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INVESTMENT OUTLOOK 11.2020

17 November 2020

In anticipation of the US elections, markets were very volatile in October. It was nevertheless surprising to us to see how strongly equity markets performed during and after the US election, despite what seemed to be a tight race and despite President Trump's refusal to concede defeat.

Markets seem to welcome President-elect Joe Biden or at least to welcome the fact that some political uncertainties are now dispelled. In our view there is no doubt that Joe Biden will take over the presidency as scheduled on 20 January.

Meanwhile Europe together with the US has become the new hotspot for the Covid pandemic. Most European governments have introduced strong lockdown measures. In the coming weeks we will see how damaging those measures turn out to be. Hope comes from the announcement by Pfizer and BioNTech that the development of a vaccine has advanced promisingly.

We remain cautiously positioned given stretched equity valuations and high levels of economic uncertainties.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

PRESIDENT-ELECT JOE BIDEN

Financial markets

October was a volatile month for equities. Uncertainties regarding US elections and the impact of a new wave of lockdown measures in Europe weighed on market sentiment. Developed markets equities fell 3.1% while emerging markets rose 2.0%. European markets were hit hardest. For example, the German DAX index fell 9.4% in October. Surprisingly, equity markets had already recovered when the outcome of the US election was still unclear, and when President Trump refused to concede defeat. Markets received a further boost when Pfizer and BioNTech announced progress with the development of a Covid vaccine.

The short-end of the yield curves remains well anchored. However, 10-year government bond yields in the US rose by 19 basis points in October and climbed further in early November. Meanwhile European yields fell by 11 basis points in October but reversed this movement in early November. Expansive monetary and fiscal policies globally are medium-term reflationary, which explains why inflation expectations (break-even inflation rates) have been rising.

The gold price fell by 0.4% in October. Growth fears led to a sharp drop of 8.5% in oil prices. At the same time, despite the risk-off environment, industrial metals surged by 3.0%, driven by robust economic fundamentals in China. Global REITS fell by 2.8% but recovered strongly in early November.

Currency movements in October were moderate. The USD regained some strength as risky assets sold off. The Chinese CNY remained on its strengthening path, driven by robust growth and exceptionally low Covid numbers in China. The CHF strengthened during the risk-off environment but depreciated in early November.

Covid-19

The number of new daily cases has risen to around 600,000. The total number of cases worldwide reached 55 m on 16 November. Europe has been hit by a strong second wave, which has brought the number of new daily cases in Europe, Middle East and Africa (EMEA) up to 300,000. New cases in the US are also rising rapidly, with about 150,000 per day. Many European governments have introduced stricter lockdown measures. It is also expected that the new Biden administration will take stronger measures.

On 9 November Pfizer and BioNTech announced that they were well advanced with the development of a vaccine, which had so far been more than 90% effective in clinical trials. Shortly after, on 16 November, Moderna too announced that its own vaccine appeared to be 94.5% effective. Equity markets soared between 3% and 8% and bond yields rose.

There are other firms working on vaccines. AstraZeneca, for example, in collaboration with Oxford University, plans to publish the results of its trials before the end of the year.

While this is exceptionally good news, there are many challenges ahead. The regulators are apparently fast-tracking approvals. This may incur an increased risk of as yet undetected side effects, which could lower people’s confidence and willingness to be vaccinated. Furthermore, there are technical issues in mass producing such vaccines and logistical issues in distributing the individual doses. For example, the Pfizer /

BioNTech vaccines needs to be kept at -70°C. Also, with the above-mentioned vaccines, booster shots have to be given several weeks after primary vaccination. Furthermore, it remains unclear how long immunity will last. Expectations are that it might be twelve months or even less.

Macroeconomics

The US ISM index rose to 59.3 after 55.4, which signals a strong recovery of the US manufacturing sector. Meanwhile the US services sector slowed somewhat as the ISM services index fell to 56.6 after 57.5. Also, the European Markit PMI rose to 54.8 after 53.7.

US non-farm payrolls rose by 638,000 in October after an upwardly revised +672,000 in the prior month. The unemployment rate fell by 1%-point to 6.9%. However, long-term unemployment continued to rise, reaching 3.56m in October, an increase of 1.15m over the September figure and the highest level since 2014.

Inflation remained extremely low in October. US headline inflation fell to 1.2% after 1.4%, and the EMU inflation rate remained unchanged in negative territory, at -0.3%.

Biden's new policy

What can we expect from a President Biden? In his first speeches after the US election Joe Biden emphasized his commitment to re-unify what seems to be a divided country. In this context, the new administration will take measures to support minorities, reduce incarceration and aim for reforms in the justice system. Another highly controversial subject and a major objective of the democrats is to double the minimum wage to USD 15 an hour.

Mr Biden plans to expand the public health insurance scheme to include an estimated 97% of the population. He refuses, however, to introduce universal health insurance for everybody, which is demanded by more left-leaning Democratic politicians

Biden will pursue a green policy with a US 1.7 tn investment program in green technologies and he will rejoin the Paris Climate Accord.

When it comes to foreign policy, Biden will certainly be a president who believes in constructive international relations. The threat of leaving NATO, for example., will clearly be off the table. At the same time, Biden will pursue a hard policy vis-à-vis China, as such action now enjoys bipartisan consensus in the US. It is likely, however, that he will try to engage with Europe to do so. It is unclear how Biden intends to deal with the sanctions on Iran and whether he would be willing to lift them in return for Iran's greater compliance with the original agreement.

When it comes to Corona, Biden wants to provide free testing for everybody and to introduce a national contact-tracing program. He is prepared to hire 100,000 people for that purpose.

Many of Biden's policy plans are highly controversial in the US. Since the senate election results are still not clear, it is difficult to see whether Biden's plans can be readily implemented. It looks likely that the Republicans will maintain their majority in the Senate, and thus will be able to block some of the most controversial initiatives, like the increase of the minimum wage and health insurance reform.

Geopolitics

On 15 November, after five long years of negotiations, the world's largest free trade zone, The Regional Comprehensive Economic Partnership (RCEP), was created. It is formed by 15 Asian countries, including China, Japan, Australia, and South Korea. India withdrew out of fear that Chinese products would swamp its economy. It can clearly be seen as a success for China, especially since that country's relations with the US and to some extent with Europe have worsened in recent years. While RCEP is far from groundbreaking, it nevertheless strengthens the ties within the Asia Pacific region.

Monetary policy

On 5 November the FOMC kept the federal funds rate unchanged between 0% and 0.25% and confirmed that it would maintain the current pace of the asset purchase program. The Fed expressed clear concern about rising numbers of corona cases and urged the government to take additional fiscal measures to support the economy. Those comments came when votes were still being counted, and it was clear that no agreement for a fiscal program could be reached among Democrats and Republicans.

ECB's president Christine Lagarde clearly signaled that the ECB is prepared to continue its accommodative policy. It would consider expanding its pandemic emergency purchase program (PEPP) and its targeted longer-term refinancing operations (TLTRO). This could result in additional EUR 500 bn of bond purchases.

Outlook

In recent weeks a number of positive news items have spurred the markets. It seems that in 2021 the availability of vaccines from various suppliers will help to manage the pandemic. We therefore feel a little more optimistic about the economic and market outlook. Nevertheless, we regard markets as being ahead of themselves, with many valuations clearly stretched. We can also imagine that the current optimism regarding vaccination could turn towards disappointment as a result of the various challenges that lie ahead of us. We expect to see market corrections in the coming months.

We have increased our equity valuations somewhat but remain underweight. This is based on elevated valuations and potential disappointments, which could produce market corrections in the coming months.

ECONOMICS

The US ISM index rose to 59.3 after 55.4, which signals a strong recovery of the US manufacturing sector. Meanwhile the US services sector slowed somewhat as the ISM services index fell to 56.6 after 57.5. Also, the European Markit PMI rose to 54.8 after 53.7. US non-farm payrolls rose 638,000 in October after an upwardly revised +672,000 in the prior month. The unemployment rate fell by 1%-point to 6.9%. However, long-term unemployment continued to rise, by 1.15m from September to 3.56msin October, the highest level since 2014.

Fig. 1: PMIs

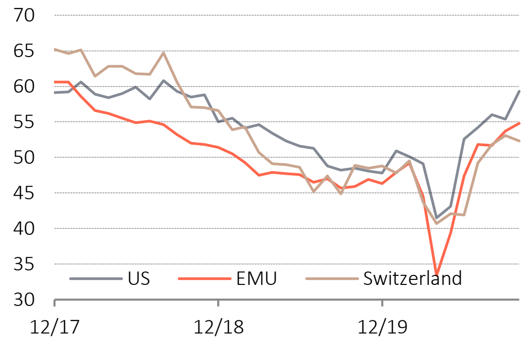


Fig. 2: PMIs

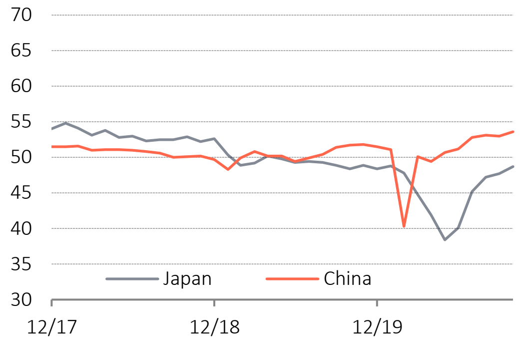


Fig 3: Consumer price inflation, in % YoY

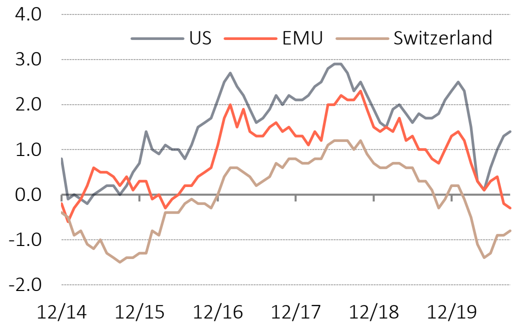


Fig. 4: Consumer price inflation, in % YoY

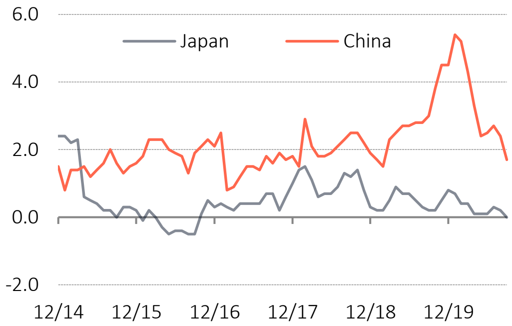


Fig 5: Unemployment rates, in %

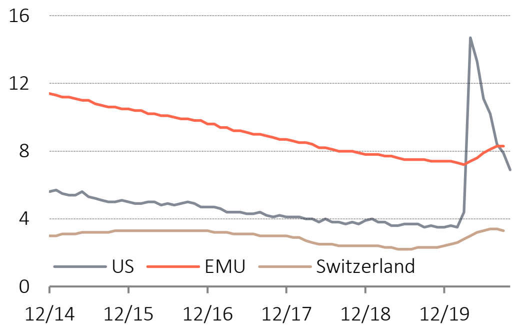
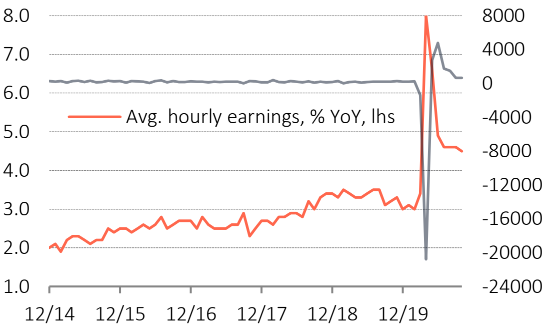


Fig 6: US labor market



FIXED INCOME

The short-end of the yield curves remains well anchored. However, 10-year government bond yields in the US rose by 19 basis points in October and climbed further in early November. Meanwhile European yields fell by 11 basis points in October but reversed this movement in early November. Expansive monetary and fiscal policies globally have a medium-term reflationary potential, which explains why inflation expectations (break-even inflation rates) have been rising recently.

Fig.7: 2Y government bond yields

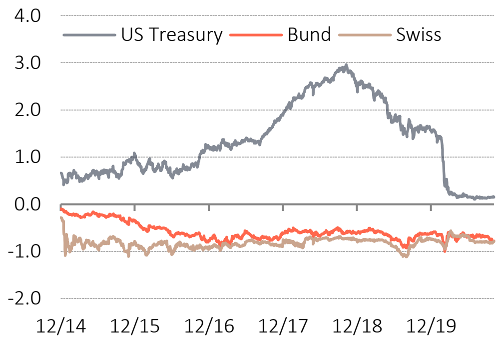


Fig. 8: 10Y government bond yields

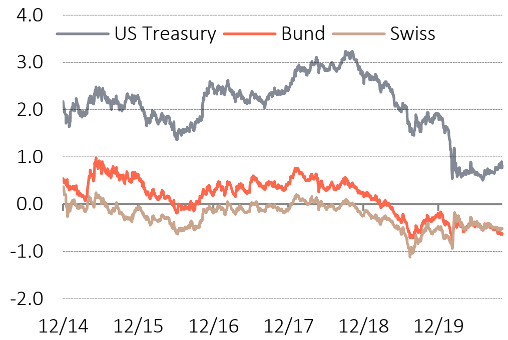


Fig 9: 10Y break-even inflation

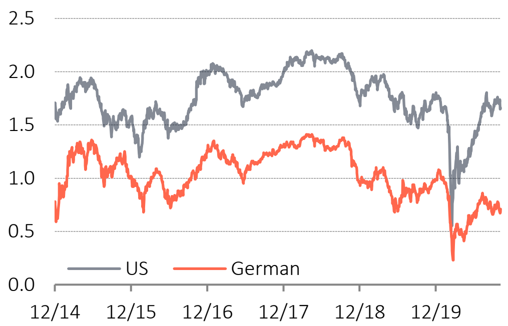


Fig. 10: Credit spreads, 5Y credit default swaps

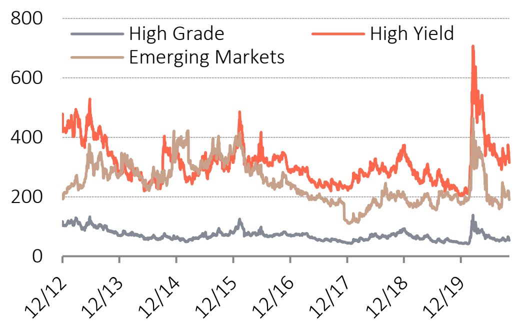


Fig 11: Money market spreads (3M-2Y)

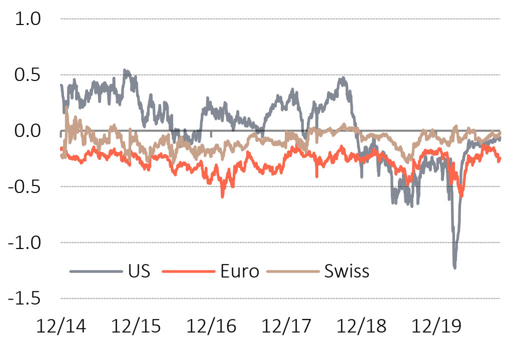
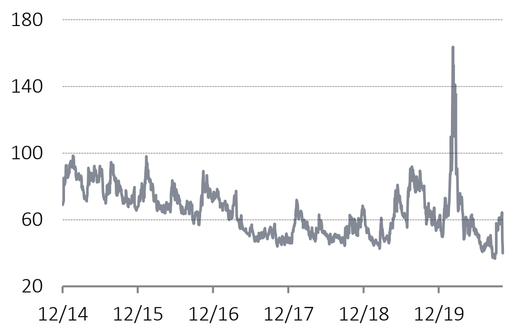


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

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Fig. 13: MSCI equity indices – major regions

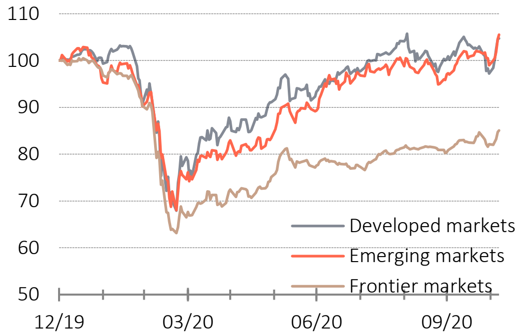


Fig.14: Equity indices – major developed markets

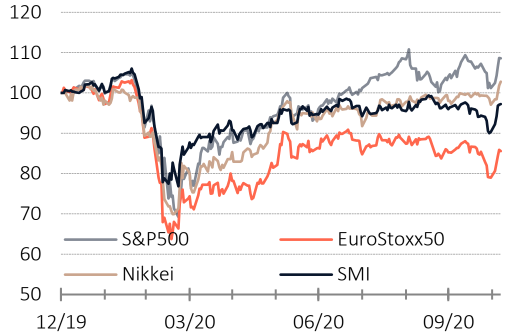


Fig 15: Equity indices – major emerging markets

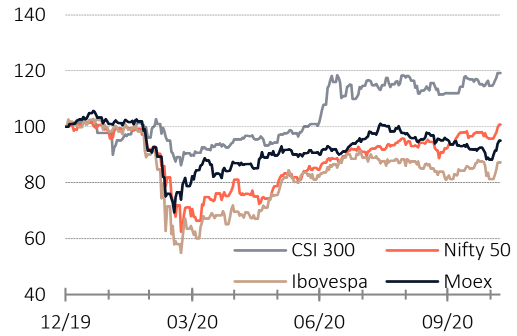


Fig. 16: Sector performance, MSCI Europe, YTD

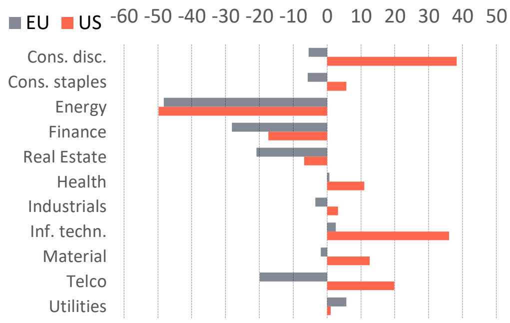


Fig 17: Price-earnings ratios

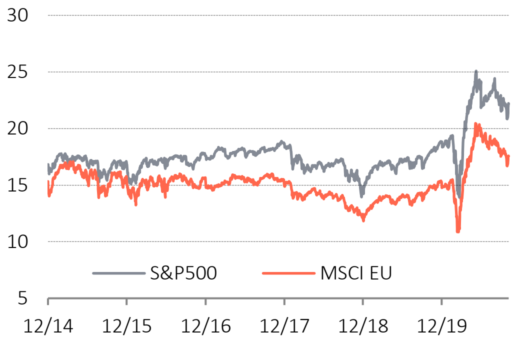
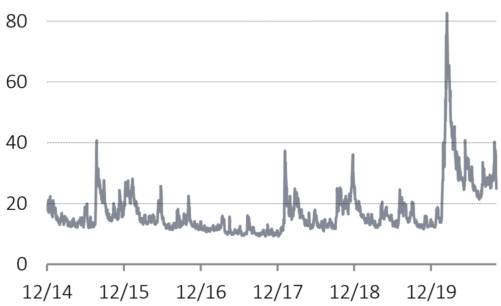


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

The gold price fell by 0.4% in October. Growth fears led to a sharp drop of 8.5% in oil prices. At the same time, despite the risk-off environment, industrial metals surged by 3.0%, driven by robust economic fundamentals in China. Global REITS fell by 2.8% but recovered strongly in early November.

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Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

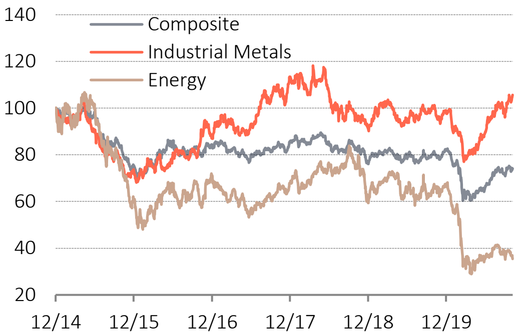


Fig. 22: HFRU hedge fund indices

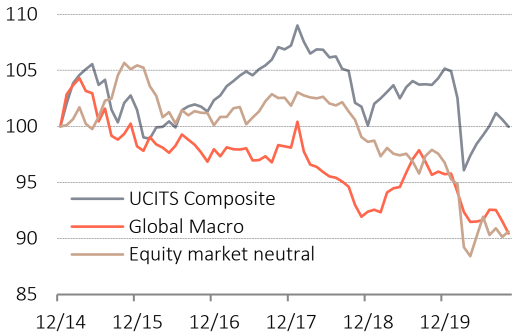


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: LPX global listed private equity

CURRENCIES

In October currency movements were moderate. The USD regained some strength as risky assets sold off. The Chinese CNY remained on its strengthening path, driven by robust growth and exceptionally low Covid numbers in China. The CHF strengthened during the risk-off environment but depreciated in early November.

Fig. 25: EUR-USD exchange rate

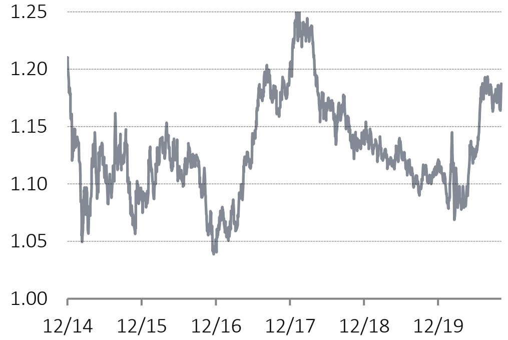


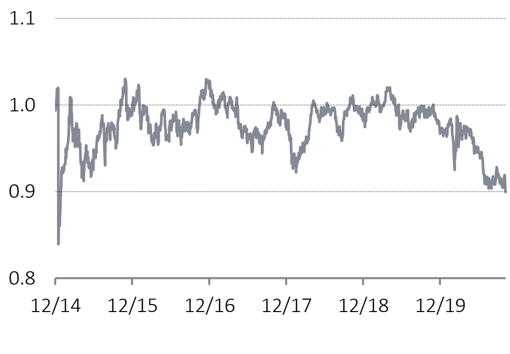
Fig. 26: GBP-USD exchange rate

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

The number of new daily cases has risen to around 600,000. The total number of cases worldwide reached 55 m on 16 November. Europe has been hit by a strong second wave, which brings the number of new daily cases in Europe, Middle East and Africa (EMEA) up to 300,000. New cases in the US are also rising rapidly, with about 150,000 per day. Many European governments have introduced stricter lockdown measures. The markets received a strong boost from the announcement by Pfizer and BioNTech that there was good progress with the development of a Covid vaccine.

Fig. 31: Total Covid-19 cases (x 1000)

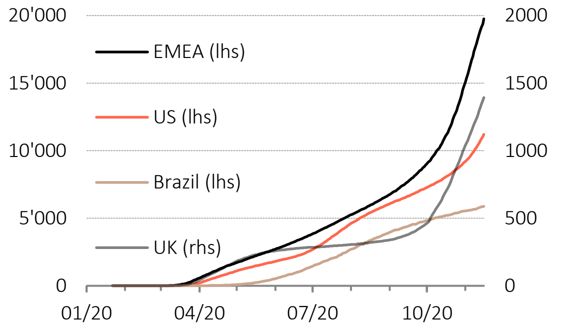


Fig. 32: New cases per day (7-day average)

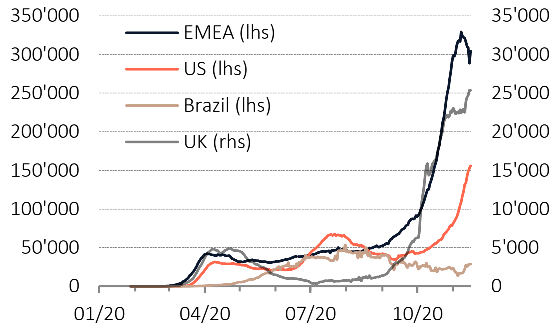


Fig 33: US bankruptcy index

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

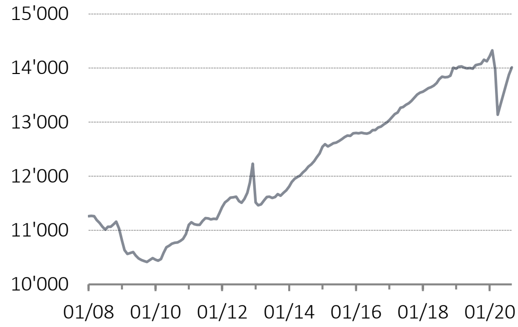


Fig 35: Central bank total assets, indexed

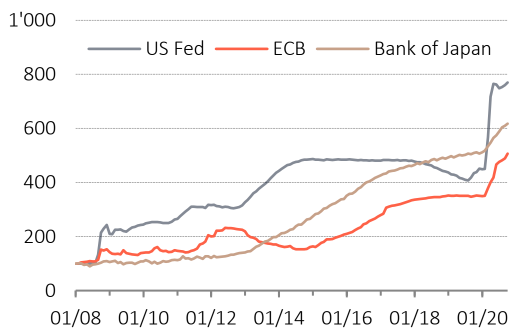
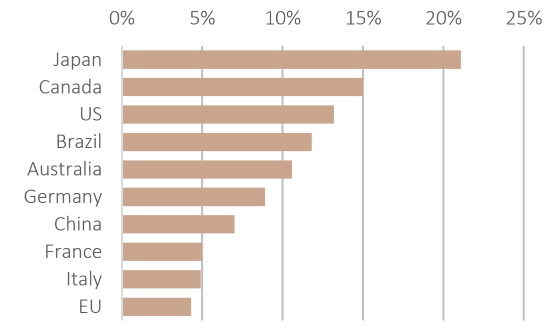


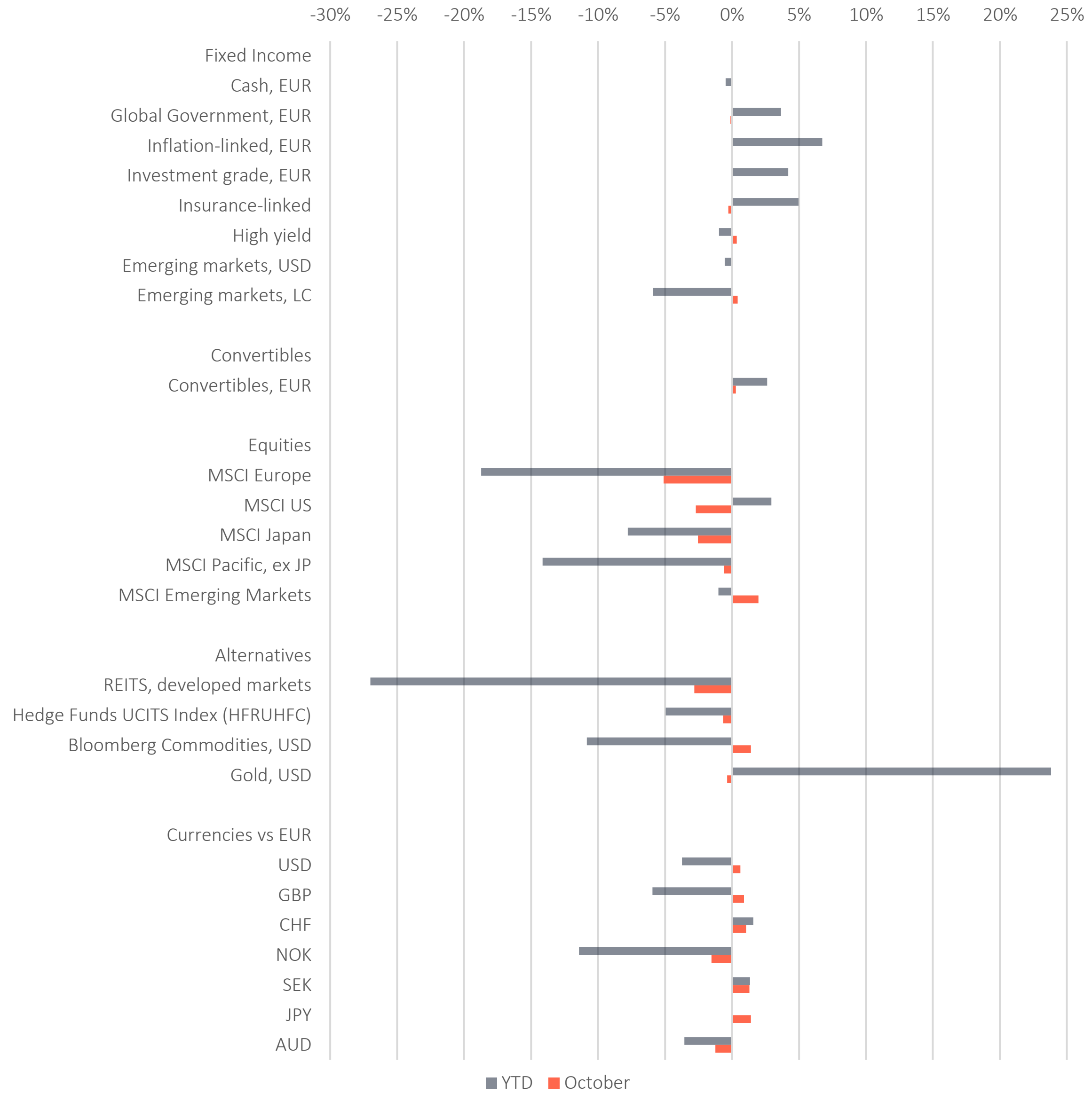
Fig 36: COVID-19 fiscal stimulus as of June 2020, % of GDP (Source: Statista)



ASSET ALLOCATION

October was a very volatile month, ahead of the US elections. Equity markets performed well in the first two weeks, but sold off in the second half of the month. The correction was driven by uncertainties regarding the outcome of the US elections as well as rising growth fears as Covid numbers in many countries surged. Fixed income markets were almost flat, while most risky assets recorded losses. Notable exceptions were industrial metals and emerging markets equities.

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



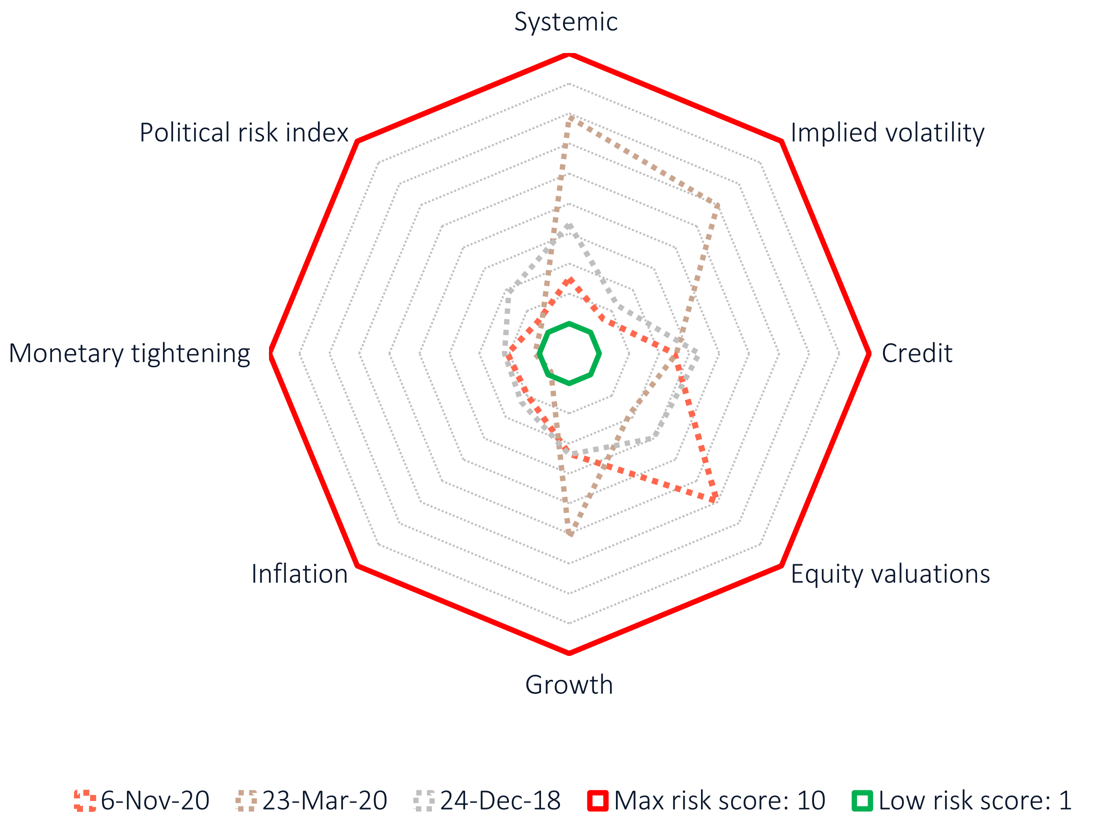
RISK MONITOR

Equity valuations remain very high. Other than that, the risk environment appears to be benign. We, would, however, urge caution with regard to the growth outlook and we think that our growth indicator may underestimate current growth risks.

While PMIs have rebounded sharply and indicate a steep recovery from the lows in Q1 and Q2, economic activity remains depressed compared to pre-Covid levels, and strengthened lockdown measures will provide further headwinds.

Fig. 38: IMT Risk Monitor

23-Mar-20 Pandemic
24 Dec 2018: Growth and monetary tightening fears



DISCLAIMER

Source for all graphs: IMT Asset Management AG, Bloomberg, Real Clear Politics, for Fig 36 Statista (de.statista.com), for Fig. 38, the political risk index: "Measuring Geopolitical Risk" by Dario Caldara and Matteo Iacoviello at https://matteoiacoviello.com/gpr.htm.