November 6, 2020

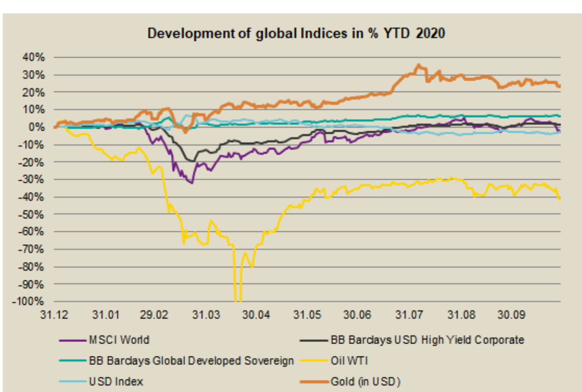
Vontobel Swiss Wealth Advisors

Investment Outlook – November 2020

Dr. Thorsten Krauss, CEFA
CIO
Vontobel Swiss Wealth Advisors

Investment Review

After a positive start into October, most stock market indices finally closed the month in negative territory due to stalling negotiations on a new coronavirus stimulus package in the U.S., sharply rising COVID19 cases in Europe and the adoption of renewed partial containment measures in several European countries. So far, the announced lockdowns are focused on certain parts of the economy and less strict than in spring. However, spiking virus cases will have a negative impact on consumer confidence and most likely weaken economic momentum in the final quarter. As a result of market fears, volatility rose and risk aversion increased. Most equity indices are now back in negative territory since the beginning of the current year. The Swiss SMI index is down by 1.5%, the S&P 500 gained 3.1%, the Euro Stoxx 50 index is down by 12.5% and the MSCI Emerging Markets index gained 0.8%, all on a total return basis in USD terms. Despite rising market risks, gold continues to move sideways in a narrow trading range close to $1900/oz. Since the beginning of 2020 gold has delivered a performance of 23.8%. Credit spreads slightly widened in recent weeks but are still far away from the panic levels seen in March.



[Source: Bloomberg, Vontobel Swiss Wealth Advisors (VSWA)]

During September and October we reduced the equity allocation in all multi-asset mandates from moderately overweight to slightly underweight by reducing the portfolio weight of several strongly performing positions back to target weight. At the most recent meeting of our Investment Committee we decided to prepare for a potential increase of our equity quota depending on the final outcome of the U.S. elections. This week we finally decided to increase our equity quota to overweight. The likely winner of the U.S. elections and new U.S. President will be Joe Biden. It is highly likely that the Democrats will lead the House, while the Republicans will have the majority in the Senate. This speaks against a "blue wave" scenario, against immediate tax hikes and in favor of a continuation of politics as is. Reduced uncertainty has already led to lower volatility, a declining risk premium and rising equity prices. Rising virus cases may pose a risk. However, governments will try to avoid the negative impact of new strict nationwide lockdowns. Equities remain our preferred asset class, given their attractive valuation versus bonds, rising earnings estimates and strong monetary support.

Global Economy

The global economy strongly recovered from the record high drop in activity witnessed during the first two quarters of 2020. The global purchasing manager indices (PMI) for the services and the manufacturing sector are back to expansion territory after a strong recovery from April lows. Sentiment in manufacturing is significantly better than in services, which we do not expect to change any time soon, as the second wave of the virus outbreak in Europe will act as a drag on the services sector. Retail sales growth is back in positive territory in all regions. However, the outlook for Eurozone retail sales remains dimmed, as indicated by consumer confidence below the long-term average. We slightly reduce our estimate for global real GDP growth for 2020 from -3.9% to -4.2% and increase our forecast for 2021 from 4.8% to 5.0%.

The U.S. economy continued to excel in October, with the majority of macroeconomic releases still above expectations. Initial U.S. real GDP for the third quarter came in above expectations, rising 33.1% quarter-on-quarter annualized, but still remains around 3% below GDP levels a year ago. The composition was mixed, with better consumption growth than expected, but capital expenditures below forecasts. Initial jobless claims recently fell to their lowest level since March, suggesting a further recovery of the labor market. The U.S. unemployment rate almost halved during five months, falling from 14.7% in April to 7.9% as of current. Pending home sales declined in three of four regions in September, falling by 2.2% against consensus expectations for an increase. The year-over-year rate increased to 21.9% in September, likely driven by record low mortgage rates. The same is true for existing home sales and new one family houses sold, which are 20.9% and 32.1% above the levels of one year ago, respectively. As macroeconomic releases continue to surprise to the upside we adhere to our growth forecast of -4.4% for the current year and +4.0% for 2021.

Euro area real GDP growth increased by 12.7 quarter-on-quarter in Q3, which was well above expectations and driven by stronger than expected data reported in France, Italy, and Spain. Despite the record quarterly improvement in Q3, the level of real Eurozone GDP remains 4.3% below its reading from Q4/2019. The Eurozone composite PMI declined from 50.4 in September to 49.4 in October, driven by weak data from France, Spain and Italy. Across sectors, services remain the weak spot, while manufacturing remaining more resilient and less exposed to renewed containment efforts. With survey based releases and high-frequency data already pointing to weakening momentum, the risks to our growth forecasts are skewed to the downside. We reduce our real GDP growth forecast from -7.1% to -7.3% for 2020 and from +5.6% to +5.2% for 2021.

Swiss macroeconomic indicators, such as the KOF Leading Indicator, the PMI manufacturing survey and retail sales, started to soften in recent months. The KOF Swiss Economic Institute recently released its autumn forecast for the Swiss economy. Under its baseline scenario it expects GDP to contract by 3.6% this year and to grow by 3.2% in 2021. If the pandemic situation continues to deteriorate, GDP is forecast to fall by 4.9%, followed by a rebound of 1.5% in 2021. Under this risk scenario GDP is not expected to return to its pre-crisis levels until at least 2023.

In the third quarter, real GDP growth in China accelerated to 4.9% year-on-year from 3.2% in Q2. Industrial production rose by 6.9% in September, in line with consensus expectations. Retail sales increased by 3.3% compared to the previous year. Solid readings on China's purchasing manager indices highlight the strength of the current economic recovery and should give the government and the People's Bank of China space to maintain a cautious approach to stimulus.

Macro data has been relatively resilient so far. However, with rising infections and more stringent lockdowns in many European countries, downside risks are certainly rising, especially for the Eurozone economy.

GDP growth (in %)

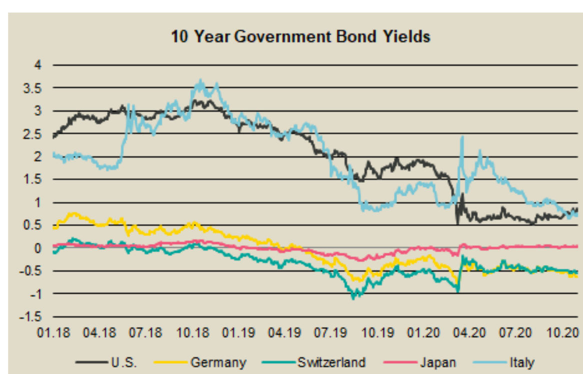
	2018	2019e	Current	Forecast 2020	Forecast 2021
Eurozone	1.8	1.2	-14.8	-7.3(-7.1)	5.2(5.6)
USA	2.9	2.3	-9.0	-4.4	4.0
Japan	0.7	1.0	-10.0	-5.3	2.3
UK	1.4	1.2	-21.5	-8.4	6.3
Switzerland	2.7	0.9	-8.3	-4.7	4.3

VSWA Forecast; () old forecast

Bonds

During October, the yield of U.S. treasuries with 10 years maturity increased from 0.68% to 0.87%, as the bond market has increasingly started to anticipate a blue wave scenario and thus a higher likelihood of a large fiscal package. With the global resurgence of the pandemic likely to pose a growth risk through winter, the scope for a further run of the reflation trade seems limited, especially in light of short-term rates anchored close to zero. The Federal Reserve's (FED's) new forward guidance implies that the FED funds rate will stay around zero for an extended period of time. FED officials reiterated their willingness to tolerate a modest overshoot of inflation above the target of 2%, although there seems no precise rule what that means in practice. FED Presidents Kaplan, George and Rosengren recently argued that sustained low interest rates or asset purchases could raise concerns on financial stability, which could theoretically alter monetary policy. However, as long as economic downside risks resulting from a potential deterioration of the virus situation prevail, inflation pressure seems limited. The core personal consumption expenditures deflator – the FED's preferred inflation gauge – increased from below 1% in April to 1.5% as of current. Sustained readings below the inflation target of 2% limit the scope for rate hikes any time soon and support our expectation of ongoing loose monetary policy.

In contrast to the U.S. trend, Eurozone sovereign bond yields with longer maturities moved lower, which was likely driven by the expectation of slowing macroeconomic momentum due to the reintroduction of partial containment measures in several European countries and very low inflation readings. In September, headline inflation for the Euro area decelerated further to -0.3% year-over-year, while core inflation fell to 0.2%, the lowest level in more than 20 years. Given extremely low inflation numbers, the European Central Bank (ECB) will most likely keep rates below zero and continue asset purchases for the foreseeable future. The same is true for Switzerland, where the economy is in much better shape as compared to the Eurozone, whereas inflation numbers are quite comparable. In October, the Swiss headline inflation fell by 0.6% and core inflation by 0.1% compared to the previous year, offering plenty of space for the Swiss National Bank (SNB) to continue its accommodative monetary policy.



[Source: Bloomberg, VSWA]

According to the most recent ECB Bank Lending Survey, credit standards on loans to non-financial corporations tightened in the third quarter on bank's rising risk aversion, while demand weakened as a result of lower financing needs.

Banks surveyed expect credit standards to tighten further in the fourth quarter on a likely deterioration in the economic outlook, but loan demand to increase, especially in the small and medium enterprises sector. In October, credit spreads slightly widened on renewed market jitters but remained far away from the panic levels reached during March and April. Compared to spring, direct policy support from major central banks is already in place, acting as a credible backstop for credit markets.

Renewed containment measures across Europe will most likely reinforce a weaker macroeconomic outlook into year-end. Thus, we are expecting further ECB easing in December, most likely by an increase in asset purchases. This will keep peripheral and credit spreads under control in case of rising risk aversion.

Key interest rates (in %)

	2018	2019	Current	Forecast 3 months	Forecast 12 months
EUR	-0.40	-0.50	-0.50	-0.50	-0.50
USD	2.50	1.75	0.25	0.25	0.25
JPY	-0.10	-0.10	-0.10	-0.10	-0.10
GBP	0.75	0.75	0.10	0.10	0.10
CHF	-0.75	-0.75	-0.75	-0.75	-0.75

VSWA Forecast; () old forecast

10-year government bond yields (in %)

	2018	2019	Current	Forecast 3 months	Forecast 12 months
EUR (Germany)	0.2	-0.2	-0.6	-0.5(-0.4)	-0.3
USD	2.7	1.9	0.8	0.7	1.0
JPY	0.0	0.0	0.0	0.0	0.0
GBP	1.3	0.8	0.2	0.2(0.3)	0.5
CHF	-0.2	-0.5	-0.6	-0.5	-0.3

VSWA Forecast; () old forecast

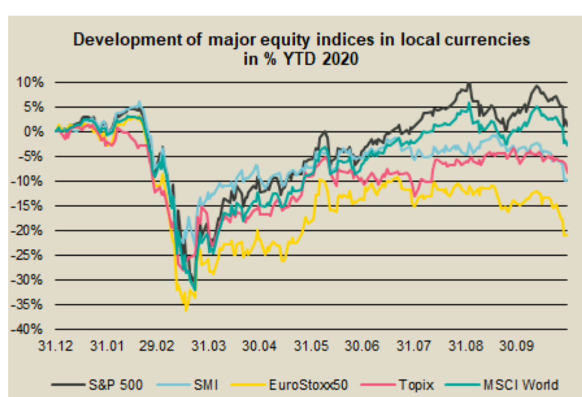
Equities

Most equity markets were down in October, as more stringent lockdowns in many countries across Europe, rising U.S. election uncertainties and stalling negotiations on a new fiscal package in the U.S. have weighed on investor sentiment. The S&P 500 index declined by 2.7%, the Swiss SMI index lost 5.9% and the Euro STOXX 50 index fell by 7.3% despite a very strong start into the reporting season. Defensive sectors, such as Utilities and Communication Services, but also Consumer Discretionary and Financials outperformed, while Energy, Technology and Healthcare underperformed.

As consensus earnings estimates continued to rise in October, falling equity markets resulted in a healthy valuation multiple compression in most equity indices, especially in Europe and Switzerland. With a price-to-earnings (PE) ratio of 20.0 based on estimates for 2021, the valuation of the S&P 500 index remains close to its 10-year average. The PE-ratio of the Euro STOXX 50 index fell to 14.9, while the Swiss SMI index currently trades at a PE-ratio of 15.9. Thus, valuation multiples for the Swiss and the Eurozone equity market are now clearly below historic averages. With a dividend yield around 3% and an earnings yield above 6% based on consensus estimates for next year, both markets offer a considerably higher longer-term return potential than the respective bond markets. The immediate impact of the election outcome on the equity market was positive. We believe that reduced uncertainty should lead to lower volatility and support equity valuation multiples.

Based on estimates for 2021, the equity risk premium for the U.S. market – defined as the difference between the market's earnings yield and the yield for 10 year U.S. Treasuries – is currently around 4.2%. For the Swiss and Eurozone equity markets we estimate an equity risk premium of 6.8% and 7.1%, respectively. Thus, the relative valuation of equities versus bonds is very attractive compared to history, which confirms the strong long-term case for equities. The reporting season for the third quarter started very positive, with more than 70% of and European companies beating earnings estimates, the highest proportion in 10 years. Reported earnings for the Euro STOXX index have surprised 15% to the upside, the largest surprise since the financial crisis of 2008. With a beat ratio of more than 80%, the proportion of companies beating consensus estimates in the U.S. is even stronger than in Europe. It seems that the consensus has underestimated the potential of businesses less affected by the pandemic, the impact of China's recovery on sales of companies most exposed and the positive effect of recently resumed share buybacks.

Investor sentiment has recently recovered from relatively pessimistic levels. According to the American Association of Individual Investors (AAII), 35% of investors surveyed are currently bullish for the stock market, whereas 35% being bearish. While some indicators, such as volatility, future positions and hedge fund allocation are still bearish, the overall reading for market sentiment is currently around neutral. According to the most recent Bank of America Fund Manager Survey, cash levels among institutional investors fell from 4.8% to 4.4% in October, with a net 27% now overweight equities. Hedge funds increased net equity exposure to 42% from 30% in September. The most neglected sector is energy, representing the most extreme underweight in 20 years, while healthcare is currently the most overweight sector. "Long U.S. technology stocks" is considered the most crowded trade, followed by "short USD" and "long gold". Historically, investors have reduced their U.S. equity exposure ahead of elections. A reversal in equity flows typically occurred between one and two months following election outcomes, lasted for several months and usually led to a post-election bounce.



[Source: Bloomberg, VSWA]

Equity market valuations

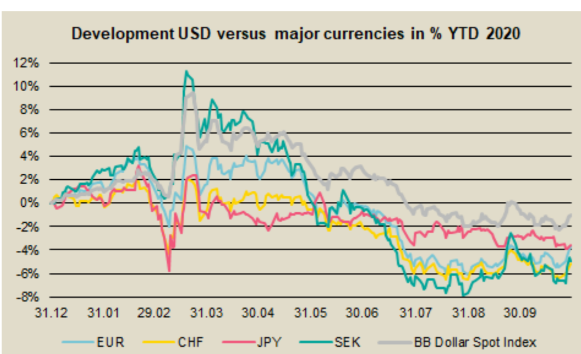
	Price to earnings ratios			Price to Book	Dividend yield %
	Expected 2020	Expected 2021	10 year average	2020E	2020E
USA	24.9	20.1	18.9	3.6	1.8
Eurozone	19.6	14.9	18.3	1.6	3.1
Switzerland	18.8	15.9	18.2	2.5	3.0
UK	18.2	12.7	22.8	1.4	3.9
Japan	21.2	14.8	17.9	1.2	2.2

VSWA Forecast; () old forecast

The probability of more restrictive measures to counter the pandemic has recently increased and could weigh on economic recovery potential and stock markets in the short term. However, clarity regarding the U.S. election outcome will likely provide some uncertainty relief. In the medium term, supportive monetary and fiscal policies, improving earnings estimates, the prospect of a better economic outlook for 2021 and attractive relative valuations versus fixed income investments are in favor of equities.

Currencies

During the last week of October, the U.S. Dollar advanced versus most G10 currencies, which is very typical for an environment of rising risk aversion and higher real yields at the longer end of the U.S. Treasury curve. The likelihood of a Democratic President, a House led by the Democrats and a Republican-led Senate implies that a potential fiscal package will be underwhelming and come through later than initially planned, making ongoing monetary stimulus a necessity. Thus, the low-for-longer yield context will likely prevail and negatively impact the U.S. Dollar until the FED may ultimately starts normalization talks. The high structural U.S. twin deficit will certainly be another long-term driver of Dollar weakness. In the very short term, we do not see much potential for an appreciation of EUR and CHF versus the USD. However, on a 12 months horizon we expect the USD to further devalue against EUR and CHF. We reduce our 12 months forecast for USD/CHF from 0.89 to 0.87 and increase our estimate for EUR/USD from 1.20 to 1.23.



[Source: Bloomberg, VSWA]

The long-term devaluation trend of the USD versus the CHF is structural, irrespective of the political party in office. It is mainly driven by the persistently low Swiss inflation regime, a low public debt level below 50% of GDP, a current account surplus around 9% of GDP and a fiscal balance, which is usually positive. For 2020, the budget deficit of Switzerland is expected to be around 5%, as opposed to 16% for the U.S. and 10% for the Eurozone.

Currencies

	2018	2019	Current	Forecast 3 months	Forecast 12 months
CHF per EUR	1.13	1.08	1.07	1.07(1.08)	1.07
CHF per USD	0.99	0.96	0.91	0.91(0.93)	0.87(0.89)
USD per EUR	1.14	1.12	1.18	1.18(1.16)	1.23(1.20)
JPY per USD	110	108	104	107	105
USD per GBP	1.28	1.32	1.30	1.27	1.30

VSWA Forecast; () old forecast

Commodities

The price of West Texas intermediate (WTI) fell from 40.2 $/bbl to 35.8 $/bbl in October, driven by fears related to the uncertain path of the second COVID wave, new lockdown headlines, potential downwards revisions of demand expectations and a still high level of excess inventories. Given high demand uncertainty, OPEC+ members will likely delay the planned production ramp-up of 2mln barrels per day in order to secure an oil market deficit through the first quarter of 2021. Sustained low oil prices at current levels would have a longer-run impact on supply. At the same time, U.S. shale production struggles to produce as much oil as before the crisis. Despite current demand trend worries we are expecting higher oil prices on a 12 months' horizon, driven by bullish developments on the supply side and the likelihood of falling oil inventories.

Despite rising market jitters, the price of gold continued to move sideways near 1900 $/oz in October. A stronger USD and rising real yields at the longer end of the U.S. Treasury curve may have prevented an upwards move. According to the World Gold Council, global gold demand dropped by 19% to 892t in the third quarter compared to the previous year, which was the lowest quarterly data point since 2009. However, the slump in consumer demand was offset by strong investment demand, which was up 21%. Total gold supply fell by 3% year over year in the third quarter to 1224t with mine production under pressure due to virus related restrictions.

Commodities

	2018	2019	Current	Forecast 3 months	Forecast 12 months
Crude oil (WTI, USD/barrel	45	61	40	45	50
Gold (USD/ troy ounce)	1281	1517	1'870	1950	2000
Copper (USD/ lb.)	3.30	2.80	2.98	3.05	3.15

VSWA Forecast; () old forecast

The long-term case for gold as the currency of last resort and tail hedge in a world of loose monetary policy and high and rising public debt levels is still intact. Thus, we continue to overweight gold relative to our respective benchmarks.

Vontobel Swiss Wealth Advisors AG
Phone: +41 (0)44 287 81 11
Phone (from the U.S.): 011 41 44 287 81 11
info@vontobeladvisors.com

www.vontobeladvisors.com