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Q 03 / 2020

Quarterly Investment Review and Outlook

What about the new normal?

Since the peak of the pandemic, market participant chatter has been dominated by the concept of "the new normal.” But is the new normal a market driven by forces of a few technology companies, a huge central bank action, and deficit spending?

Recent equity index performances were generated by a few IT-strong companies, all linked to this phenomena of the new normal. However, in order for the market to move further ahead, we might need a little less "new normal" and a little more “previous normal.”

Considering the current mixed bag of market factors, investors most likely want to see a path to sustainable gains – sustainable in terms of both physical mobility *and* monetary gains.

We strongly believe that both will take shape, but not necessary at the same time.

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Quarterly Report – Q03/2020

At a glance

Review – 3rd quarter of 2020

a) Rotation out of tech, but it's not game over for the tech rally

With the Nasdaq still up by more than 45% from its March low – even with this month's sell-off – and US large cap gains leaning heavily, related to the "new normal," questions have resurfaced over tech valuations.

Over the past five years, mid-cycle corrections of around 10% have been followed by subsequent six-month returns of around 20%. Rebalancing some excess is an opportune way for the market to reposition itself for the next upwards thrust.

b) The Fed is doing nothing and this is not enough

The Fed started implementing its new strategy, i.e., as long as inflation doesn't go above 2%, there will be no tightening. In absolute terms, this means that no interest rate hike is to be expected prior to 2023.

c) Negative interest rates in the UK?

On the back of difficult Brexit negotiations, the lockdown impact, and a resurgence of new COVID cases, the MCP announced it is studying the implementation of negative interest rates.

d) Where is the barrel price headed?

The supply/demand equation is at an equilibrium, with a barrel price of USD 40-45; this is supportive for the economic outlook – that is, it is neither too low nor too high.

e) Talks are shifting

During the last 6 months, talks were clustered around healthcare issues. We expect that political issues (Brexit, US elections, US/China tensions, and the Supreme Court nomination), will capture investor attention during the 4th quarter of 2020.

f) Upside scenario

We expect that the upside potential is truly warranted once a vaccine becomes available. In this phase of the market, we expect a sector rotation to take place, i.e., a reduction in US large tech stocks in favor of next tier growth stocks that are exposed to 5G, China's new consumers, and IIoT.

g) Downside risks

There are a number of lingering downside risks: a) no COVID-19 vaccine by March of 2021, b) a new general lock down, c) global growth impeded by a lack of progress in US-China trade discussions, d) political gridlock following the US elections, amongst others.

While any single risk or concern can be addressed by investors, the simultaneous occurrence of several risks is difficult to manage; such an event could leave the market at much lower levels.

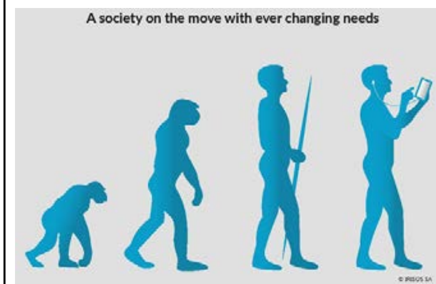
h) Taking advantage of diverging markets.

Amid uncertainties about a vaccine, fiscal developments, lackluster consumer spending, CB actions, and other worries, investors should expect diverging markets. Not being invested is most likely to be costly; capital-protected notes allow investors to benefit from rising and falling markets while simultaneously protecting the underlying capital.

These product types go beyond the traditional style of investing, but and nevertheless, they include, value and cyclical stocks, growth and value, and more importantly, they benefit from a geographical diversification. Given this, such market neutral instruments are complementary for each portfolio.

Consumer migration or dislocated consumers?

Six months into the pandemic, some companies are starting to feel the heat as the sales channels and approaches they have been relying on for years are burning up faster than ever. The reality is that customers have now migrated to digital in every area of their lives, including IT-related consumption, cars, doctors' visits, food, and more. This trend is not new, but has become more prevalent. Since 2015, the IRISOS investment strategy has focused on companies related to the digital age transformation. And since 2017, this investment strategy has been made available to the greater public via an actively managed investment certificate [download fact sheet]. This investment opportunity has proven to be a great performance provider – on average, +18.5 p.a. Let's dive a little deeper into the matter.



COVID-19 has accelerated a trend that was clearly in place even prior to the pandemic; that is, successful ecosystems interconnect sets of services through which users can access a variety of cross-sectoral needs in one integrated experience. The prime example which can be mentioned in the instance is Apple with its multifaceted ecosystem, built from scratch. Dominant players disrupt the market by using hyperscale platforms to contest the market share of incumbent players; they disintermediate, i.e. remove the middle man by appealing directly to consumers, and often substitute for, the offerings of traditional competitors by controlling customer interfaces and control points such as search, advertising, and messaging.

Today, some of the biggest companies by market capitalization are related to digital B2C and B2B business models. Some companies straddle different areas of expertise: Amazon, for example, ties together e-commerce, cloud computing, logistics, and consumer electronics; while China's Tencent provides services including social media, gaming, finance, and cloud computing.

When looking at the business models and eco-systems that the next 100 companies (by market share) are trying to build, we note that most operate with systems which fall somewhere between the old and the new. Still, they are accelerating towards Ecosystem 2.0.

Ecosystem 2.0

How does Ecosystem 2.0 work? For starters, it creates value along two dimensions. It allows participants to consolidate ranges of users, which are then segmented into different categories of the touchpoint concept (also called a sales funnel). Fast-moving ecosystem creators don't try to build everything they need in-house. Instead, successful ecosystem organizers assemble and partner extensively with other participants, either within their traditional industry boundaries or outside of them. These moves can spark fresh innovation and efficiencies along value chains to improve customer experiences, while opening new avenues of value creation for a wide range of participants.

Traditional players often change the way they serve their clients. Instead of limiting themselves to services within their historical business model concept, they may go above and beyond in an effort to serve customers from A to Z, throughout an entire process. For instance, let's look at the United Kingdom's ZPG; they are angling to create a start-to-finish ecosystem that covers all of the processes related to "moving." This ecosystem includes property search, property comparisons, mortgage shopping, household moving, switching phone, cable, and utilities, and accessing home-improvement professionals to get offers for improvements.

It is expected that more than 15 industry sub-sectors, mostly related to mobility, travel, hospitality, health, housing, and staples, may evolve into one single ecosystem concept. This concept would be a kind of virtuous network of networks that leverages AI to focus on customer service with cross- and up-selling and service opportunities. In fact, this shift will happen as a sure thing. The value creation is immense, and the scale of the integrated network could reach USD 60 trillion as soon as 2025.

Recent research concluded that both consumers and corporations understand the appeal of such integrated systems. About 70% of consumers confirm that they are tempted to make use of the benefits provided by Ecosystem 2.0, while about 40% of S&P 500 companies are likely to join or form an ecosystem within the next 18 months.

5G

The rollout of 5G communication systems will accelerate the move towards Ecosystem 2.0. This in turn will increase the demand for hardware and software to build data centers, maintain communication exchanges, and provide application programming interfaces that reduce latency. Advanced systems go one step further: they are providing tools to manage vast databases and using AI to improve their own concepts, while understanding the flows that occur elsewhere, thereby channeling more consumers to their own ecosystem.

Welcome to tomorrow – but stay well anchored in the present, as the future can become a well-orchestrated trap for the uninformed.

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Investment recommendations by type

1. Equities:

Short-term view: - Neutral

Medium-term view: - With the shortest recession behind us, we believe that equity markets are truly at their fair value at present! We remain strongly positive on strong secular trends; in particular, 5G, IT security, and IT-Services.

2. Bonds:

Short-term view: - Neutral

Medium-term view: - With the market recovering, we favor BBB and single A debtors, yielding in the range of 6% p.a. We recommend a focus on companies with strong historic cash-flows, as weaker companies will experience a rating reduction.

3. Credit:

Short-term view: - **Highly Attractive**

Medium-term view: - With spreads at all-time high and Central Banks rolling a renewed bond purchasing program, a sharp recovery in 6 to 9 months can be expected.

4. Metals:

Short-term view: - Neutral

Medium-term view: - Neutral to negative: Historically, metals are a refuge play – however, this only partially materialized.

4. Commodities:

Short-term view: - Neutral to negative

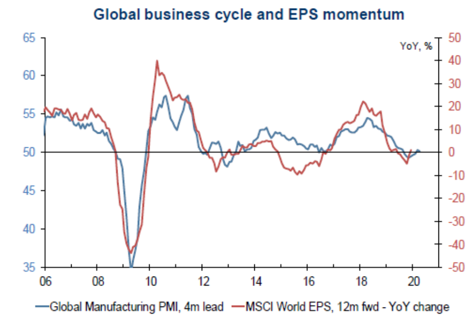
Medium-term view: - In the oil market, the supply/demand equation starts to find its own new balance, though at much lower levels.

5. Structured solutions:

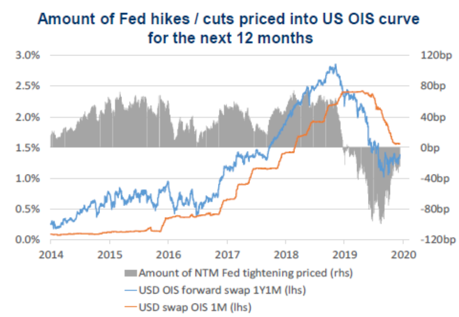
Short-term view: - With the market being back to a level prior to 2016 and an increased level of volatility, conditional capital guaranteed products offer an ideal risk/ reward.

Medium-term view: - Longer-term investors should consider taking profit on the combined strategy of "Main versus X-over," and switch to a single credit strategy of "Main" only.

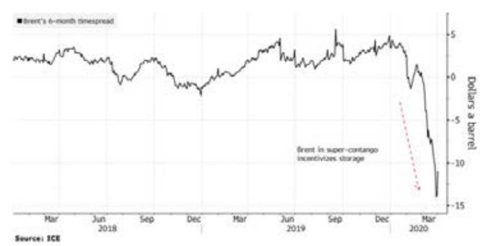
EPS Momentum again at average!



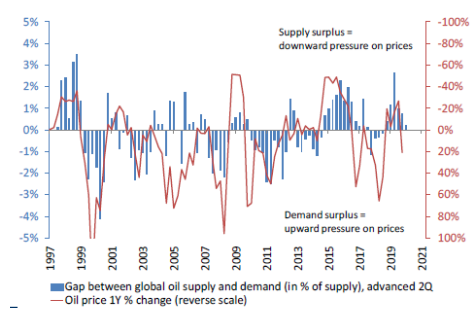
Fed hikes versus cuts: Expect the cycle to reverse



Unsold oil impacting the spot price.



Excess of supply vs. demand before the crisis!



Investment recommendations by theme

1. Globalization 2.0:

Short-term view: - Mixed

Medium-term view: - **With interest rates stable until at least 2023, a risk-on strategy is warranted.**

More then ever, we believe we have entered into a reversal of Globalization 1.0 and that there will be excellent opportunities.

2. From monetary policy to fiscal policy

Short-term view: - Neutral

Medium-term view: - Fiscal and monetary policies are expected to be very accommodating for the quarters to come.

3. Volatility

Short-term view: - Neutral

Medium-term view: - In the past, event-driven sell-offs [e.g., EM debt crisis, collapse of LTCM (1998), TMT over-valuation (2001), retreat of energy prices (Q4/15), US-China trade war (Q4/2018)], have resulted in average market corrections of in excess of 10%. The most recent market correction and the resulting volatility is no different.

At present, there are a few triggers left that can further disrupt the market. Volatility is relatively high and investors can take advantage of selling the latter.

4. Global order – a quick shift

Short-term view: - Neutral

Medium-term view: - The impact of COVID-19 will not be over quickly, as there is substantial damage to consumer confidence which will impact the global order.

The gigantic amount of debt that has been added in the course of the last few weeks will make the states prioritize decisions differently when compared with the last GFC.

The present crisis highlights the limits of restless globalization; for instance, it could be that the world population depends on one single supply chain of basic preparations for medical purposes.

Globalization is entering a period of unparalleled deconstruction that promises to transform industries for years to come.

Asset class view:

Cash / FX

Many investors are long USD, be it by definition or be it for historical reasons. Historically, the USD has devaluated on average by around 4% annually, while at the same time interest rates have adjusted to lower levels during the past 30 years. This was a positive for US consumers.

The long-term outlook for the dollar remains negative, given the persistently expansive Fed policy and the Fed's commitment to keep average inflation at 2%, i.e., looking for an overshoot of inflation after persistently below-target inflation in recent years. Yet, this time around, it may result in a slightly less favorable situation for US consumers, and consequently, we see more opportunities elsewhere.

Near term, we see a 1.15-1.20 trading range for the EUR/USD; on the back of a European trade recovery, the pair could appreciate by around 15% versus the USD.

MMF

We consider short-term money market instruments to be passive investment vehicles. Although they have their benefits (low cost, very high capital resilience, and projectable returns), they have lost some of their past appeal, i.e., as short-term interest rates are below zero for the main reference currencies, returns have become negative. It is for this reason that we do not actively cover this asset class; instead, they are offered in a passive manner, for the purpose of having the allocation and when required.

Bonds

During its last meeting before US elections, the Federal Reserve voted to keep short-term interest rates anchored near zero. The Fed also provided specific language about its intent to hold rates low until inflation increases. According to input from individual members, rates could stay anchored near zero through 2023.

This statement is the blueprint for all other central banks from developed market countries. Interest rates cannot go up in the near future, given the ongoing QE.

Given the above, along with the already low interest rate scenario, income seeking investors need to focus on alternative risk-on strategies such as income proxy strategies (see our current selection in “Products”)

Bond Funds / Equity Funds

We consider Bond / Equity Funds and trackers, ETF Bond / Equity Selections to be the opportune investment vehicle for passive investors. Their advantages are important: optimal benchmarking, cost effectiveness, and high degree of diversification.

IRISOS SA takes a proactive stance vis-à-vis the market; we therefore use Investment Funds and ETF Structures only when we do not have the opportunity to cover a specific segment of the investor’s asset allocation. For this reason, we do not follow or issue a particular view on a fund, strategy, or concept to follow.

Equities

Global equities have performed well ever since their March lows, but the dispersion of performance across the sectors is high. Market euphoria is centered around mega caps in the tech sector, “stay-at-home” enablers, and content delivery companies; we continue to believe that the market has legs to run still further.

FED Fund rates

FED Balance sheet

US TIPS yiels are negative!

Typical early cycle performers such as real estate, consumer discretionaries, industrials, and materials have underperformed during the same period.

Short to medium term, we believe that valuations for the broader IT sector are toppish, but specific names are still offering an attractive upside opportunity. Furthermore, we think that a catch-up rally may occur for cyclicals from the industrials and materials sector.

Credit

We believe prospects for global credit remain attractive, particularly in Europe, where companies are less leveraged. While the majority of spread compression is now accounted for, credit should perform well on continued central bank support and a recovering global economy.

We have a preference for EUR-denominated credit notes, as well as USD-denominated emerging market (EM) bonds, particularly EM sovereign and Asia high-yield bonds. As we see further normalization in the economic recovery, both opportunities offer attractive valuations, outright and relative.

Products:

To benefit from tactical and strategic investment opportunities, we engineer a number of vehicles that can be

- Income proxies,
- Participative instruments, or
- Leveraged product strategies.

Given present market conditions (low interest environment, fast progressing stock market segments, and a pro-market stance of central banks), it is opportune to invest via such vehicles. Our present strategic opportunities see values in:

- Income opportunities: WOF on Oil Majors, stay-at-home companies, and Swiss Prime Companies
- Leverage Opportunity: Capital protected note linked with a Market Neutral Strategy

For product references and term sheets, please follow the links below

- Oil Majors: [link]
- E-Marketing Opportunity [link]
- Swiss Prime Companies [link]

Strategic Allocation:

The flagship strategy was launched in 2017; it is based on a fundamental top-down and bottom-up thematic equity offering. It is a pure-play approach to actual growth themes such as artificial intelligence (AI), Cloud computing, connectivity, robotics and automation, biotechnology, and the "new normal" for consumers. The concept favors companies that manage, develop, and implement knowledge-intensive processes. The allocation is risk optimized with market standard tools, combined with our heat-map identification process.

Within the portfolio allocation, we identify two performance drivers which are impacted by short-term consumer behaviors and the longer-term capex spending. Typically, in the short-term, we find social media and consumer-spending-related stocks, while in the second segment we have companies that benefit from capex related to secular trends of 5G, the shift from CPU to GPU, AR/AV technologies, and IIOT, amongst others.

While market valuation is high, we don't consider our key performance drivers as overvalued! Based on the PEG-Ratio, we consider that our secular growth themes are still below fair value when considering their long-term growth opportunity

Product fact sheet [link]

Market-by-Market View

United States:

The coordinated nature of monetary and fiscal policy is unprecedented in recent history, and goes much further than we've seen at any point during the financial crisis.

Particularly in the US and the UK, governments are trying to save the economy by creating a lot of cash. In fact, it is not a stretch to argue that the pledge from UK Chancellor Sunak to cover up to 80% of workers' salaries through this crisis is a flirtation with the idea of a basic income. In the US, the 2.2-trillion-dollar-package includes around USD 500bn worth of means-tested helicopter money for US taxpayers.

Consumer strength

More still needs to be done, especially in light of the shocking increase in US jobless claims, the first 'hard' data point showing the severity of this crisis. The US consumer is still one of the key global economic players. But if households were to receive enough cash to meet their basic budgetary needs – food, shelter, insurance – people could stay inside and sit the crisis out. And if businesses had enough cash as well, they could afford to stay shut for a few months and start re-hiring workers from Q3 onwards.

It will not be painless, and we will see businesses fail, but if it's handled correctly, there is enough productive capacity left to turn back on as the health crisis is brought under control relatively quickly. Hysteresis and other structural negative economic effects might then be limited.

Trade hopes

Trade tensions have most likely come to an end for the time being. Weak consumer demand will thus reduce demand for US and Asian products and services.

Presidential elections

The run-up to the US presidential election is currently underway. It is hard to say whether or not the present administration will be re-elected, but we tend to believe that it will not be.

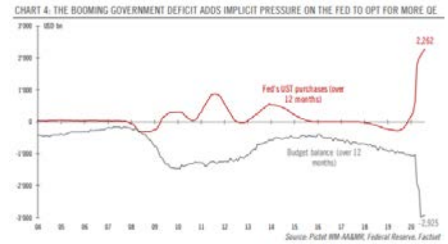
Outlook

The spread of coronavirus, collapse in oil prices, lower interest rates, and sudden rise in unemployed workers have dramatically altered the outlook for economic and profit growth. As a result, stocks have plummeted since their all-time high on 19 February. Encouragingly, right before the virus hit, the US economy was on solid footing – consumer balance sheets were healthy, the banking system was sound, and inflation was contained. This suggests that economic activity should bounce back once the virus runs its course, especially as governments ramp up fiscal stimulus.

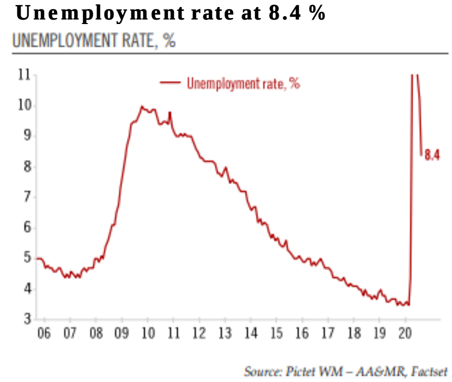
For long term investors, valuations are looking attractive and stocks will likely be higher over a 12-month horizon. However, stocks will likely remain volatile in the short run until the extent of the economic damage becomes clearer.

Energy demand in the US

More QE to come, for sure!



Unemployment rate at 8.4 %



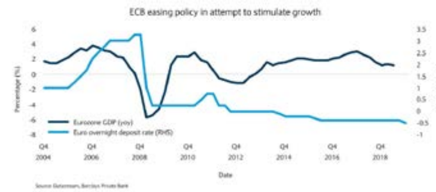
Europe:

Within developed markets, open economies such as those in Europe are the most starkly exposed to the present crisis, as has been the case in the past. We expect earnings in the Eurozone to contract for the second year in a row. The euro area remains one of the most prominent weak spots globally. The earnings growth forecast is substantially below other markets, based on a subdued outlook for a Euro-zone economy that remains mired in a manufacturing recession. The weakness in Eurozone earnings has been already been confirmed by fourth-quarter results.

However, after the market sell-off, valuations now appear very attractive relative to bonds and in absolute terms. The 12-month forward PE ratio is at 9.9x, a 20% discount to its historical average and now a 30% discount to global equities.

Our sector stance remains relatively well balanced to cope with the negative impact. We are overweight on industrials (more attractive than communication services) and utilities (solid EPS growth and an attractive dividend yield). We are underweight on communication services (stagnating revenues) and materials (stretched valuations and poor earnings momentum). At the country level, we are overweight on France (because of the luxury exposure which is the best performing sector) and underweight on the Netherlands (deteriorating earnings momentum). We are neutral on Germany, and negative on Italy, Spain and Belgium.

ECB easing policy in attempt to stimulate growth



Fiscal response

The European Central Bank has launched a Pandemic Emergency Purchase Program, backing its claim to do "whatever it takes." Fiscal policy makers are ramping up their response as well, with programs announced so far worth 16% of GDP for the UK, 15% of GDP for Germany, and 15% of GDP for France. We believe these measures and policymakers' willingness to do more will help us avoid a global financial crisis-style credit crunch. So far, however, the market impact of widespread restrictions on personal movement has overwhelmed this set of policy responses.

Emerging Markets:

Containment measures in Europe and the USA should prove sufficient to halt the spread of the virus; we expect this status quo to stretch well into May, for some regions into June. The virus may again spread out in China, based on foreign-based Chinese travelling back home. Restrictions in Europe and the US could be reimposed intermittently for the remainder of the year.

In this scenario, government policy would not meaningfully off-set the lengthy demand shock, leading to a sharp rise in bankruptcies and joblessness. Companies would forgo significant revenue, and losses would be borne by shareholders, creditors, and banks. Given this and because Asian economies are not yet self-sufficient, economic growth could result in an L-shaped profile through 2020.

The recovery in China's industrial sector seems to be moderating, but domestic consumption continues to rebound. On current trends, there could be an upside risk to our growth forecast for China. After a strong Q2 recovery, the Chinese industrial sector growth seems to be moderating. The official manufacturing purchasing manager index (PMI) came in at 51.0 in August. It appears that the initial stimulus spending on infrastructure is waning; the same can be observed for import data.

This comes in contrast with exports; these continue to expand. They were up 7.2% in July and 0.5% in June; hence, year over year (YoY) they are positive, up by 9.5%. As China continues to be the backbone of the global manufacturing industry these ratios are set to improve further until further notice.

On the consumption side, passenger car sales have accelerated, which should translate into positive retails sales for Q3/2020. Online sales of services, including items such as air tickets, travel packages, and gaming, returned to positive growth in July for the first time since December 2019.

On a broader note: services play more and more of an important role in each economy. In China, about 54% of global GDP is related to services. If the recovery of services maintains its current pace, then global GDP growth for China should exceed 2% for 2020.

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Sector Analysis

Basic Materials

The Materials sector is sensitive to fluctuations in the global economy and the US dollar, concerns about the US-China trading relationship, and the COVID-19 pandemic. Accommodative monetary and fiscal policies have begun to improve prospects for global economic growth. This has allowed the US dollar to trend lower, which historically provides a strong tailwind for the sector.

However, the sector still faces challenges. Global growth is not necessarily expected to provide an enduring tailwind to industrial metals or demand for chemicals (the largest industry in the sector). Although gas prices have rebounded off lows recently, along with the price of crude oil, a still-weak demand for gasoline continues to weigh on ethanol demand and corn prices, further reducing demand for agriculture chemicals.

The sector has become more attractive recently. With positive macroeconomic factors, we think there is a solid chance for sector contributors to outperform others.

Concerns: A more discounted stock valuation is still possible. Once virus concerns lift, we would expect a sharp rebound in activity. Areas of potential concern are increased protectionism, slowing revenue growth and oversupply in several areas of materials.

Investment opportunities:
This sector is one of the most correlated to global industrial production. While production is getting back online in China, it looks set to take a steep fall in the US and Europe.

Communications Services

The Communication Services sector is concentrated in a handful of cutting-edge companies that nearly all consumers have contact with on a daily basis. This includes companies like search engines (Google) and social media companies (Facebook), streaming services and entertainment (Netflix, Disney), and wireless and cable telecommunications companies (Verizon, AT&T, Comcast), to name a handful of the largest companies.

COVID-19 has had a positive impact on the overall sector performance, as some bigger companies within key segments have had a tailwind from social distancing, which has increased demand for social media and streaming entertainment.

The larger companies that enjoy significant competitive advantages due to their dominance in their respective business lines – search engine, social media and telecom – also face emerging antitrust risks. The rollout of fifth-generation (5G) cellular wireless technology could increase demand, as 5G is expected to increase speeds and allow for more exposure to the “Internet of Things” and automated car technologies – increasing growth potential. However, upgrading networks will require substantial capital investment, and the pandemic has slowed progress.

In terms of relative valuations, the few individual companies that compose more than 50% of the sector are difficult to assess. And the current Communication Services sector was launched in 2018, so a historic comparison against the sector’s own figures is not feasible. This is compounded by the notion that the high-growth companies that dominate the sector are difficult to value.

We believe that many Communication Services companies face unique risks, but their strong competitive advantages within the larger economic system make them unique enablers.

Investment opportunities:

We currently believe many Communication Services companies face risks that outweigh their potential rewards, which is why we have a “hold” rating on most of the sector’s companies (GOOG, DI, NFLX, FB, AMZN).

Consumer Discretionaries

The sector has a number of industries with a high degree of exposure to the COVID-19 business shutdowns and shelter-in-place orders, and they have been under sharp pressure – in particular, hotels and leisure, autos and auto components, and apparel industries. However, those industries are counterweighted by the internet retail industry – Amazon, in particular – which constitutes more than 40% of the sector's market cap all on its own. This obviously creates great distortion within the sector itself.

The fundamentals for many of the companies in the sector remain challenged, but beaten-down earnings and sales expectations have begun to turn significantly higher. The renewed spike in new COVID-19 cases and uncertainty regarding any enduring change in social distancing could fundamentally impact consumer products and services over the long term, but the areas of home improvement and online shopping have strong structural tailwinds.

Most Consumer Discretionaries sector companies are facing a long and painful healing process. While this is underway, the sector will be subject to two distinctive groups: a) online companies (Amazon and the like), and b) the traditional Consumer Discretionary companies with an outdated business model. The massive dislocation of the economy will impact the second group in particular. Valuing them properly, in present and future valuation, is quite difficult.

Investment opportunities:

The virus-driven hit to the economy will likely lead to slower consumer spending as unemployment rises. Still, secular growth in e-commerce is a net positive driver for the sector.

We favor companies that benefit from "stay-at-home" such as: AMZN, Visa, Mastercard, Alibaba, Nike, amongst others.

Consumer Staples

Historically, the Consumer Staples sector has outperformed during periods of economic slowdown and uncertainty, as investors are attracted by the perceived relative stability of the group. After all, consumers always need to buy basics such as food, soap, and cleaning supplies, regardless of economic conditions.

Over the past years, retailers have aggressively cut costs, leaving them in reasonable condition to deal with no pricing power and a limited growth opportunity. We expect that the retail sub-sector will not be affected too much by the present health crisis, as the supporting fundamentals remain about the same as before. However, other sectors, such as basic hospitability, are expected to face a prolonged period of headwinds. The sector's relative valuation has somehow improved, but in the absence of a possible vaccination, the upside appears to be limited for the time being. On the other hand, as growth-oriented sectors have captured much investor attention in the past months, the defensive characteristics of the sector could lead to a renewed interest in case of a sector rotation, which could push prices into a much higher territory

Europe: European consumer staples have a wide geographical exposure which should be beneficial at present. More importantly, most European consumer staples are lean and have efficiency programs running with the aim of improving earnings growth.

Americas: The mass consumer environment in the United States of America is challenging. Major risks include a prolonged period of regional COVID cases and supply chain disruption.

Investment opportunities:

The sector has been one of the best performers since equities began to plummet after the 19 February peak. Demand should remain relatively resilient for products that satisfy everyday needs, despite disruption to the economy. However, other sectors of the market appear better positioned if markets begin to bottom.

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Key figures for Europe:

(as of 25.09.2020)

Target values:

Present fair value (DJStoxx600): 350
E12 months value (DJStoxx600): 390
Upside potential: +11.4%

Key economic ratios:

GDP Growth 20(E)	-7.6
GDP Growth 21 (E)	6.3
CPI 20(E)	0.0
CPI 21 (E)	1.0
P/E 2018 (E):	15.7
P/E 2019 (E):	14.3
Div. Yield 2018:	3.1
Div. Yield 2019:	3.3

Most likely next short-term move:

DJStoxx600	flat/down
DJStoxx50	flat/down
SMI	flat/down
DAX	flat/down

Key names to look at:

Strong intellectual property:
- Roche
- Novartis
- Amadeus

High competitiveness:
- Siemens
- Daimler
- Gemalto
- Richemont
- Swatch

Sustainable dividends:
- ABN-Amro
- Imperial Tobacco
- Altria
- Philip Morris

Given the overall competitive outlook for the sector, investors should seek companies with strong balance sheets, low financing costs, and a strong focus on products and services. Because of the high absolute valuation and the limited upside potential, high yield dividend stocks are at risk; companies to consider include AD, ABI, BAT, NESN, EL, MO, and PM.

Energy

While the price of oil is well above recent lows, the Energy sector continues to face uncertainty due to the massive supply/demand imbalance related to the economic shutdown. Considering that the sector targets a C02-neutral industry by 2040, the question of when the oil market will rebalance is warranted.

However, we remain confident about the sector's future. Oil production is being slashed quickly, putting less pressure on constrained storage capacity, and demand appears to be stabilizing as economies are reopening. While consumption may shift to products with a lower carbon footprint, we see an ever-growing demand for petrochemical products. This is a lasting secular growth trend that goes hand-in-hand with population growth in Asia.

We think that the Energy sector has put in a low for now. While supply/demand imbalances will persist for some time into the future, we make the following observations:

- On the back of current valuations, dividend payments and short- and medium-term fundamentals, oil majors offer a valuable opportunity at present,
- The ongoing weakness of the USD is sector positive,
- The relatively small sector, with a limited number of real growth stories, can benefit from rating changes relatively quickly.

Investment opportunities:

The collapse in oil prices due to the inability of Saudi Arabia and Russia to agree on a production cut darkens the outlook for the sector, and oil demand has slowed substantially as the coronavirus spreads globally. While conditions are challenging, oil prices are far below sustainable levels and are primed for a recovery when markets stabilize.

In terms of names, we favor global up- and downstream operators as they are most likely the only players to endure a lasting price-war with Saudi Arabia.

We favor names such as: BP, RDSA, BKR, CVX, COP, XOM, SLB

Financial Services

We currently have a negative to neutral stance on the Financials sector. This is for the following reasons:

- Future dividend payouts will be based on a formula dependent on banks' trailing quarterly net income, which could force reductions going forward. Additionally, banks may need to re-run their stress tests later this year.
- Loan defaults are expected to rise significantly in coming months. In this sense, we note that a number of banks have already increased provisions to cover for such incidents. This is resulting in lower profit margins.
- Valuations are relatively attractive. But this comes on the back of low expected earnings growth, which is partly reflected by the sharp underperformance of the sector year-to-date.

While we are monitoring these developments on an ongoing basis, we think that the improving macroeconomic environment will eventually help the sector find some support at some point in the future.

Key figures for USA:

(as of 25.09.2020)

Target values

Present fair value S&P 500:	3'250
E12 months value S&P 500:	3'500
Upside potential:	+7.5%

(as of 25.09.2020)

Key economic ratios:

GDP Growth 20(E)	-5.2
GDP Growth 21 (E)	3.7
CPI 20(E)	0.0
CPI 21 (E)	1.0
P/E 2020 (E):	20.1
P/E 2021 (E):	18.2
Div. Yield 2020:	1.9
Div. Yield 2021:	2.0

Most likely next short-term move:

S&P 500	down
Nasdaq	down

Key names to look at:

Strong intellectual property
- VISA
- Mastercard

Technology:
- Microsoft
- Micron Technology
- Nvidia
- Apple
- IBM

Financials:
- VISA

Investment opportunities:

The fall in interest rates to global financial crisis-era lows, and the sharp slowdown in the economy will drive a steep drop in profits for banks. But banks are well-capitalized and should see a sharp rebound when market volatility subsides.

We continue to have a particular interest in secular growth companies that should emerge from the crisis with strong long-term growth prospects. Our preference goes to American Express, Intercontinental Exchange, MasterCard and Visa.

Moreover, investors seeking deeply discounted valuations with strong expense leverage and robust capital should consider an engagement in Ameriprise, Capital One, and State Street.

Healthcare

The COVID-19 pandemic has resulted in a breakdown of many historic relationships within the markets. While the virus has been disruptive, the Healthcare sector has so far maintained many of its traditional non-cyclical properties. During the past several months of stronger markets, Healthcare has underperformed most other sectors.

Amid the COVID-19 pandemic, there has been an assumption by many that the Healthcare sector should fundamentally benefit. However, while there are pockets within the sector that are in process of benefiting, the majority is not.

With the sharp drop in doctor visits and delays in elective surgeries, insurance companies will make up for some of the lower premium income with lower claims payouts. However, fewer visits translate into fewer diagnostic tests and drug prescriptions, leading to hospitals with lower billable services and surgeries, and ultimately to lower sales for pharmaceuticals. As economies reopen, some of this is expected to reverse, and consequently, the earnings outlook should improve.

Some companies within the biotech and pharma industries stand to benefit if they produce tests and vaccines for the virus, but at a high cost and causing potential delays of other trials. And recently, the market has become far more selective in assessing the potential winners.

Beyond the COVID-19 impact, however, the Healthcare sector has many long-term positives, including an aging global population and a growing middle class in emerging markets, all of whom will demand more extensive drug treatments and medical care over time. And balance sheets in the Healthcare sector remain flush with cash, increasing the possibility of higher dividend payments, share-enhancing stock buybacks, and mergers and acquisitions.

In terms of valuations, we compare the Healthcare sector relative to its own history and to other sectors, and they appear to be rather attractive.

The sector's macro impact is neutral in the sense that the sector is not cyclical in nature. We think valuations are attractive, and the sector's long-term and short-term fundamentals are positive.

Investment opportunities:

The healthcare market is fragmented, as its players are striving to increase their market share through such strategies as improvements to existing solutions and software platforms, development of new platforms, and strategic alliances with other market players. Therefore, several players account for significant individual shares in the market.

While political risks for the sector have improved as prospects fade for Medicare for All, there is still uncertainty about the outlook for drug price regulation, which will likely persist beyond the US election, regardless of who wins.

Key figures for Asia:

(as of 25.09.2020)

Target values:

Present fair value MXAPJ:	695
E12 months value MXAPJ:	800
Upside potential:	+15%

Key economic ratios:

GDP Growth 20(E)	-2.0
GDP Growth 21 (E)	6.9
CPI 20(E)	1.9
CPI 21 (E)	2.8
P/E 2020 (E):	14.4
P/E 2021 (E):	12.8
Div. Yield 2020:	2.4
Div. Yield 2021:	2.5

Most likely next short-term move:

MXAPJ down

Key names to look at:

- Tencent
- Alibaba

Industrials

The Industrials sector has suffered significantly from the global economic recession, with industrial output faltering as a manufacturing downturn has broadened globally. While defense spending is likely safe, the sharp retrenchment in the economy and travel has weighed on airlines and the transportation industry in general.

There are now improving prospects for economic growth, and the markets have begun to trade as would be typically seen in an early stage of the business cycle. While the path of the economy remains highly uncertain, this provides a nice macroeconomic tailwind for the sector.

Valuations remain poor. Expectations for 2020 earnings have been slashed by more than 50% in recent months. The fundamentals for the sector have improved – despite uncertainty surrounding global growth – as companies entered the crisis in a strong position and earnings revisions have turned higher. Once an enduring economic recovery emerges, investment in more-efficient equipment will help offset weaker productivity going forward.

Additionally, the sector has historically had higher-than-average sensitivity to the overall market – which could be a tailwind if the rally continues and the leadership of the market broadens. The sector's long-term momentum is highly positive and this is good news for transportation stocks and home-repair enablers, amongst the classic names.

Investment opportunities:

The sharp slowdown in the global economy hits the sector particularly hard, but valuations are attractive. Medium-term investors may look at the following: CSX, Siemens, Easy-Jet, Lockheed Martin, and Stanley Black & Decker.

Technology

The S&P 500's incredible recovery from its trough in March has been fueled by the outperformance of the top five companies, most of them related to IT. To date, these companies have yielded +34% in returns. They reflect companies with strong business models, high margins, and solid balance sheets.

While we very much are pro-cycle IT investors, we do see some consolidation risks in the very near-term. In terms of timing, this could occur, for instance, when the first vaccine is launched, which could lead to a general sector rotation.

While the US election campaign now enters its last phase, trade policy risks could resurface. This could put an end to the good performance of the personal computers sub-sector, while the wireless phone and capital expenditures market could spiral down a bit further.

While the valuation of the technology sector is quite elevated, it is backed by strong fundamentals relative to other sectors. Revenues and earnings growth are expected to be resilient over the next two years, and earnings revisions continue to improve. When looking at the 3- to 5-year window, the opportunity of the sector is even more favorable, as strong and lasting secular growth trends are at work.

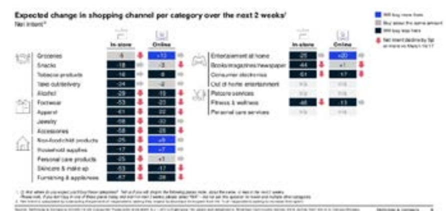
There are many compelling reasons to favor the sector, such as short product cycles, a high consumer appetite for apps, etc. But first and foremost, we think that there are a number of secular long-term growth trends in play which make present valuations still look inexpensive.

Investment opportunities:

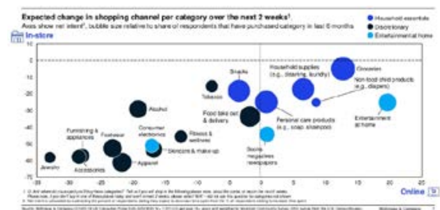
Although the near-term is highly uncertain due to COVID-19, we believe investors should focus on technology companies that have attractive longer-term growth opportunities due to established franchises in large and secularly growing addressable markets such as software, cloud, and security. In this vein, we highlight Microsoft, Palo Alto Networks, Salesforce.com, Splunk, and Accenture.

Stay-at-home to be become a winner

... details of the expected shopping channel changes, ...



... with basics and entertainment to shine.



Real Estate

Based on the addressable market segment, the Real Estate sector has first and foremost a domestic orientation. With interest rates declining almost on an ongoing basis for the past 30 years, real estate investments have been for many citizens a complementary income stream. For professional real estate investors, the ever-lower interest environment was a “cheap” funding source to leverage almost any property project.

However, in fewer than six months, this well-established concept has been challenged, and the COVID-19 pandemic has clearly highlighted its limits. In fact, private home owners, like real investment trusts (REITS), are starting to feel the heat and are tending to struggle. Rental income is no longer as safe as in the past, funding for real estate purchases has dried up, new commercial property rent demands are non-existent, and finally, existing leases are being renegotiated.

The outlook for the sector will be highly dependent on the speed at which the economy and the unemployment market can recover. While government support payments to businesses and unemployed benefits will help bridge the present downturn, a slow, drawn-out recovery would become a longer-term headwind for the sector. Even with the economy recovering more quickly, the real estate market is set to recover only during a second phase. For longer-term investors, the real estate market, while interest rates stay low, offers some valuable opportunities.

Investment opportunities:

The sharp slowdown in the global economy hit the sector particularly hard, but valuations. While valuations are attractive, it may take time for all segments to recover.

Even so, there sub-segments that are less exposed to the sharp downturn. In fact, we have two distinctive eco-spheres: the digital world and our physical one. The blur is important, with the following result: one global economy built on the back of bytes, and another composed of bricks and mortar.

As the economy is changing, data centers (cloud capacities) are required. This shift has significant ramifications for the global economy across all industry segments. Some real estate companies will experience a higher growth rates than others. Names to look at: Sergo, Goodman Group, GLP, Nippon Prologis, A-Reit, Mapletree Logistics, Equinix.

Utilities

By definition, Utilities are defensive investment opportunities, and they tend to underperform during pro-growth periods. The opposite is true when the market undergoes turbulence, because demand for their products and services remains about the same throughout all business cycles. We also note that the sector stocks were used by income-seeking investors as income proxies.

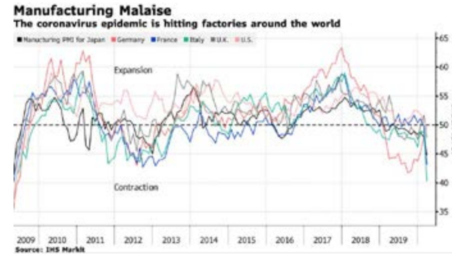
However, this historical relationship was called into question in the February-March correction. Prior to the crisis, the sector's valuation had reached record-high levels, which was a kind of self-exuberance given it is a capital-intensive sector. The dividend pay-out ratio, as well as the high dividend yield were not questioned. This is now the case! Given this, the underperformance year-to-date is unlikely to be reversed any time soon.

This view is supported by the fact that other sectors appear to be better positioned to benefit from renewed economic growth, short- and long-term.

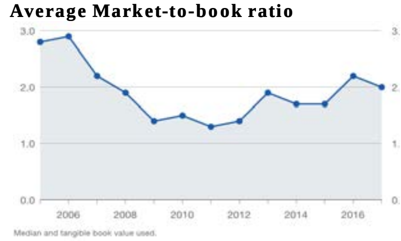
Investment opportunities:

The recent spike in volatility may have encouraged investors to seek the perceived safety of the utilities sector, but we continue to believe that this is not the right move. A growing economy and rising interest rates don’t make for utilities performance, and we therefore believe underperformance will likely continue. For those who still wish to seek exposure to the sector, it may be opportune to consider the following names: in Europe, Centrica, Fortum, E.On, and RWE; in the US, American Water Works, DTE Energy, Excelon, and Nextera Energy.

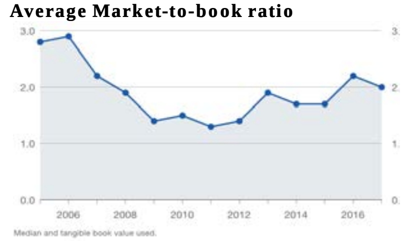
Average ROI of Banks recovered but remains stable!



Average Market-to-book ratio



Average Market-to-book ratio



Foreign exchange

Currencies

Many investors are long USD, be it by definition or be it for historical reasons. Historically, the USD has devaluated on average by around 4% annually, while at the same time, interest rates have adjusted to lower levels during the past 30 years. This was a positive for US consumers.

The long-term outlook for the dollar remains negative, given the persistently expansive Fed policy and the Fed's commitment to keep average inflation at 2%, i.e., looking for an overshoot of inflation after persistently below-target inflation in recent years. Yet, this time around, this may result in a slightly less favorable situation for US consumers, and consequently we see more opportunities elsewhere.

Near term, we see a 1.15-1.20 trading range for the EUR/USD; on the back of a European trade recovery, the pair could appreciate by around 15% versus the USD.

Investment considerations:

We see a clear bias for EUR/USD to drop below 1.15 in the near term. But the tide should turn for the euro in 1H20, either due to easing trade tension and improving global growth or due to more pronounced Fed easing.

In the coming months, we recommend positioning for a 1.25 upside barrier and for a downside of around 1.12.

One risk is an unexpected rebound in US inflation and growth that brings the possibility of Fed rate hikes coming back into the picture earlier than expected. This would lift the greenback. Another risk would be a US recession after escalating trade disputes, which could weaken the USD earlier and faster, since the Fed would likely cut rates aggressively.

Target values in 3 months:

EUR/USD:	1.1250 - 1.2000
GBP/USD:	1.2500 - 1.3500
USD/CHF:	0.9000 -0.9750

Target values in 12 months:

EUR/USD:	1.20 - 1.2750
GBP/USD:	1.30 - 1.40
USD/CHF:	0.90 - 1.00

Purchase power parities:

EUR/USD:	1.28
GBP/USD:	1.56
USD/CHF:	0.93
EUR/CHF:	1.19

Most likely next move:

EUR/USD	down
GBP/USD	down
USD/CHF	down

Target values in 3 months:

Oil:	$35 - $50
Gold:	$1,800

Target values in 12 months:

Oil:	$40 - $55
Gold:	$1,600

Upside potentials:

S&P GSCI	up
Oil	up
Gold	up

Next most likely move:

S&P GSCI	up
Oil	up
Gold	up

Commodity related stocks:

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Capital market assumptions

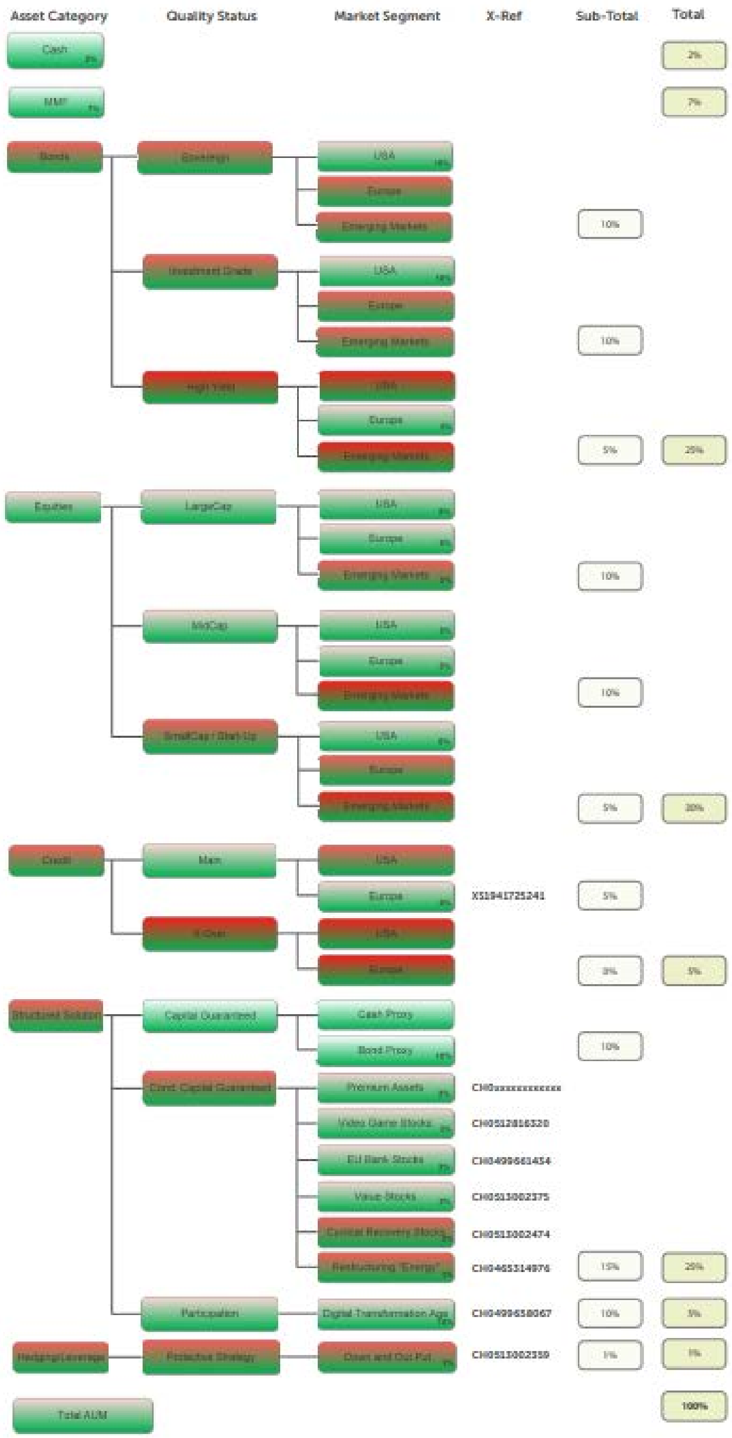
Return forecasts

Forecasts are in local currency (except EM equities); all figures are annualized

	Forecasts for the next 7Y			Average returns over the past 10Y	
	Return	Vol		Return	Vol
Cash USD	2.50%	0.00%		0.80%	0.40%
Cash EUR	0.30%	0.00%		0.10%	0.50%
Fixed income					
USD High grade bonds 5-10Y	2.60%	5.00%		5.00%	4.10%
EUR High grade bonds 5-10Y	-0.20%	4.20%		4.40%	3.90%
USD Inflation linked bonds	2.40%	4.70%		3.00%	3.30%
USD Corp bonds (IG)	3.30%	4.40%		4.80%	2.90%
USD High yield bonds	4.70%	9.70%		8.40%	6.10%
EUR High yield bonds	2.30%	8.70%		8.70%	7.30%
USD Senior loans	5.70%	6.90%		5.50%	3.50%
EUR Senior loans	3.50%	6.30%		6.00%	3.10%
EM Sovereign bonds (USD)	4.90%	8.60%		7.40%	6.30%
Equities					
US	5.70%	15.20%		13.50%	12.70%
EM (USD)	9.20%	20.70%		3.70%	17.00%
Eurozone	5.10%	17.30%		7.30%	14.40%
UK	6.00%	16.30%		7.30%	11.50%
Japan	4.60%	19.30%		7.80%	17.20%
Switzerland	4.50%	14.00%		8.40%	11.00%
Alternative Solutions					
HF (FOF, USD)	3.50%	5.20%		2.90%	3.90%
Alternative, other risks (USD)	7.20%	10.00%		7.80%	7.20%
Alternative, Private Estate (USD)	7.90%	9.20%		9.40%	5.10%
Alternative, Private Equity (USD)	10.20%	14.50%		13.90%	8.10%
Alternative, Private debt (USD)	8.20%	4.50%		10.20%	4.70%

Bloomberg, JPMorgan, MSCI, HFRL, BAML, UBS, IRISOS

Base-case Allocation USD Balanced



Disclaimer: Allocation may change as a result of the risk optimization - Past performance is no guarantee of future returns.

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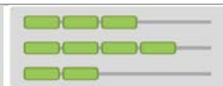
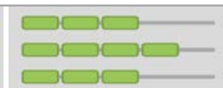
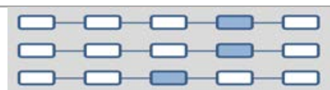
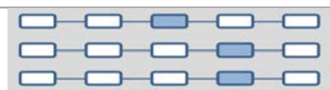
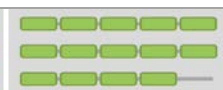
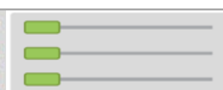
Asset Allocation Preferences – September, 2020

Sector	Region	Fundamental	Risk/Reward	Investment case
Basic Materials	Americas Europe EM			The Materials sector has been sensitive to fluctuations in the global economy, as well as concerns about US-China trade and COVID-19. Accommodative monetary and fiscal policies may eventually support global economic growth. Recent trade agreements have eased some trade uncertainty, but the sector still faces significant challenges. Earnings are expected to recover after a sharp contraction in Q1 and grow moderately, boosting profit margin, yet wage costs are expected to rise as skilled-labor shortages will occur in certain segments of the market.
Consumer Staples	Americas Europe EM			The sector historically has outperformed during periods of economic slowdown and uncertainty, as investors are attracted by the perceived relative stability of the group. After all, consumers tend to buy food, soap and laundry detergent regardless of economic conditions. However, the sector's relative safety has prompted investors to push valuations to above-average levels. A supply-chain disruption related to the coronavirus could affect already slim margins in much of the space.
Consumer Disc.	Americas Europe EM			The sector has a number of industries with a fair amount of exposure to China – such as hotels and leisure, autos and auto components, and apparel. However, those industries make up a relatively small weight in the sector, which also includes internet retail. Despite the overconcentration of internet companies in the sector and a weakening sales outlook, we judge the fundamentals to be positive for the Consumer Discretionary sector, as some of its core underpinnings remain upbeat.
Energy	Americas Europe EM			The renewed rise in the value of the US dollar also has pressured the energy sector amid the pullback in oil prices, resulting in weak relative performance, compounding multi-year underperformance. The secular issues that the sector faces such as, concerns about slow global growth, are yet another headwind to the sector. While this has led to attractive valuations from a historical perspective, very poor fundamentals lead us to believe that it's a value trap.
Healthcare	Americas Europe EM			While there was a strong relative performance recently, the current discount to the overall market in numerous valuation metrics remains attractive; the sector has generally traded at a premium to the market over the past 15 years. The durability of Healthcare sector earnings during economic downturns tends to lead to outperformance during periods of economic weakness. We think that solid macroeconomic factors and attractive relative valuations mean an outperform rating for the sector is appropriate.
Financial Services	Americas Europe EM			Topline revenue growth may prove to be elusive as regulatory burdens remain high, and areas such as asset management and brokerage services suffer from severe price competition and low short-term interest rates. Additionally, the sector's sensitivity to interest rates and the stock market could translate into sharp underperformance should we see a significant pullback in the market. Payment services remain attractive investment opportunities.
Industrials	Americas Europe EM			The sector has suffered from concerns about slowing global economic growth, with industrial output faltering as a manufacturing downturn has broadened globally. This has prompted business leaders around the world to put capital spending on hold, while stalling revenue growth. Although fundamentals were extremely good pre-crisis, corporations are expected to continue to work on more-efficient equipment to help offset weaker productivity once COVID-19 has passed. The rebuilding of inventories could signal the start of new cycle.
IT	Americas Europe EM			Capital expenditures have been below trend for several years, and a return to more normal spending levels would boost the sector. Rising wages, including an increased minimum wage, could accelerate this trend, as companies may turn to technology to replace increasingly expensive human workers. Consumer confidence has generally remained strong, but we are waiting for new data that might reflect the outbreak of coronavirus, which might disrupt the replacement market for mobile applications.
Com. Services	Americas Europe EM			While these companies enjoy significant competitive advantages due to their dominance in their respective business lines, there are also emerging antitrust risks. The rollout of fifth-generation (5G) cellular wireless technology could increase demand, as 5G is expected to increase speeds and allow for more exposure to the "Internet of Things" and automated car technologies, increasing growth potential. However, upgrading networks will require substantial capital investment. This makes the Communication Services companies face unique risks.
Utilities	Americas Europe EM			Utilities stocks are among the most positively affected by falling interest rates, as investors seek higher yields, because the sector has high fixed costs, and as the underlying activities are capital intensive. The sector has experienced good momentum relative to the other sectors – both on a short- and long-term basis – which could continue if interest rates continue to fall. While defensiveness can be attractive in uncertain times, valuations are not. In fact, they have risen to well above historical levels both on an absolute basis and relative to the other sectors.

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Expected costs of running investment strategies with our company

Estimates based on yearly activities (in % of total AUM)	Conservative	Balanced	Dynamic	Taylor-Made
Year with low activity *	1.20	1.49	1.78	2.03
Year with average activity *	1.39	1.68	2.15	2.55
Year with high activity *	1.78	2.86	3.53	3.63

***Subject to change according to market conditions, product strategies, currency diversification, and product turnover. Figures are indicative only and not binding by any means.

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Sources:
Analysis and comments: Bloomberg, Reuters, Natixis, UBS, BNP-Parisbas
Data and graphics: Bloomberg, Reuters

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