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Investment policy Q2/2020

English Version

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A vortex of uncertainties between panic and rationality

Investment Policy

Covid-19 coronavirus pandemic has drastically changed the financial and economic scenarios, leading above all to abrupt corrections of equity values, as well as imposing massive monetary and fiscal interventions. Making predictions is arduous, but these interventions may not be sufficient to protect the system from a risk of inevitable recession, causing a progressive deterioration of financial conditions, with consequent situations of illiquidity and insolvency by the most vulnerable issuers. On the other hand, as in any particularly critical market situation, choices on the wave of panic and emotion should be avoided. Indeed, an accurate analysis of the performance of the different investment classes in the turbulence phases can lead to medium-long term opportunities. Financial history indicates how deep and sudden crises were followed by equally important and sometimes rapid rallies.

Outlook

For now, we forecast a long phase of uncertainty related to the epidemiological dynamics of the virus and its impacts on public budgets, financial institutions and companies. The initial supply shock born from the Chinese pole has evolved into a demand shock and financial turbulence. The high level of indebtedness, or leverage, present in the financial, real estate, private sector, could partially frustrate the interest rate reductions by central banks, as, beyond these terms of reference, the risk premium is expected to grow due to fear of default and illiquidity, at least in the short term. The falls in private consumption also weigh and everything can generate a deflationary spiral but, at a later stage, we could instead witness a new scenario: rethinking globalized choices, possible monetization of debt, widespread nationalizations and even more marked welfare policies, especially in certain European countries, with the possibility therefore of reigniting inflation in the longer term, favoring public and private debtors but once again penalizing savers.

Macro

The difficulties that the ongoing pandemic can create in supply chains for companies, increasingly dependent on China, the limits on the movement of goods and people, the lower demand and the greater expenses borne by public and private institutions, will weigh on growth of many countries and will impose, massive monetary and fiscal interventions, with programs of public interventions and extraordinary measures. The rapid restoration of the production chains will also be crucial. The Trump administration has launched a large tax exemption program and other extraordinary support measures - which includes specific measures for the sectors most affected - for a package of more than $ 2,000 billion. However, on the eve of the turbulence, US economic data appeared positive, all the more so in comparison with the European data. Other broad economic support measures came from the Government of the People's Republic of China, whose economy also showed signs of slowing down already on the eve of the virus explosion. In Italy, the rigid measures adopted and the € 25 billion bill (with a further bill for the same amount) can lead to a particularly difficult situation for public finances, even if the European Commission is ready to give up on budget constraints given the circumstances. In Germany, the government has made liquidity available for a minimum of € 550 billion and without a ceiling, declaring it is ready to provide other funds. France, for its part, will initially spend € 45 billion (but go up to € 300 billion) to help small businesses and employees. In Great Britain, where Johnson initially decided on a contrarian approach to lock-down, has finally changed course and provided stimulus for £ 330 billion. Instead, Spain announced a € 200 billion stimulus plan. For Switzerland, despite its relatively solid fundamentals, still there will be a drop in domestic demand and exports, all the more so if the franc appreciates further. We remind, in this regard, the interventionism of the Confederation which, in addition to following the rigid policy, began in Ticino with regard to the pandemic, has dedicated CHF 10 billion to deal with the emergency. Last, the G-20 will inject $ 5'000 billion to tackle the emergency, as well as IFM with $ 1'000 billion.

Fixed Income

While government bond yields have touched all-time lows to then rebound, extraordinary interventions in support of the financial markets have not been lacking on both sides of the Atlantic. The U.S. Federal Reserve has once again proved particularly responsive, intervening with two short-term interest rate cuts, which have effectively reduced the cost of money to zero, injecting $ 1.5 trillion into the system and launching a new $ 700 billion quantitative easing (QE). The other central banks have moved in the same direction, albeit with less substantial volumes: the Bank of England has reduced its rate by 65 bps with a current rate of 0.1 bps and has launched a new QE; the Bank of Japan will provide ample liquidity to the markets and is doubling its purchases of equity ETFs. The European Central Bank (ECB), after an initial € 120 billion QE program that heavily disappointed the markets, decided to intervene with an extraordinary plan, while leaving the reference rate unchanged. The ECB has launched a new purchasing program called PEPP, Pandemic Emergency Purchase Programme for at least € 750 billion that will last at least until the end of the year and will include also Commercial Papers and Greek debt. For allocation choices in the corporate bond field a prudent approach is a must, as the financial stress to which companies are subjected will inevitably lead to an increase in defaults rate, especially in the more week sectors such as transports, OIL and automative below IG. The dramatic widening of spreads, however, represents an opportunity to invest in solid issuers bearing in mind the possible illiquidity risk. Emerging market issues, which offer high rates of return, could benefit from more stable growth thanks to a weak dollar and extra-accommodative policies from central banks, even if in the short term their currencies are weakening. Among those issues, especially interesting are those from the Asian area that have shown good resilience thanks to the Chinese ability to respond to the pandemic. The sector of high-yield issues appears to be equally affected, but it should be considered their correlation with their relative reference share values and a market that is seriously under-liquidated on the stress days. In addition to diversification, caution should be used until the equity market shows some form of stabilization.

Equities

The "perfect storm" has hit a rally, which, after 11 almost uninterrupted years, was still looking for support, especially on Wall Street, after the phase of ample liquidity, the widespread corporate buybacks and corporate tax breaks. However, the corrections observed in some sessions appear excessive as well as indiscriminate, especially due to the computerized programs and the "crazy" algorithms, and it will be crucial to find the right "extra-emotional" assessment threshold, while taking into account a prospective drop in profits in many areas. What happened, despite all the precautions that the scenario imposes, still confirms our general appreciation, within a portfolio, for the equity component, albeit with a prudent approach and with the reduction of the sectors most exposed to risk, such as luxury, raw materials, airlines, tourism. In terms of geographical diversification, although the European equity markets, as well as the Japanese appear theoretically more interesting in terms of valuation, we still prefer the greater security of the US listings, above all for the greater liquidity. In Switzerland, after corrections, the pharmaceutical sector is interesting. The emerging markets and China itself, albeit promising, will have to deal with the impact of the pandemic. Among the sectors our preferences go to those related to demographic dynamics, the themes of water, cybersecurity and what is related to the world of new generation batteries.

Alternative Investments

The new scenario has had a heavy impact on most of the raw materials, whose main recipient is China. If industrial metals suffered, an even more dramatic drop was that of crude oil, due to the breakdown of the agreements within the OPEC+. In particular Russia's refusal to accept the additional cuts of daily production proposed by Saudi Arabia, led to a rapid and heavy collapse in the quotations of the crude oil due to expected lower demand and higher supply. Moscow's decision derives from a financial condition that has been strengthening in recent years, in terms of debt and reserves, and a "break even" price of around $ 40 a barrel, compared to the 80-90 needed to finance the reform and diversification projects of Saudi Arabia. The new "price war" penalizes above all the US shale oil industry, with a "breakeven point" around $ 50, in which the costs are higher, the productivity of the wells lower and the financial situation of many companies is difficult. Subsequently, with Trump's intervention, the situation eased with Russia and Saudi Arabia that should agree on a cut of 10-15 million barrels per day. At this point, zero and negative rates, together with tensions and uncertainties, still favor gold as a safe haven asset. In reality, it had already entered a positive trend due to economic and geopolitical uncertainties, the massive purchases made by some central banks and the increased volatility of stocks. It is true that with the emergence of the pandemic and the collapse of the markets, gold was under pressure due to the choice of many managers who sold it to cover the heavy losses suffered on other portions of the portfolio. In the medium to long term, gold can benefit not only from the current critical phase, but also from extreme deflationary and inflationary developments in the scenarios. Among alternative products, those that exploit the increased volatility of the markets are also interesting.

Forex

The reduction in the differential between dollar and euro yields can play against the greenback, at least temporarily, given the unfavorable political pressures. However, economic and market developments will define the trends, which could penalize the European currency. The Swiss franc and the Japanese yen could further strengthen, confirming for the moment their role of "safe haven currency". Some emerging market currencies offer attractive returns, but monetary risk should be protected to avoid those capital losses with which financial history is studded and which moments of financial turbulence accentuate.

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Axion SWISS Bank SA
Viale S. Franscini 22
CH 6901 Lugano
Switzerland

Tel: +41(0)91 910 95 10
Fax: +41(0)91 910 95 14
Web: www.axionbank.ch
Email: mail@axionbank.ch