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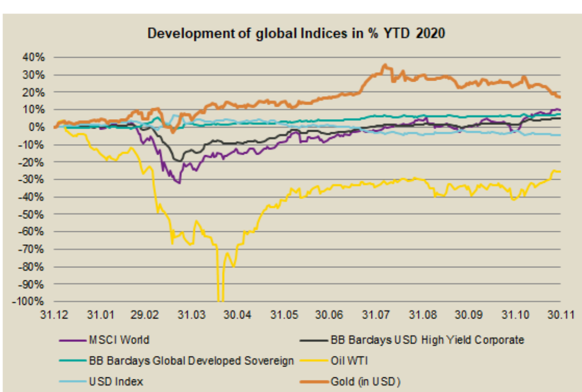
Vontobel Swiss Wealth Advisors

Investment Outlook – December 2020

Dr. Thorsten Krauss, CEFA
CIO
Vontobel Swiss Wealth Advisors

Investment Review

With global equities up almost 13%, November was the best month since January 1975 based on the MSCI World Index. Positive vaccine news from Pfizer and Moderna spurred prospects of a strong economic recovery in 2021 and triggered a material improvement in risk sentiment, even as many countries across the world are faced by a winter resurgence of the pandemic and several European countries re-imposed partial lockdowns. Market participants are expecting an emergency approval of at least one vaccine during the final weeks of 2020, likely setting the stage for improving economic momentum and a persisting risk-on environment through 2021. Since the beginning of 2020, most major equity indices are now back in positive territory. The S&P 500 Index delivered 14.0%, the Swiss SMI Index gained 9.1%, the Euro Stoxx 50 index is up by 1.9% and the MSCI Emerging Markets index returned 10.5%, all on a total return basis in USD terms. Closing the month at $1777/oz, gold continued to move lower as a result of decreasing market stress, but remains among the best performing asset classes, with a return of 17.1% year to date. Government bond yields moved sideways and credit spreads slightly tightened on improving sentiment towards risk assets.



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

At the most recent meeting of our Investment Committee we decided to stay course and keep the equity quota in all multi-asset mandates at overweight. The potential availability of a vaccine by year end limits the economic downside risks and brightens the prospects for a recovery in 2021. Fiscal policy should remain supportive over the next months and monetary policy likely stay accommodative over the medium term, especially in light of the Federal Reserve's adjusted policy goal of a symmetric inflation target. Relative valuation of equities versus bonds is still attractive given extremely low yields across the fixed income space, which will likely persist for several years. Against the background of a very strong reporting season analysts continue to revise their earnings estimates for the next 12 months upwards. Thus, equities clearly remain our preferred asset class on a medium-term to longer-term time horizon.

Global Economy

Following positive trial results from Moderna and Pfizer, the U.S. Food and Drug Administration (FDA) will likely grant an emergency approval for these vaccines in the coming weeks. Based on comments from European Commission officials, three vaccines should also be approved in the EU by year end. In its baseline estimate, Goldman Sachs assumes that above 50% of the population may be vaccinated by the end of the second quarter in most major developed markets. This forecast is based on the assumption that vaccine supply will surpass demand at the beginning of Q2 and that vaccinations during Q1 are focused on high-risk groups, mostly health care workers and individuals with comorbid conditions. Widespread immunization will likely drive a sharp pickup in global growth starting in Q2. We increase our forecast for global real GDP growth for the current year from -4.2% to -3.8% and adhere to our forecast of 5.0% global GDP growth for 2021.

The U.S. economy has rebounded quickly after the pandemic induced recession in Q1 and Q2. However, certain sectors and income groups were hit harder and are recovering more slowly than others. Workers in low-wage industries have been hit by larger income declines during the pandemic and are still significantly below their pre-pandemic income levels. The main reason is that job losses during the first half of 2020 were concentrated in virus-sensitive industries, such as leisure and hospitality, which have a high share of low-wage workers. However, another fiscal package in Q1 and likely employment gains in virus-sensitive industries triggered by the prospect of a vaccine should have a positive impact on personal income across all income groups and likely support private consumption. Purchasing manager surveys for the services and manufacturing sector remained comfortably in expansion zone in November, pointing to a low likelihood of a double dip in economic momentum. Consumer confidence decreased in November, reflecting drops in expectations for income, business and labor market conditions on rising virus cases. As macroeconomic momentum remains supportive, we increase our real GDP growth forecast for 2020 from -4.4% to -3.6% and leave our forecast for 2021 unchanged at +4.0%.

The Eurozone Composite Purchasing Manager Index (PMI) declined sharply from 50 in October to 45.1 in November, which was slightly below consensus expectations. The decline was mainly driven by a weak services component, while the manufacturing component of the survey only fell slightly and remained in growth territory. Across countries, the overall decline was skewed towards France with Germany outperforming. However, the German IFO business climate index also deteriorated in November, reflecting more pessimistic expectations given partial lockdowns across Europe. Recent data confirm our expectation of a potential contraction in Eurozone economic activity during the next weeks, which will be much less severe compared to March and April. We reduce our real GDP growth forecast for 2020 from -7.3% to -7.5% and from +5.2% to +4.9% for 2021.

The Swiss KOF Leading Indicator continued to decline in November, but remains above its long-term average, still pointing to a positive growth environment. The Swiss PMI manufacturing survey unexpectedly increased in November and clearly remains in expansion territory. Swiss retail sales also increased by 3.1% in October compared to the previous year. We adhere to our growth forecast of -4.7% for 2020 and reduce our estimate for 2021 from 4.3% to 4.0%.

The Chinese Composite PMI rose to 55.7 in November, suggesting economic momentum strengthened further. The improvement was broad based, as manufacturing as well as services sentiment improved. The broader Caixin manufacturing PMI increased further to 54.9 in November, which was the strongest reading since November 2010. While consumption lagged in the early stages of China's recovery, more recent data show a pick-up in consumer demand.

Our base case for 2021 implies a relatively weak recovery in Q1 and a stronger rebound in the following quarters as virus related uncertainty gradually decreases. Fiscal stimulus will be sufficient to balance out restrictions and avoid a negative feedback loop. Major central banks will most likely continue to support the economic recovery throughout 2021.

GDP growth (in %)

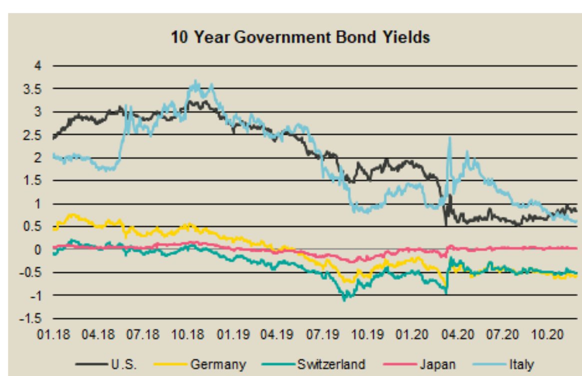
	2018	2019e	Current	Forecast 2020	Forecast 2021
Eurozone	1.8	1.2	-4.4	-7.5(-7.3)	4.9(5.2)
USA	2.9	2.3	-2.9	-3.6(-4.4)	4.0
Japan	0.7	1.0	-5.9	-5.3	2.6(2.3)
UK	1.4	1.2	-9.6	-10.4(-8.4)	5.5(6.3)
Switzerland	2.7	0.9	-1.7	-4.7	4.0(4.3)

VSWA Forecast; () old forecast

Bonds

Despite a strong risk-on environment, government bond yields remained more or less unchanged. The current yield of U.S. Treasuries with 10 year maturity is 0.86% compared to 0.87% by end of October. The longer end of the Treasury curve is usually driven by inflation expectations, which will likely remain muted over the next years despite a very accommodative monetary policy. In our view there are a few reasons for a muted inflation outlook. Healthcare represents around 23% of the core personal consumption expenditures (PCE) basket and in politics there is bipartisan support to keep inflation for drugs and medical services at low levels. The recent launch of Amazon Pharmacy will also make drug pricing more transparent. The trend to suburbanization may continue and restrain rental inflation over the coming years. This will likely keep inflation in housing low, which represents around 20% of the core PCE basket. Consumer electronics even faces deflation as prices for video and audio equipment as well as computers are expected to fall by around 8% per year over the next years. U.S. real GDP may be back to pre-pandemic levels by mid-2021. However, output gaps usually take many years to close. The current output gap is reflected in persistent labor market weakness and lack of pricing power in many industries, both being a headwind to inflation. We see modest upside for U.S. 10 year yields to around 1.2% over the next 12 months, while the short end of the curve should remain anchored close to zero given the dovish monetary policy outlook.

Similar to the U.S., we expect longer-term government bond yields in the Eurozone and Switzerland to slightly increase in 2021 on a more favorable economic outlook. Core inflation in the Eurozone and Switzerland is even lower compared to the U.S. and the appreciation of the EUR and the CHF in 2020 should add further headwind to inflation in both countries. As a rule of thumb, a permanent move of 10% in the effective exchange rate of the Euro impacts core inflation by around 0.4% over the following two to three years. According to preliminary releases, Eurozone core inflation remained at a 20-year low of 0.2% in November, while Swiss core consumer prices declined by 0.1% in October compared to the previous year. Given extremely low inflation data, the future path for monetary policy in the Eurozone as well as in Switzerland seems pretty obvious.



[Source: Bloomberg, VSWA]

After moving sideways for several months, credit spreads continued to tighten on positive vaccine news and certainty regarding the U.S. elections. For 2021, we expect spread compression to continue and credit spreads to inch closer to pre-pandemic levels. A more favorable macroeconomic picture in 2021 should translate into a benign backdrop for corporate earnings, credit ratings and defaults, thus supporting credit risk appetite. At the same time, ultra-loose monetary policy will continue to support the search for yield. Through direct intervention by the FED and the European Central Bank (ECB) in credit markets, tail risks are kept under control and volatility in credit markets limited.

Given unattractive nominal and real yields and our expectation of slightly rising government bond yields during 2021, we continue to underweight the asset class in our multi-asset-mandates. Within fixed income we remain focused on corporate bonds, which should profit from an improving macroeconomic outlook and further spread compression.

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	-0.3
USD	2.7	1.9	0.9	0.9(0.7)	1.2(1.0)
JPY	0.0	0.0	0.0	0.0	0.0
GBP	1.3	0.8	0.3	0.2	0.5
CHF	-0.2	-0.5	-0.5	-0.5	-0.3

VSWA Forecast; () old forecast

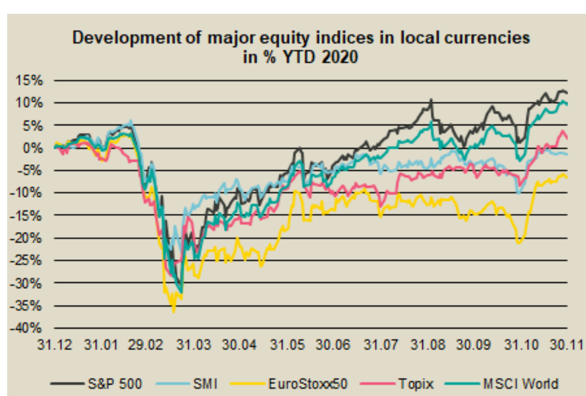
Equities

November has been one of the best months on record for global equities as strong earnings releases for the third quarter, rising optimism regarding a potential vaccine as well as the prospect of a Democratic U.S. President kept in check by a Republican Senate boosted investor sentiment. The S&P 500 and the NASDAQ 100 increased more than 10%, the Swiss SMI gained 9.4% and the Euro STOXX 50 jumped even by 18%. Cyclical sectors, such as Energy, Financials and Industrial were among the best performers, while Utilities, Consumer Staples and Healthcare lagged behind the overall market.

After the strong rally from depressed March lows, current valuation multiples suggest that global equities are clearly anticipating a much better growth environment in 2021. Average Price-to-earnings (PE) ratios of 17.0 for the Swiss equity market, 17.6 for Eurozone equities and 20.9 for the S&P 500 Index based on estimates for 2021 are in the range of historic averages but seem not outright cheap given the still uncertain economic environment, which will admittedly most likely improve during 2021. However, consensus estimates for the next 12 months on an index level are still 7% below pre-pandemic levels in Switzerland, 8% below in U.S., and 28% below in Europe. During recessions, companies usually try to reduce costs by adapting their workforce and investing in efficiency projects. As a result, many companies are able to earn higher profit margins in the years following a recession compared to before a recession, which usually leads to a strong earnings cycle. Thus, there is no reason to believe that aggregated earnings will remain below pre-pandemic levels for an extended period of time. Analysts will likely have to adjust their estimates higher during the next months, which is very typical for post-recession periods. Upside revisions have a positive impact on valuation multiples and may offer further upside for equity markets.

Given the current zero-yield environment, which will likely continue in the medium term, it is pretty obvious that equity valuation multiples can't be as low as 10 years ago, when 10 year Treasuries yielded 3.5%. The so-called equity risk premium, which compares the earnings yield of equity markets with bond yields, is still high across major indices compared to the longer-term history. Based on estimates for 2021, the equity risk premium is currently around 3.7% for the U.S., 6.1% for the Eurozone and 6.3% for Switzerland. Expected upside revisions of company earnings will likely increase the equity risk premium, making equites even more attractive versus bonds and confirming the strong long-term case for equities. The reporting season for the third quarter proved to be one of the best earnings seasons in many years with Industrials, Consumer stocks and Financials particularly strong. Strong earnings releases also resulted in upwards revisions of analyst estimates, which bottomed by mid of 2020 and started to trend higher since.

Since the U.S. Presidential election, investor sentiment and risk asset positioning increased materially. The American Association of Individual Investors (AAII) survey spiked to post-crisis highs, with 47% of investors now being bullish for the stock market and only 27% being bearish. Global equity funds recorded the largest inflows since the year 2000, while safe assets, such as money market funds and government bond funds recorded outflows. As institutional investors moved into riskier buckets of the equity universe, such as small-caps, cyclicals and value stocks, cash levels fell from 4.4% in October to currently 4.1%. A net 46% of asset allocators are now overweighting stocks, representing the highest level since January 2018. This pick-up in risk-asset flows largely reflects an improved macroeconomic outlook and reduced negative tail risks for the recovery in 2021.



[Source: Bloomberg, VSWA]

Equity market valuations

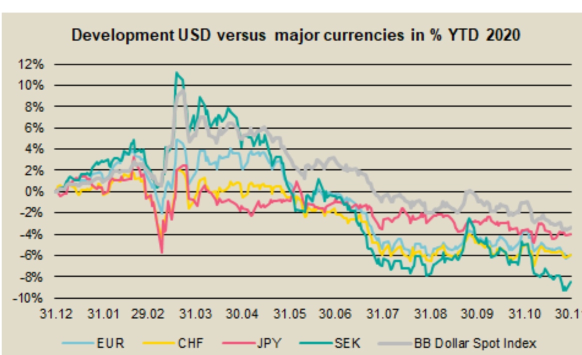
	Price to earnings ratios			Price to Book	Dividend yield %
	Expected 2020	Expected 2021	10 year average	2020E	2020E
USA	25.4	20.9	19.0	3.8	1.7
Eurozone	22.6	17.6	18.6	1.8	2.6
Switzerland	20.1	17.0	18.3	2.7	2.9
UK	21.0	14.4	23.0	1.5	3.5
Japan	22.6	15.8	18.0	1.3	2.1

VSWA Forecast; () old forecast

We remain optimistic regarding the outlook for global equities in 2021. While we acknowledge short-term fears surrounding further lockdown measures, the prospect of a vaccine, which may be available by year end, reduces the risk of persisting uncertainty in many segments of the economy. Other factors reinforcing our positive view on equities are the expectation of a strong earnings recovery in 2021 and thereafter, a likely continuation of ultra-accommodative monetary policy and a more attractive valuation versus the bond markets.

Currencies

During November, the USD depreciated against all G10 currencies as a result of the general risk-on environment, with cyclical currencies, such as the Australian Dollar and the Norwegian Krona gaining between 4.5% and 7.5%, respectively. With increasing prospects for further U.S. fiscal stimulus, a rising likelihood of a successful vaccine roll-out, China's economic rebound driving global growth, and the FED expected to keep rates low for years, demand for the world's reserve currency has fallen. Since the beginning of 2000 the U.S. Dollar has declined against all but one G10 currencies. It has also dropped 8% against the Swiss Franc and 4% against the Japanese Yen, which also serve as traditional safe haven currencies. This underlines the massive impact of the FED's unprecedented stimulus and large fiscal packages leading to record high budget deficits. During the global financial crisis, when the U.S. central bank was also engaged in quantitative easing, the Dollar has gone through a similar decline. According to the Commodity Futures Exchange Commission (CFTC) global asset managers have boosted their short bets on the U.S. Dollar to record levels.



[Source: Bloomberg, VSWA]

On 2nd December, USDCHF broke through 0.90, which had been tested several times in the second half of 2020 and each time acted as an important support area. During the next 12 months we see the risk of a further leg down in USDCHF, as the lower-for-longer yield environment will likely prevail and negatively impact the U.S. Dollar.

In light of the high structural U.S. twin deficit, the longer-term outlook for the USD against the CHF is in our view even less compelling. Given the long-term nature of this trend, U.S. investors should re-assess and potentially increase their exposure to international assets. Given the persistently low Swiss inflation regime, one of the world's lowest public debt levels, and a high current account surplus, Swiss assets stand out in a global context by their defensive nature.

Currencies

	2018	2019	Current	Forecast 3 months	Forecast 12 months
CHF per EUR	1.13	1.08	1.08	1.08(1.07)	1.08(1.07)
CHF per USD	0.99	0.96	0.89	0.89	0.87
USD per EUR	1.14	1.12	1.21	1.21(1.18)	1.23
JPY per USD	110	108	104	107	105
USD per GBP	1.28	1.32	1.33	1.32(1.27)	1.35(1.30)

VSWA Forecast; () old forecast

Commodities

Oil had been struggling in the recovery of risky assets but significantly picked up in November as the price of West Texas intermediate (WTI) jumped more than 25% to 45.3 $/bbl. As of writing, the OPEC countries and its allies seem to be closing in on an agreement to modestly boost their oil output by around 500.000 barrels per day starting next month. The agreement would mark a compromise to bridge differences between producers over whether the time was right to start rolling back cuts agreed to earlier in the year in an effort to stabilize prices. We maintain our constructive view on oil given our expectation of an improving macroeconomic backdrop in 2021.

Having traded in a range between approximately 1850 and 1950 $/oz during the past two months, gold moved lower and closed the month at 1777 $/oz. Given decreasing financial stress, the prospect of slightly rising yields and still low inflation data, the short-term potential for gold seems limited. However, as published by the CFTC, net long positions of speculative investors in gold futures continuously decreased since the end of the first quarter, signaling that the very bullish sentiment reached in March has changed into a probably more realistic assessment of the future price appreciation potential of gold.

Commodities

	2018	2019	Current	Forecast 3 months	Forecast 12 months
Crude oil (WTI, USD/barrel	45	61	43	45	50
Gold (USD/ troy ounce)	1281	1517	1'831	1900(1950)	1900(2000)
Copper (USD/ lb.)	3.30	2.80	3.25	3.45(3.05)	3.45(3.15)

VSWA Forecast; () old forecast

Gold's long-term perspectives are in our view still intact. A potential weakness of the USD, negative real yields for considerable time, high and rising public debt levels in many countries across the world and the looming risk of debt monetization speak in favor of gold as a portfolio diversifier, strategic "black swan" hedge and currency of last resort. We continue to overweight gold relative to our respective benchmarks.

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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