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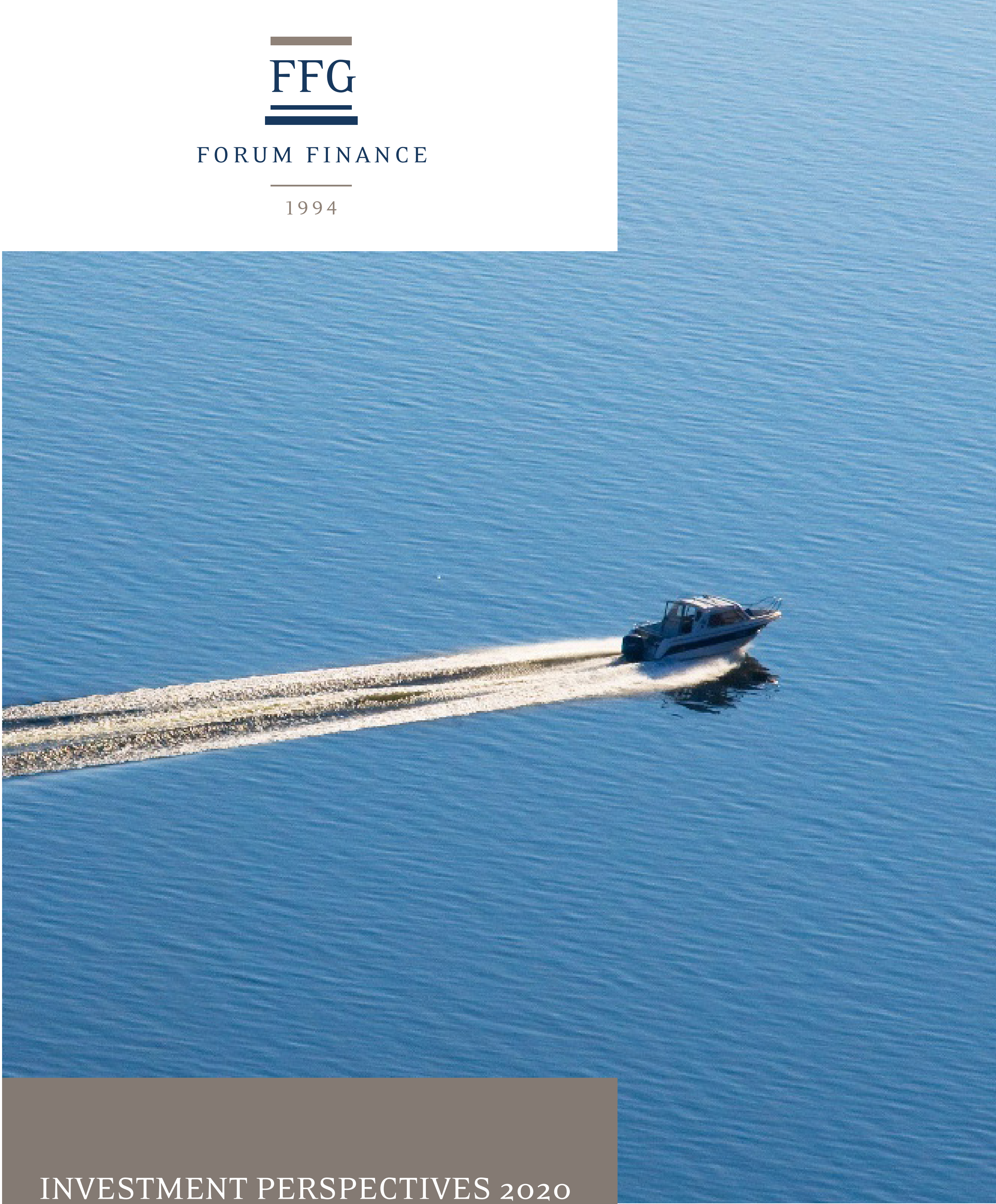


INVESTMENT PERSPECTIVES 2020
MID-YEAR REVIEW & OUTLOOK

JULY 2020

CONTENTS

EXECUTIVE SUMMARY

In this mid-year publication, we review the first half of 2020 and analyse some current key economic indicators before outlining the asset allocation that we recommend for the second half of the year.

The economy has been hit by a "black swan" event

The first half of 2020 has been a most extraordinary period as the global economy was temporarily brought to a standstill. Governments took unprecedented lockdown measures to limit the spreading of the Covid-19 coronavirus and this pandemic represents a "black swan", defined as an unpredictable event with potentially devastating consequences. The global economy is currently going through a recession, which should prove to be extremely severe but also extremely short. Global GDP is expected to contract by around 5% in 2020 compared to projections of 3% growth before the Covid-19 shock, with a strong rebound expected from a 2020 Q2 trough into 2021.

A war-like effort from monetary and fiscal authorities to fight the Covid-19 pandemic

The responses of the central banks and governments to limit the economic damage from the pandemic were extremely quick and on a scale never observed previously. The main central banks deployed the full range of their crisis tools within weeks. The US Fed funds rate was slashed to zero, massive quantitative easing was reintroduced and a broad range of additional measures were taken; these significant interventions contributed to improve the functioning of markets which had been under acute stress in March. Governments also acted promptly and decisively. Between early February and early April, G20 governments announced nearly 8 percent of 2019 G20 GDP in fiscal support, with this percentage now exceeding 10% following the addition of new plans. Global fiscal packages are estimated to be worth around $9 trillion, with the G20 economies accounting for the bulk of this amount: $8 trillion.

Equity markets have moved in both directions at record speeds

Financial markets went into a tailspin in February after having ignored the Covid-19 risks for some time. Equity markets plunged by over 30% in a matter of weeks as investors came to terms with the devastating impact of the pandemic on the world economy. The market correction was amplified by the unwinding of a high level of leverage and all asset classes were caught up in the turmoil during a brief period in March. Equity markets then rebounded at a pace never seen before during equity recoveries following a bear market; this rally has been driven by the drastic measures taken by central banks and governments. Financial conditions are now very supportive for capital markets but question marks over the sustainability of the rally of equities remain. There is also a distinct risk that markets have become far too reliant on all these supports, in view of weaker economic fundamentals.

We maintain portfolio hedging in view of elevated uncertainty

Thanks to our quick hedging we did not have to sell positions. We were thus able to hold onto our long term convictions and our option protection strategy greatly reduced the volatility of portfolios. We recognize that markets are being driven by a huge wave of monetary and fiscal support, but we believe that they are not taking account of a number of risks which could ultimately have a significant impact. That explains why we hold a neutral equity exposure combined with a put spread to limit the potential downside risk; in an environment fraught with uncertainty and in view of expensive valuations, we consider the management of portfolio risk as paramount.

In the next section of the document, we will evaluate the macro environment and the prevailing financial conditions by highlighting several key indicators that we observe. Following a brief overview of the first half returns of the different asset classes, we will outline our current market outlook and asset allocation.

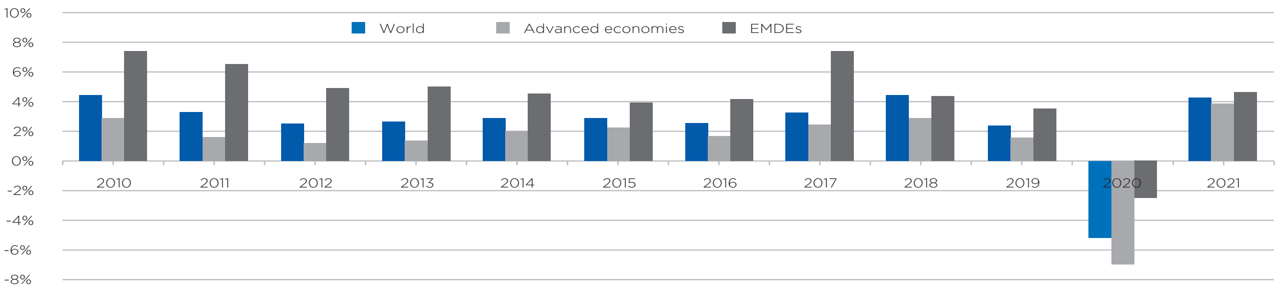
THE MACRO ENVIRONMENT

WORLD ECONOMIC GROWTH

The global economy comes to a screeching halt

The improving outlook for the global economy at the beginning of 2020 quickly gave way to rising concerns over the impact of the Covid-19 coronavirus, with China taking drastic measures in the Province of Hubei to limit its spreading from the city of Wuhan. What appeared initially as a domestic Chinese problem rapidly escalated into a widespread “black swan” shock which forced many governments to put their economies into a lockdown. With the global economy having been at a standstill temporarily, the ongoing recession is likely to be the deepest on record, but could also well be the shortest. The average lockdown lasted approximately two months and economies have been reopening at various speeds but with social distancing and other restrictive measures still in place. This unprecedented situation makes it extremely difficult to forecast the ultimate outcome for the economy but global GDP is expected to contract by around 5% in 2020 compared to projections of 3% growth before the Covid-19 shock. Assuming the pandemic fades in the second half of this year, and that policy actions will have proved to be effective to limit structural economic damage, a strong rebound should be observed in 2021. This recovery will, however, not be sufficient for economic activity to reach pre-crisis levels by the end of next year.

GDP GROWTH



Source: World Bank

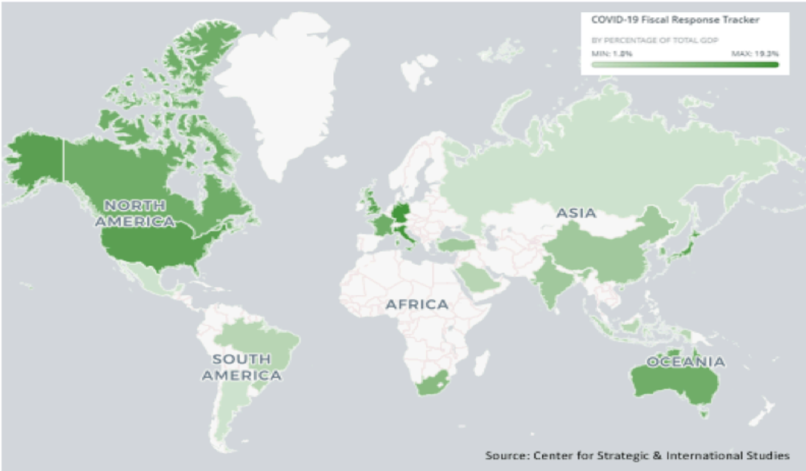
The chart above shows the latest World Bank’s growth projections for 2020 and 2021, with a baseline forecast for a 5.2% contraction for the world economy this year and for growth of 4.2% next year. The chart also shows that the projected 2021 growth rate of advanced economies will be well above its long-term average as a result of large-scale fiscal and monetary responses.

UNPRECEDENTED MONETARY AND FISCAL SUPPORT

Central banks were extremely quick to react to the stress in financial markets (see “Financial Conditions” section) and governments also acted promptly and decisively in response to the pandemic. The size and speed of the support measures taken to limit the economic damage from the spreading of the virus are unprecedented and have dwarfed those carried out during the great financial crisis. Between early February and early April, G20 governments announced nearly 8 percent of 2019 G20 GDP in fiscal support, with this percentage now exceeding 10% following the addition of new plans.

Global fiscal packages are estimated to be worth around $9 trillion, with the G20 economies accounting for the bulk of this amount: $8 trillion. Almost all the support has focused on keeping companies and individuals afloat, by providing loans to companies and direct payments to households, rather than stimulating new demand and investment. Public spending has not yet reached its limit; at the time of writing, the US is reported to be considering a $1 trillion infrastructure plan as a way of boosting economic growth whereas the European Union is discussing a €750 billion recovery fund to help the countries the hardest hit by the Covid-19 crisis. Generally speaking, emerging countries have been more constrained and have announced far less fiscal support than G20 peers. The main consequences of these massive fiscal packages are for a significant increase of the debt-to-GDP ratios and for budget deficits to explode. The issues of how and when to reduce public debt and to rebalance fiscal accounts will remain a challenge for governments for many years ahead.

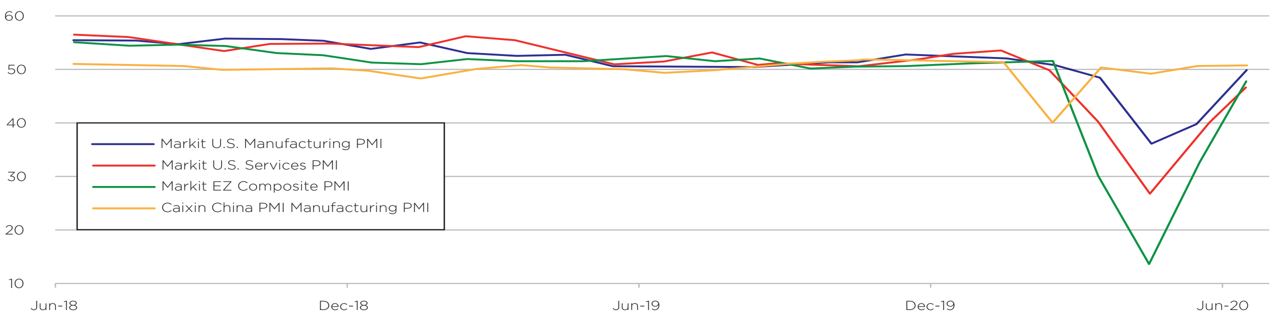
THE COVID-19 FISCAL RESPONSE



The chart shows the different level of fiscal response across the various regions. Japan, Germany, the United States and Australia are the countries having announced the largest emergency fiscal measures as a share of GDP, with Japan spending the equivalent to 21%, Germany 18%, the US 14% and Australia 12%. In contrast, the fiscal spending of EM countries has been smaller and generally ranged from 3.5% to 4.5%.

LEADING INDICATOR

PURCHASING MANAGER INDEXES



Source: Bloomberg LP

The chart above shows the extensive damage of the shutdown of economies on Purchasing Manager Indexes (PMIs), which plunged to levels never observed previously. In fine, China appears to have coped relatively well, with a number of economic indicators quickly returning back to pre-crisis levels. Out of the main economic regions, the Eurozone has been the worst affected area as the simultaneous closing of the region's economies translated into a drop of the Eurozone Global Composite Index from a level of 51.6 in February to a trough of 13.6; the latest data shows that the downturn in business activity is slowing markedly, with a May reading of 47.5, but it remains below the 50 mark, which means that most businesses reported a contraction in activity compared with the previous month.

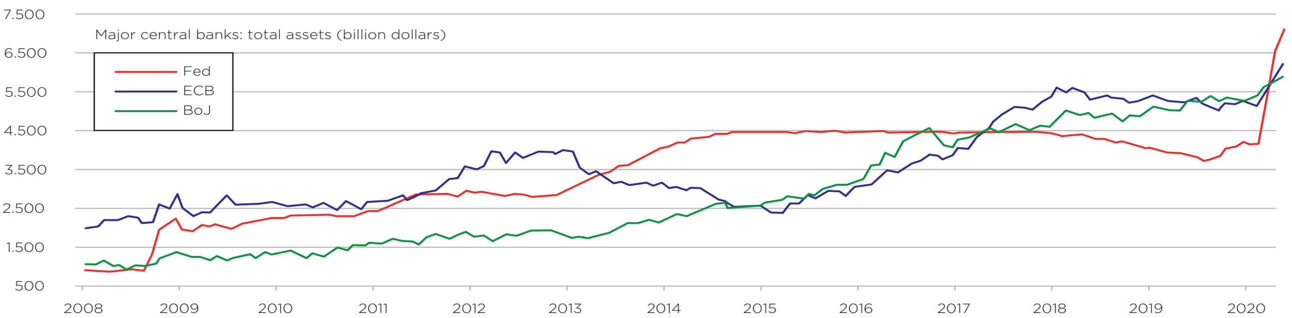
FINANCIAL CONDITIONS

THE CENTRAL BANKS RACE TO THE RESCUE OF THE MARKETS

The financial markets proved to be resilient to the negative Covid-19 headlines until February 21st. Equities dropped thereafter at a record pace and bond markets were hit by vanishing liquidity, even in those considered the safest, and by a significant widening of credit spreads. As markets entered into meltdown, the main central banks reacted swiftly and forcefully to the Covid-19 pandemic by deploying the full range of crisis tools within weeks. In March, the Federal Reserve cut its target rate by a total of 1.5% at two emergency meetings, bringing it down to a range of 0% to 0.25%. The bank resumed purchasing massive amounts of securities, Treasuries and mortgage-backed securities in particular, and for the first time high yield corporate bonds. It announced a broad array of actions, including up to $2.3 trillion in lending to support households, employers, financial markets, and state and local governments. The significant interventions by the central bank contributed to improve the functioning of markets and to facilitate the gradual reopening of primary markets. In view of elevated stress in the currency markets, due to a rush for US dollars, the Fed also made dollars available to other central banks by providing international swap lines.

Like the Fed, the European Central Bank responded to the pandemic by pledging to lend freely and by increasing its purchases of government and corporate debt. The ECB initially announced it would buy an additional €120 billion under its pre-existing Asset Purchase Program (APP). It then launched the €750 billion Pandemic Emergency Purchase Program (PEPP), which will last at least until the end of 2020; the assets to be bought under the PEPP include national and regional government bonds, including Greek sovereign debt, supra-national debt and various types of private sector bonds. This program was later increased by €600 billion to €1'350 billion and its term extended at least to the end of June 2021. Amidst a number of other measures, the easing of collateral restrictions meant that bonds that had recently lost their investment-grade rating, otherwise known as "fallen angels", would also be accepted by the ECB as collateral. Other key central banks across the world acted in a similar way and the list of measures described previously is far from being exhaustive. This emphasizes the unprecedented level of intervention by the central banks which have played a crucial role in bringing stability back to the markets and preventing a spiralling financial crisis.

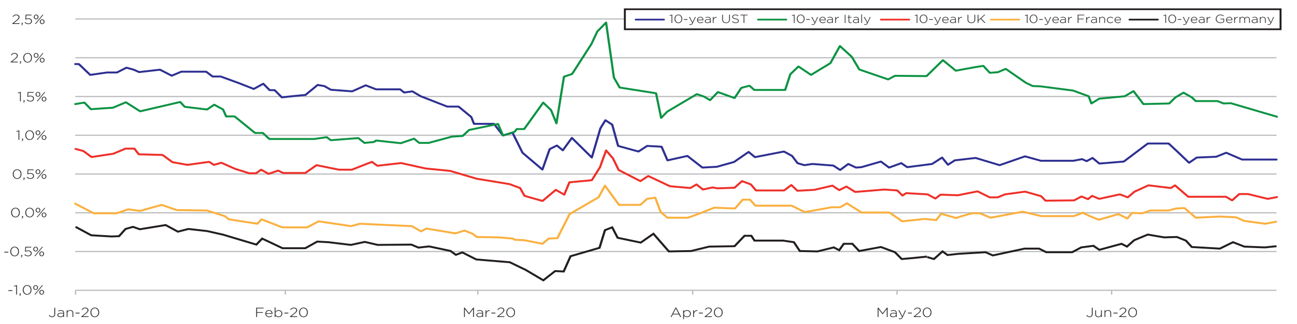
THE EXPLODING BALANCE SHEETS OF THE MAIN CENTRAL BANKS



Source: Bloomberg LP

The chart above shows the dramatic expansion of the balance sheet of the Federal Reserve which grew from $4.1 trillion to $7.1 trillion between mid-March and June. The increase in size of the balance sheets of the ECB and the Bank of Japan have been less spectacular during the recent period, but are meaningful nevertheless. The balance sheet of the BOJ now amounts to 115% of Japan's GDP, with those of the Fed and the ECB representing around a third of their respective GDPs.

GOVERNMENT BOND YIELDS

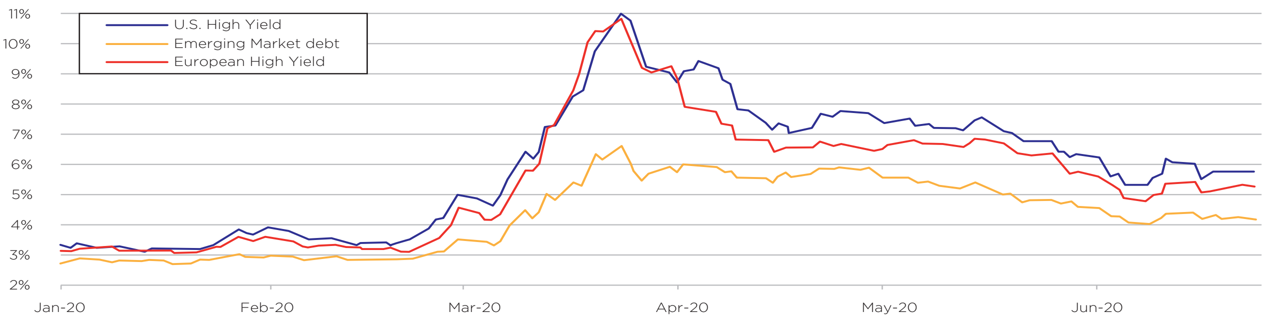


Source: Bloomberg LP

The yields of G-7 sovereign bonds had already been in decline since the beginning of the year when the Covid-19 pandemic contributed to strengthen this trend, except for a brief period in March. This sudden spike of yields was the result of severe market dislocation as all asset classes were hit by forced liquidations and by significant deleveraging. The actions of the Federal Reserve, which slashed rates to zero and intervened massively in many bond markets' segments, contributed to improve liquidity and have driven 10-year Treasury yields to around 0.7% from a level of 1.92% in January. This trend has been observed across sovereign debt markets of the other G-7 countries, with the exception of Italy, whose 10-year yield climbed from 1.42% in January to a March peak of 2.3% to drop only gradually back to end-2019 levels.

BONDS' SPREADS

EMERGING MARKET DEBT AND HIGH YIELD SPREADS

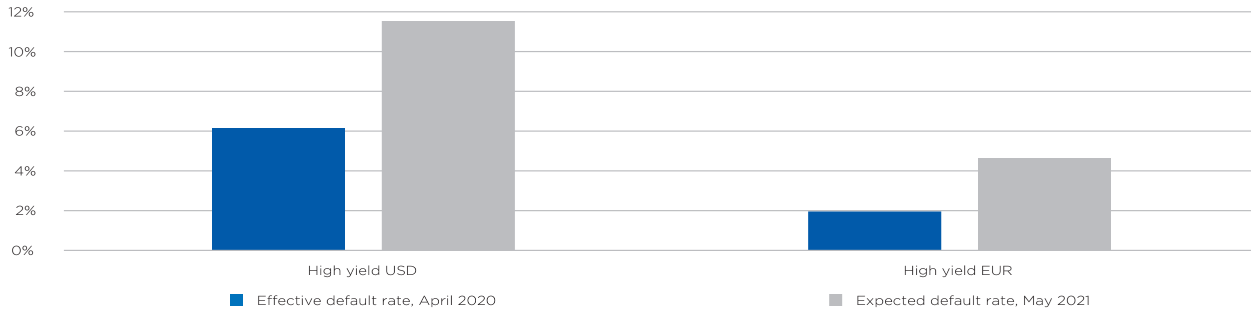


Source: Bloomberg LP

As shown in the chart above, high yield spreads widened significantly from the end of February in a move closely correlated to the drop of equities. Some sectors were hit particularly hard due to the impact of the spreading of the Covid-19 coronavirus; the accelerating fall of oil prices put energy issuers under severe pressure while those within the travel and automotive industries figured amongst the worst performers as their activity came to a standstill. For some time, the primary market for corporate debt was totally closed, including for investment-grade issuers. Once the Federal Reserve announced that it would buy corporate debt, including high yield debt, the market started to trade better. High yield spreads contracted in two stages but have not returned to pre-crisis levels. New issuance reached record levels as companies tapped corporate bond markets to shore up their balance sheets.

Emerging markets sovereign debt proved to be more resilient than high yield debt as its spread widened to a much lesser degree; EM corporate debt was more impacted, unsurprisingly, as a result of currency weakness, lower commodity prices and a general selloff of risky assets. It took longer for EM debt to regain its composure as investors were initially more reluctant to reposition themselves in EM corporate debt.

EXPECTED DEFAULT RATES



Source: Moody's

The corporate bond market has had to face a large and rapid number of downgrades, with many companies having lost their investment-grade rating to become "fallen angels". Vanguard estimates that as much as $400 billion worth of BBB bonds could be at risk of downgrade to high-yield in the United States as a result of the pandemic, depending on the path of the economic recovery; this would amount to around 6.5% of the US investment-grade market and nearly 14% of the BBB market. In Europe, Vanguard estimates that up to €200 billion in investment-grade bonds could be downgraded to high yield in the worst case scenario. A rise of default rates is unavoidable and the chart above shows that Moody's now expects the default rates of US and European high yield to climb from 6.2% and 2% to 11.6% and 4.7% respectively in the year ahead.

THE MACRO ENVIRONMENT/FINANCIAL CONDITIONS: CONCLUSIONS

The outlook for the global economy is obviously brighter than a few months ago, as business activity gradually picks up, but many virus-related questions remain unanswered and the economic fallout from the pandemic is impossible to evaluate. Global trade could shrink by 10-30% this year, a very wide range, the decline of the current unemployment rates will still leave them well above pre-crisis levels and certain industries will suffer from a prolonged period of a contraction of their activity. Other risks include rising commercial tensions once again, between the US and China in particular, but also between the US and Europe. Upcoming US elections could well produce a new administration, with the possibility of a Democratic majority in both the House and the Senate; this outcome could lead to a reversal of many of Donald Trump's policies, including the probable introduction of a less favourable corporate tax regime.

Following a period of massive stress, financial conditions are now very supportive for financial markets. Quantitative easing and fiscal support are at unprecedented levels, while real interest rates are likely to stay negative for a long time. The result of these measures will be for central banks' balance sheets to keep on growing from the present record levels and for public accounts to remain structurally imbalanced. This framework has contributed to stabilize capital markets and has triggered a spectacular rebound of risky assets; this trend has also been accompanied by question marks over the sustainability of the rally of equities. There is also a distinct risk that markets have become far too reliant on all these supports, in view of deteriorating economic fundamentals.

High debt-to-GDP ratios and slow growth should characterize the global economy in the years ahead, once the post-virus economic rebound normalizes. The pandemic shock has brought forward the shift toward joint monetary and fiscal responses and the issues of how and when to reduce the levels of public debt and to rebalance fiscal accounts will remain a big challenge for governments.

FINANCIAL MARKETS

	End 2019	May 2020	June 2020	MTD	2020
EQUITIES					
S&P 500	3'230.8	3'044.3	3'100.3	+ 1.8%	- 4.0%
Euro Stoxx 50	3'745.2	3'050.2	3'234.1	+ 6.0%	- 13.6%
MSCI EM	1'114.7	930.4	995.1	+ 7.0%	- 10.7%
YIELDS					
UST 10-year	1.92%	0.65%	0.66%	+ 1bps	- 126bps
Bund 10-year	- 0.19%	- 0.45%	- 0.46%	- 1bps	- 27bps
BBB EU	0.97%	1.41%	1.12%	- 29bps	+ 15bps
CURRENCIES					
EUR/USD	1.121	1.111	1.123	+ 1.2%	+ 0.2%
USD/CHF	0.967	0.962	0.947	- 1.6%	- 2.1%
EUR/CHF	1.086	1.067	1.064	- 0.3%	- 2.0%
USD/JPY	108.6	107.8	107.9	+ 0.1%	- 0.6%
GBP/USD	1.326	1.234	1.240	+ 0.5%	- 6.5%
COMMODITIES					
CRB Index	185.8	132.2	138.0	+ 4.3%	- 25.7%
Oil, WTI	$ 61.1	$ 35.5	$ 39.3	+ 10.7%	- 35.7%
Gold	$ 1'517	$ 1'730	$ 1'781	+ 2.9%	+ 17.4%

Equity markets have moved in both directions at a record pace

Following a solid start to the year, with several indices reaching all-time highs, equity markets plunged by over 30% in a matter of weeks as investors came to terms with the devastating impact of the Covid-19 coronavirus on the world economy. The market correction was amplified by the unwinding of a high level of leverage and all asset classes were caught up in the turmoil during a brief period in March. Equity markets then rebounded at a pace never observed previously during equity recoveries following a bear market; this rally has been driven by the unprecedented and quick response by central banks and governments which announced measures largely superior in size to those deployed during the great financial crisis. US equity markets outperformed due to the outsized contribution of a small number of mega-caps in the Technology and Communications sectors, in particular Apple, Microsoft, Amazon, Alphabet and Facebook.
The Growth style continued to outpace Value, until a temporary reversal of these trends towards the end of May, with lagging cyclical sectors such as Energy, Financials, Industrials and Materials making up some lost ground.

US Treasury yields are trading within a much lower range

Government bond markets rallied during the first part of the correction of equity markets before getting caught up in a liquidation wave across all asset classes. The massive monetary support from the main central banks then contributed to improve market liquidity and to push bond yields much lower. 10-year Treasury yields, which had traded below 0.5% in early March, jumped to 1.25% on March 18 before stabilising around 0.6% as markets regained some of their composure. The trends of high-yield credit and emerging markets' bonds have remained closely correlated to those of equities even if their recovery has somewhat lagged as spreads remain much wider than those observed before the market correction.

The major FX crosses are close to their early-year levels

The major currencies, with the exception of a weaker sterling, have ended June with limited changes even if intra-year movements have been wide. Following an early-year period of dollar strength, lower Treasury yields and the slashing of interest rates by the Federal Reserve triggered a plunge of the US currency, reflected by a rebound of the EUR/USD parity from 1.079 to 1.145. An ensuing rush for dollars, amidst the market panic in March, caused a violent trend reversal; once again, the Fed intervened to establish international swap lines which helped to restore some stability. From mid-May onwards, the euro benefited from the proposal for a European recovery fund to substantially appreciate and to end June at 1.123 against the USD.

A rollercoaster ride for oil prices and strong support for gold

It has been a most dramatic half-year for oil prices which plunged by over 80% until the end of April before staging a rebound to recover around 50% of their year-to-date losses. A massive imbalance resulted from the collapse of demand for oil as the global economy was placed into lockdown, with production taking time to be cut. In contrast, gold benefited from much lower bond yields and safe haven demand to appreciate by 17% during the first half. With the exception of a two-week period in March when all assets were sold off, gold traded higher or, at least, remained stable even during the rally of risky assets.

MARKETS' OUTLOOK

Financial markets are facing an extraordinary level of uncertainty...

"It is dangerous to make forecasts, especially about the future". This saying rings even more true than usual in view of a level of uncertainty which is well above average. Many questions related to the Covid-19 coronavirus remain without any indisputable answers, including the risk of a second wave in the fall and the timing of when a vaccine will become widely available. The economic outlook is also the subject of much conjecture resulting into a wide range of potential outcomes; in particular, will consumer spending, by far the largest component of GDP, revert to its previous pattern or prove to be meaningfully altered. The results of major political events ahead, such as the US elections and Brexit negotiations, are also difficult to predict and could have a major bearing on capital markets, without mentioning geopolitical and social issues. All this to say that the more optimistic sentiment currently prevailing in the markets could quickly give way to more caution. This largely explains why we continue to hold on to some portfolio protection.

...and are even more addicted to monetary support

The behaviour of markets since February has been most dramatic. A short period of extreme fear was followed immediately by a strong rebound which, for the equity markets at least, seems to have mutated into euphoria. Financial assets have been propped up by unprecedented monetary support provided by the main central banks and by fiscal packages on a massive scale. Without a quick recovery of the economy and the ability of companies to return to their longer-term profitability trend, equity markets are at risk of correcting in view of demanding valuations. If that were the case, they are likely to expect central bankers to come back to their rescue once again, in a repeat of an often observed pattern since the great financial crisis. Central banks have proved to be unable to wean capital markets off their provision of what now appears as endless liquidity and the correlation between asset prices and the size of Central banks' balance sheets is as high as ever.

DEBT INSTRUMENTS

G-7 sovereign debt yields are likely to remain capped

We would expect G-7 sovereign debt yields to remain relatively capped, mainly as a result of central banks' policies. The significant increase of debt issuance by governments to finance massive fiscal packages is made possible by central banks' purchase programs and their tacit commitment to control yield curves. We are underweight investment grade bonds due to their lack of income and unattractive valuations. We much prefer credit risk to duration risk, hence our overweight in high yield credit and emerging market debt which offer better value in our opinion. Spreads have room to tighten even if the careful selection of issuers has become even more important as default risks are rising.

EQUITIES

The fast rebound of equities leaves them vulnerable to disappointments

Our outlook for equity markets is cautious at this stage in view of expensive valuations and optimistic economic expectations. We acknowledge the unprecedented monetary and fiscal support but consider that many risks are not priced in. The upcoming reporting period of second quarter earnings could dampen market enthusiasm if companies were to provide underwhelming guidance for the quarters ahead. Equities might also have to start discounting a partial reversal of policies introduced by the Trump administration if the latest polls on US November elections were to be confirmed by the counting of votes.

The dispersion in the markets is very high and indices have often distorted the underlying reality due to some heavyweight components. Most of our investments have outperformed their respective benchmarks, due to our preference for active managers, and we believe that these quality stock pickers are likely to continue outperforming going forward.

FX

Dollar weakness could persist

The multi-year rally of the U.S. dollar appears to be in the process of ending with “cyclical” currencies, including the euro and emerging markets’ ones, having outperformed significantly during the recent period. The dollar is still overvalued, in terms of purchasing power parity, and the global demand for dollars seems to have been satisfied by the Fed’s provision of dollar liquidity swaps with many foreign central banks. Also, an outperformance of the euro and EM FX is usually observed during cyclical recoveries, so we are maintaining our current underweight exposure to the dollar.

ASSET ALLOCATION 2ND HALF 2020

CASH (4%)

Underweight

The allocation to cash remains slightly underweight after having been boosted recently by the redemption of one of the alternative strategies. Cash was deployed in March to purchase equity protection and a new position in gold, meaning that the current underweight allocation to cash does not reflect a higher level of risk within the portfolios.

DEBT INSTRUMENTS (41%)

Overweight

We have maintained our overweight allocation into debt instruments unchanged since the beginning of the year. As a reminder, our exposure to investment-grade bonds is underweight and our focus continues to be more on high-yield bonds, senior secured loans, convertible bonds and emerging market corporate debt. Our main investment-grade positions are invested into sovereign and quasi-sovereign bonds issued by the most creditworthy nations as well as Euro-denominated corporate credit; in view of the massive support provided by the main central banks, these positions should provide stability and gradually recover beyond the early-year highs.

Our allocation to high-yield bonds is overweight and mainly implemented through investments into senior secured loans, high yield bonds, a maturity-dated high-yield fund and EM corporate debt. We consider that current market fundamentals provide an attractive risk/reward and we are confident in the ability of the managers of the different funds to avoid market pitfalls, including a rising risk of defaults.

The «specialist bonds» allocation has remained overweight and is close to the maximum of its range. Convertible bonds have fared relatively well during the recent testing market conditions and continue to represent a core holding within the portfolios.

EQUITIES (47%)

Neutral

The exposure to equities is slightly lower than at the beginning of the year as a result of market movements. The main activity within the asset class has been the hedging of part of the equity exposure since the beginning of March. This contributed to limit the drawdown of the portfolios during the market correction but also enabled to participate in the rebound of equities. The holding of a plain vanilla Put has recently been switched into a Put spread; portfolios now benefit from downside protection from a higher level than previously but this protection is only limited until the lower strike of this spread.

In relative terms, we consider that European and emerging markets' equities offer more potential upside than US equities. Value stocks have also been out of favour for a long time but they benefit from extremely attractive valuations relative to Growth ones. That is why we are keeping a good balance in the portfolios between current outperformers and those which have lagged significantly.

COMMODITIES (3%)

Underweight

The market stress across all asset classes in March provided a brief window of opportunity for us to initiate a new position in gold at a price below $1'500 per ounce. Gold should benefit from low Treasury yields, a weaker US dollar and an uncertain environment to offer portfolio diversification.

HEDGE FUNDS (5%)

Underweight

The allocation to hedge funds is underweight and has decreased recently following the redemption of the Alternative Risk Premia strategy. Several hedge funds fulfilled their role well during the correction of the markets and still remain amongst the best year-to-date contributors

ASSET ALLOCATION GRID 2ND HALF 2020

For our balanced accounts, we apply the following grid:

	ALLOCATION	JULY 2020
SHORT-TERM DEPOSITS	0 – 20%	4%
DEBT INSTRUMENTS	15 – 55%	41%
Investment grade bonds	5 – 45%	8%
EM & high-yield bonds	0 – 20%	15%
Specialist bonds	0 – 15%	18%
EQUITIES	20 – 60%	47%
Developed markets	15 – 50%	41%
Emerging markets	0 – 30%	6%
COMMODITIES	0 – 15%	3%
Physical gold	0 – 5%	3%
Other commodities	0 – 10%	0%
HEDGE FUNDS	0 – 25%	5%
		100%

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