

»FischView

Monthly Update – October 2020

As at 22 September 2020

Summary

- Our market assessment in recent months was based on our analysis of the monetary and fiscal policy support packages that were created to cope with the Covid-19 crisis. More specifically, we looked closely at the relationship between the size of the stimulus packages and valuation levels seen in equity and credit markets.
- The crisis was caused by an exogenous shock and was not the result of systemic factors, misallocations or structural weaknesses in the global economy. Therefore, our macro model did not provide meaningful signals during this period, as it does not incorporate this type of exogenous shock.
- Meanwhile, the input variables for our macro model (these are both economic and monetary indicators) are once again beginning to react in the typical way, as was historically the case in the pre-crisis environment, with regards to forecasts for e.g. economic growth and developments in the equity and credit markets. The temporary and severe distortions caused by the massive interventions carried out by governments and central banks have eased. The global economic system appears once again to be developing on the basis of endogenous forces and is no longer being influenced by exogenous shock waves.
- Overall, the model is producing positive signals related to the economy and equity and credit markets. However, these results are still being distorted towards the upside in part by strong base and trend effects. Furthermore, short-term risks (the US elections, the lack of stimulus packages and the spread of Covid-19) as well as the current weakening of market technicals and money supply dynamics, are not fully reflected in the model's parameters.
- Taking into account these increasing short to medium-term risks in the current environment, our overall assessment has been reduced to neutral.
- The structurally positive model assessment in the medium to longer term remains valid: there is no real bubble because of the low interest rate levels, loose monetary policy and the recovering economy, which all justify higher valuations. Nevertheless, we expect a sharp increase in volatility in the coming weeks with the potential for a temporary correction due to the risks mentioned above.

Highlights and key changes

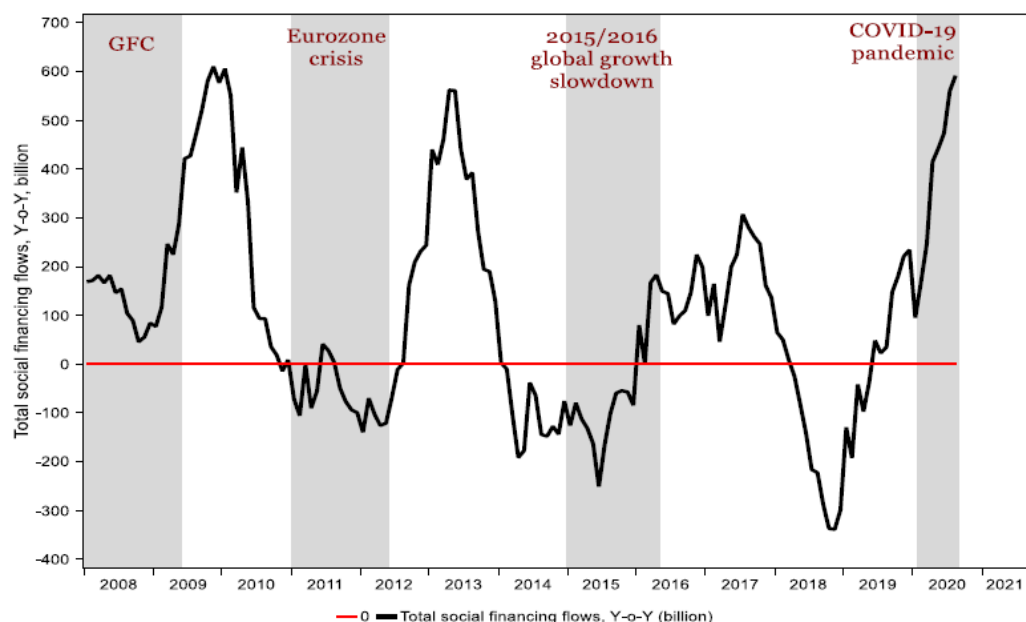
- We have been observing a slowdown in the momentum of monetary policy for some time now (slow expansion of the balance sheets of the Fed and the ECB, decreasing momentum of money supply growth, refinancing problems of small and medium-sized enterprises (SMEs), declining velocity of money circulation). Nevertheless, the resulting negative effects on financial markets are offset by a significant acceleration in the global economy. Since monetary policy is unlikely to lose any further momentum and the recovery of the global economy is continuing at the same pace, the medium-term outlook for financial markets is actually positive overall. This has also been confirmed by our macro model.
- Additionally, the US dollar has stabilised somewhat and inflation expectations remain very subdued. This means that the danger of a chain reaction (i.e. falling dollar, rising commodity prices, rising inflation and higher interest rates), which has existed for some time, is not acute at the moment. Meanwhile, central banks are maintaining their room for manoeuvre for the potential loosening of monetary policy further if needed, which means any increase in long-term interest rates remains limited for the time being.
- Equity market valuations remain relatively high after the recent market correction. However, taking into account the very low level of interest rates, there is no real bubble. In the US, dividend yields on equity markets are currently around 1.8 percentage points above three-month T-bill rates. In comparison to history, this represents an appropriate risk premium for the equity market. Valuations in credit markets are also within a fair range. The high yield market is currently pricing in a default rate of 5%, which also represents the appropriate level of risk compensation. However, there could be problems in the energy sector if the oil price does not soon recover significantly from its current low levels.
- By contrast, in the government bond market, especially in the US, we see clear overvaluation levels and significant risks due to the rapid increase in national debt and the interest rates being kept artificially low by the central bank. However, these issues are likely to only become relevant for markets in the medium to long term, especially if the US dollar weakens further.
- There are currently various short-term risks that are not fully reflected in our macro model. The US presidential elections are difficult to assess. More specifically, a possible challenge to the election result would be problematic. In addition, there is uncertainty about another Covid-19 stimulus programme from the US government.
- An additional uncertainty factor is the continuing strong global spread of the Covid-19 epidemic. On the one hand, mortality rates are declining significantly and health systems are operating well within their capacity limits. On the other hand, there are increasing signs of longer-term, structural economic damage, which could have a negative impact on equity and credit market valuations in the foreseeable future. However, the current rapid development of vaccines and treatment therapies should limit this damage. In addition, further fiscal stimulus programmes can be expected worldwide.
- Market liquidity in both the convertible bond market and corporate bonds is reasonably good, despite weaker equity markets. This signals limited stress within financial markets and illustrates the effectiveness of monetary policy.

Topics “on the radar”

The current economic acceleration worldwide, especially in China, is an important long-term positive factor for financial markets. The associated problems with regards to implementing a continued loose monetary policy should be partly compensated for. Nevertheless, in the short to medium term there may be a sharp increase in market volatility once the transition from a monetary to a cyclically driven upswing takes place.

The following chart shows credit growth in China on an annual basis. The policy pursued by the Chinese government until 2019 of "deleveraging" the financial system has now been reversed in the exact opposite direction. This is positive in the short to medium term. It is also noteworthy that demand for credit from the private sector appears to be increasing in China and is not being induced by the central bank via an artificial expansion of the money supply.

Chart: Chinese total credit growth (year-on-year, billion CNY)



Source: Longview Economics, Macrobond

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible bonds	<ul style="list-style-type: none"> – Industrials – Utilities – Technology 	<ul style="list-style-type: none"> – Shopping center REITS – Energy
Global High Yield	<ul style="list-style-type: none"> – 'B' rating segment in Europe – Telecom – Industrials 	<ul style="list-style-type: none"> – 'CCC' rating segment – Asia – Banks
Emerging Market Corporates - Defensive	<ul style="list-style-type: none"> – Asia 	<ul style="list-style-type: none"> – Europe
Emerging Market Corporates - Opportunistic	<ul style="list-style-type: none"> – EM high yield 	<ul style="list-style-type: none"> – EM investment grade
Global Corporates	<ul style="list-style-type: none"> – North America – Telecom & media – Pharma 	<ul style="list-style-type: none"> – Pacific – Energy – Asia high yield

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

Disclaimer

This presentation ("Presentation") is provided solely for information purposes and is intended for institutional investors only. Non-institutional investors who obtain this documentation are please asked to discard it or return it to the sender. This Presentation is not a prospectus or an offer or invitation to buy financial products.

This Presentation is provided for marketing reasons and is not to be seen as investment research. This Presentation is not prepared in accordance with legal requirements designed to promote the independence of investment research, and that it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

HISTORICAL PERFORMANCE IS NO GUARANTEE OF FUTURE PERFORMANCE

Investments in financial products are associated with risks. **It is possible to lose the entire amount of the invested capital.**

Insofar as the information contained in this Presentation comes from external sources, Fisch Asset Management AG cannot guarantee that the information is accurate, complete and up to date.

Statements concerning future developments and estimates are based on assumptions that may be inaccurate, that could change or that are based on simplified models. Fisch does not know whether its statements concerning future developments will be correct. Fisch may also change its opinion concerning a future development. In such case, Fisch has no obligation to inform anyone about the change in opinion.

Fisch expressly states that this Presentation is not intended for private investors and advises institutional investors to first consult financial, legal and tax experts who are familiar with their specific situation and understand the product.

This Presentation is especially not intended for US persons (private or institutional) as defined by the FATCA legislation or under SEC regulations. US persons may not invest in any investment funds managed by Fisch, and Fisch is also not permitted to manage mandates from US persons. If Fisch learns that a US person is invested in a product it manages, it will inform the fund management company and, if necessary, other persons and demand that the US person sell the product.

Fisch has outsourced the storage and archiving of company data to a specialized third party firm. The outsourcing is limited to the storage and archiving of data and occurs abroad. The processing of data is done within Fisch and is not outsourced. The activity of the third party firm essentially consists of setting up and maintaining the corresponding servers. The regulatory authorities and the auditing firm have been informed by Fisch about the outsourcing, and the data protection and regulatory requirements are fulfilled.

Fisch accepts no liability for damages arising directly or indirectly as a result of this Presentation.