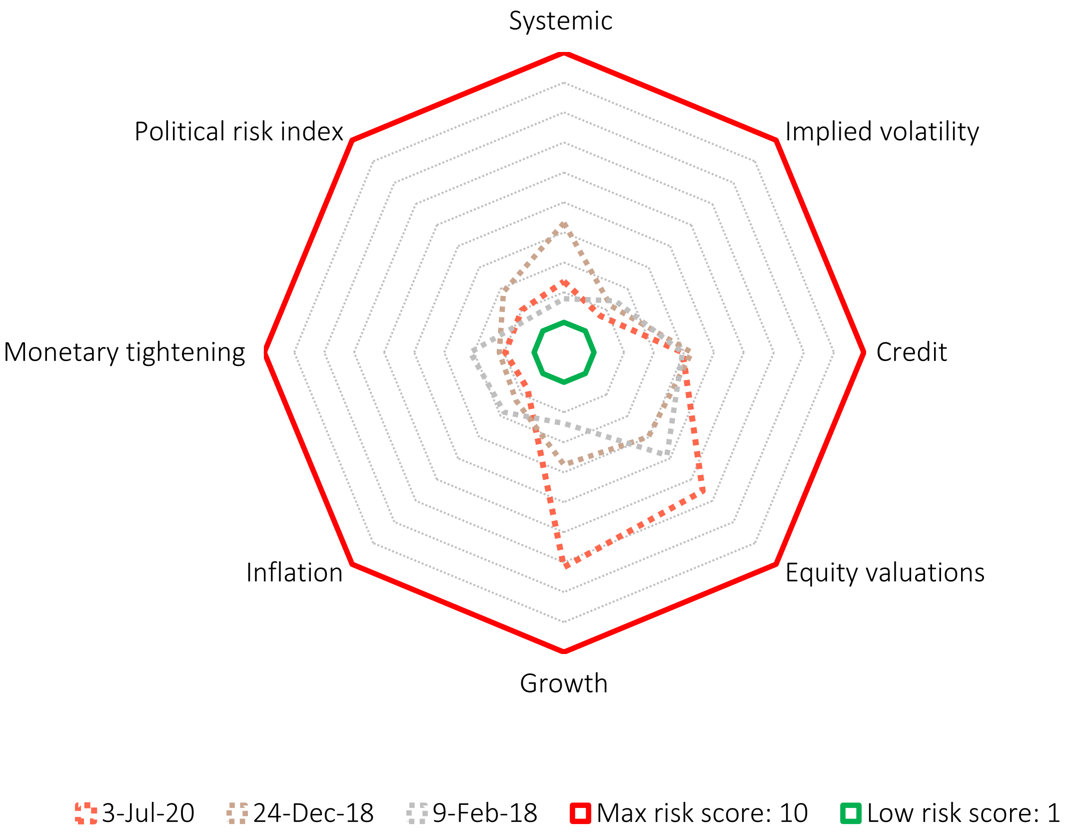


RISK MONITOR

Our growth risk indicator spiked and reached the highest level of 10 in May. Since then it has retreated somewhat. Nevertheless, growth risks remain the major concern for markets. Surprisingly, at the same time equity valuations reached historic heights. We find the elevated equity valuations rather extraordinary considering that the world economy is undergoing one of the biggest slumps in history and the outlook remains clouded. Monetary tightening and inflation risks remain at very low levels.

Fig. 38: IMT Risk Monitor

24 Dec 2018: Growth and monetary tightening fears
09 Feb 2018: Inflation fear and technical correction



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Source for all graphs: Bloomberg, Statista (Fig. 36), IMT Asset Management AG.