2020: The Year Of The Pandemic That We Will All Remember

We began 2020 with the manufacturing sector in trouble, and particularly so in Europe. The Trump tax cut effects were fading and there was evidence that the liquidity provided by central banks had reached its limits to lift the economy from the soft patch, and expectations that fiscal spending was needed to address income inequalities: particularly in infrastructure, but also in social benefit programs. For these reasons, after an exceptional 2019 for investors, we were mildly positive on equities. Then came the pandemic. Nobody saw it coming, and very few expected it to still be raging almost one year later. Of the negative risks to financial markets we highlighted a year ago, the only one nearing a pandemic was a 'catastrophic climate event'. Of the positive 'risks' to financial markets we cited 'relaxed rules for fiscal spending' and 'the launch of a European Infrastructure fund': obviously we got both, worldwide and in amounts unimaginable only a year ago. Europe launched its first mutualized debt that will finance the European Recovery Fund. Fiscal rules and austerity have been discarded: governments have been, and continue to inject cash in their economies in multiple forms of support worth several percentages of their national GDP. Suffice to say that The Netherlands, once the champion of fiscal rigidity and frugality, is now outspending France in terms of percentage of its GDP. Over in the US, on top of the already agreed 900 billion package, Biden's administration could top it up with 1 to 1.5 trl USD more, (that is on top of the 2.5 trl package of March of last year): that would be equivalent to 9 to 11% of its GDP for 2021. On the other hand central banks offer essentially unlimited support for an indefinite time, with zero or negative rates.

In an effort to recap what happened to the financial markets and the economies, after much of the world's government decided to shut down their economies, and put 4 billion people into a lockdown:

- March was the most volatile month in the stock market history, (measured by the S&P 500), only to be followed by the strongest rally out of a bear market since 1932 that led to new highs;
- The peak-to-trough drawdown of 34% was the largest since the 48% of 2008;
- The 12% decline on the 16th of March was the worst since Black Monday in 1987;
- Huge dichotomy of sector performances: technology up 44%, energy down 34%;
- It was however not an extraordinary year for technology stocks: the Nasdaq 100 was up 85% and 102% respectively in 1998 and 1999;
- From a risk reward point of view however, this seems like a normal year: average volatility for the S&P is 16%, while average returns are 8%. In 2020 the

S&P returned 18%, with 35% realized volatility: investors therefore faced twice the volatility for twice the returns;

- A new breed of investor appeared, at first derided by much of the professional community, but that with ex-post analysis had a huge impact on the market's recovery. Investors that, mostly in their twenties and bored at home, with no sports, no betting and no new series on TV, (and with the fresh check from the US treasury), purchased equities for the first time. They trade on ‘zero-cost’ platforms, shun mutual funds, purchase mainly single stocks, are often leveraged and make extensive use of options (which by nature are leveraged): the so-called Robinhood traders. They probably saved the markets, as during the sell-off they stepped in to buy, as many professional investors were ready to liquidate their portfolios;
- Money markets and fixed income trading essentially froze, forcing central banks to intervene in both markets: ECB and FED’s balance sheets are now at or above 7 trillion in their respective currencies;
- 10 year Treasury notes returned 10% in 2020;
- US oil futures managed to settle at negative prices, as there was nowhere to store the commodity, (WTI involves actual delivery of the commodity, while Brent is cash settled);
- Gold had its best year since 2010, when Greece scared the markets;
- The USD lost a lot of ground versus its peers, shedding almost 10% versus the Euro, as it gets sucked into downward spiral by US twin deficits. The US is dependent on foreign savings to the tune of 3.4% of GDP. With ever large deficits, China is highly unlikely, to say the least, to help fill that void;
- Bitcoin soared 300% last year: we will refrain from making any recommendation. While some institutional investors embraced it, younger generations refer to it to the digital gold. It does appear however to have a high correlation with risk assets, namely stocks, albeit with a very large beta;

In the US, the economy went from having the lowest unemployment rate in 50 years to the highest in 80 in the span of just two months, as the country doesn’t have the safety nets that Europe has. Manufacturing is now keeping economies afloat, while services are struggling, as they are obviously more exposed to the government-imposed restrictions. China is the only major economy which will post positive economic growth in 2020, having implemented extremely strict measures to control the pandemic, which likely would not have been possible in Western democracies.

In the middle of the pandemic we also had to deal with a more and more erratic US President, Brexit, and a Sino-American trade war that morphed into a technology war.

I think we all agree, that we all look forward when, hopefully by mid-2021, and thanks to vaccines, we will change the subject of many of our discussions from ‘number of hospitalizations', 'lockdowns' or 'vaccine(s)', to 'that great restaurant' or that family event.

MAIN PORTFOLIO ACTIVITIES IN 2020 AND OUR USP

After the great stock performance of 2019, we decided to enter 2020 with some portfolio protection. During the sell-off of February-March, we gradually unwound these positions and in mid-March decided to take more radical measures in our portfolios:

- We sold most remaining Puts;
- Increased gold by 2%;
- Bought 3% of equities;
- Hedged all USD;
- Converted the European dividend strategy to a European economic recovery strategy;

And later, (in May), we reduced the equity allocation, and purchased Calls.

As the year progressed we added another thematic to our portfolio. In late May we added a thematic linked to everything that rotates around animals and pets: food, healthcare, toys, insurance, amongst others. In the summer we sold our calls and bought protection again, that would cover the period over the US elections and Brexit. In September we added a position in Asian bonds, while in November we added a position in US small caps.

Our portfolios withstood the shock comparatively well during the turmoil. In particular, the structural combination of a Market Conscious block with a more Strategic one, invested in our key thematic ideas worked quite well. In the market conscious part, we had positive performance from the expected volatility dampeners: covered bonds and inflation linkers, are up 3.6% and 8.2% ytd respectively. In that same block Euro government bonds are up 3.5%, while in USD portfolios treasuries are up 10%, and therefore significantly added alpha. The strategic block in our portfolios generally performed very well, and our thematics added significant alpha in 2020, and greatly helped our overall performance:

- The Global Consumer theme is up 37% for the year;
- Health Improving Technologies and Services investment theme is up 46%;
- The Asian Technology investment is up 39%;
- Family Holdings theme ended the year at +1.34%, well ahead of the MSCI Europe which ended at -3.32%;
- Our basket composed of European strategic industries and national champions, returned 61% since its implementation on the 23rd of March, that compares with the MSCI Europe, up 42.7% over the same period;

- Gold in EUR is up 15% for the year;
- Our latest thematic addition, Animal Health and Wellbeing, returned 40% since being added in May.

In summary, our portfolio construction and thematic approach was validated in 2020 and we will look at making some structural changes, as the financial world as we knew it, has changed for the foreseeable future.

OUTLOOK 2021

With 2021 having begun we are currently witnessing a tug of war between virus propagation and taxes, versus vaccines and stimulus, with the latter pair having the upper hand. While in Q1 news about the propagation of the new English variant will induce even tougher lockdown measures, the acceleration in vaccine(s) delivery will deliver hope for the second part of the year. As commented over the last couple of months, we believe that the current environment will be particularly supportive for risk assets over the next several months, as markets typically anticipate events 6 to 9 months in advance: the markets is and will discount a V-shaped recovery for end of Q2/Q3. Estimates are that by May/June, a sufficient portion of the population will have been vaccinated: we expect thereafter an explosion in retail sales, travel, and all those things that people had to give-up for the past 10 months. In an environment with zero or negative rates, continued monetary support and continued and expanding fiscal policy support, we expect a strong rebound in earnings by about 30% due to a favorable base effect. While certainly not cheap, by historic measures, compared to a 17 trillion stock of negative-yielding bonds, equities are a cheaper asset class. Also, let us not forget that, besides the pandemic, the other two major disruptive events of the last five years, the Trump presidency and Brexit ended, or are about to end.

While we believe the market's general trajectory will be up, at least for the first part of the year, sector rotations, Q1 portfolio adjustments will likely mean that the market will advance by two steps forward and one step back. While sectoral rotation will likely favor more exposure to cyclicals, the reflation trade, and value, do not dismiss technology and secular growth stocks. In 2020 we got an advanced taste of the future in tele-everything: working, shopping, entertaining and more: much of it will likely remain going forward, as the 4th industrial revolution evolves. Sustainability is here to stay and will ever permeate our lives. The megatrends of 2019, just became the hypertrends of the present. Also the hunt for medical supplies, but also chain supply issues that emerged , for example, in technology or the car industry, means more will be produced domestically or not far away.

What we expect medium term, is rather the end of the outrageous outperformance of some stocks/sectors, a conversion of styles, and a more broad-based market participation.

From an economic point of view, it is more complicated. Some economies held up better: e.g. Germany's GDP at -6% versus France and Italy at -9%. While data has been quite volatile, (particularly in the US where they annualize most of the data), and surveys questionable as most people were/are at home, the big question over the next 12 months is how many jobs will return? Many companies profited from the pandemic to further automate manufacturing or execute restructuring plans. Will all currently closed bars and restaurants reopen when this is over? Will insurance and banks keep all those middle managers, when admittedly things worked quite well homeworking? Assuming economies are now running at 90-95% of their pre-pandemic levels, it could admittedly take years before the job market recovers to the pre-pandemic level. Over in the US obviously with Biden's hold of Congress, there is a lot of talk about potentially raising taxes for corporates to 28% from the current 21%: we think it will be less and probably towards the end of the year, as he will not want to derail the economic recovery. Many countries are discussing new methods of levying taxes including digitals taxes, taxing robots or wealth taxes: we think they will indeed come, but not in 2021.

Being rather optimistic for risk assets during the part of the year what could go wrong later-on?

- Companies' operating leverage could disappoint, delaying an earnings' recovery.
- Vaccines roll-out disappoint, or even worse a mutation of the virus renders them useless.
- Retail investors walk away, (see above).
- A larger than anticipated pick-up in inflation causes central banks, while moderately, to react, causing a 'taper tantrum', similar to 2013, when bond yields surged.
- A worsening in the tech war between China and the US.
- Several geopolitical flashpoints could worsen.

STRATEGY

We did not make any changes to our Tactical Asset Allocation last month.

We are now overweight equities, with financial markets drifting higher, and most of our thematic exposures carry a beta higher than the market. Our downside protections into January 2021 are now essentially written off and we are pondering whether we should renew them. On the currency side we continue to be fully hedged against USD.

Gold, in the above scenario, and amidst zero USD rates and a record stock of almost 17 trillion USD of negative yielding bonds, becomes an even more desirable asset. We continue to think that it is an ideal diversifier in a multi-asset portfolio, a storage of long-term wealth, and a winner of several countries' de-dollarization process, (China or Russia for example).

Overall Exposure

We are Overweight Equities, and Underweight Fixed Income, Overweight Cash along with a long Gold position, fully USD hedged.

Equity: Overweight

Overweight Continental Europe, Underweight UK, Underweight US, Neutral Japan, Neutral Asia ex Japan, Overweight Emerging Asia.

Thematic Equities

Global Consumer, Health Improving Technologies and Services, Asian Technology, European Family Holdings, European COVID Recovery, Pet and Animal Wellbeing.

Fixed Income: Underweight

Underweight High Yield in EUR and USD. Overweight in Investment Grade EUR and USD Bonds, Underweight Sovereigns, Underweight EMs. Long Global Inflation Linked Securities, Long Covered Bonds, long Hybrids, long Asian bonds.

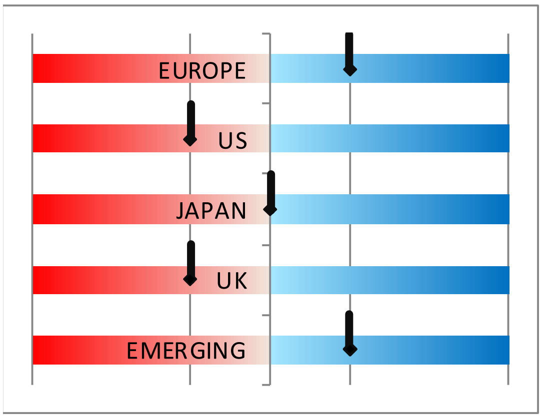
Currencies: **Underweight USD**, (Portfolios are fully USD hedged)

Commodities: Overweight

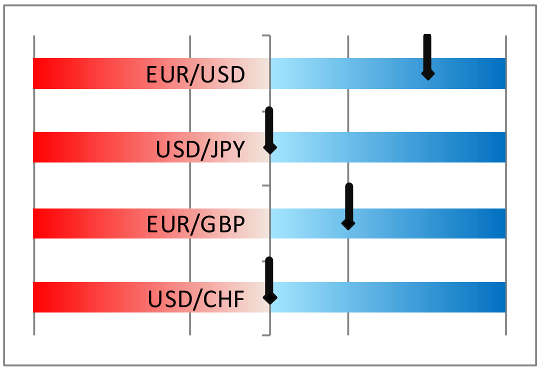
Long Gold.

CONVICTION THERMOMETER

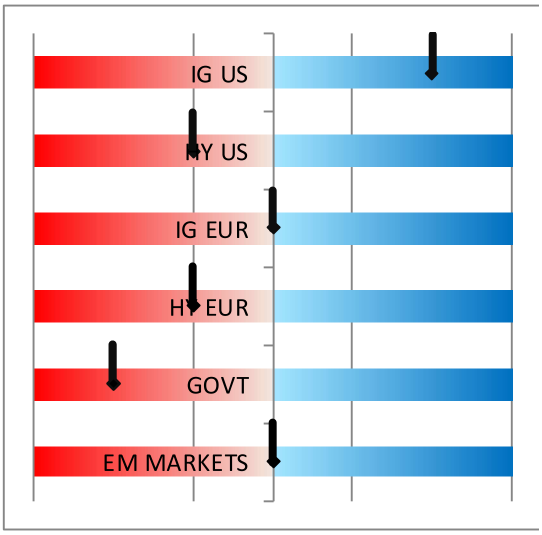
Equities



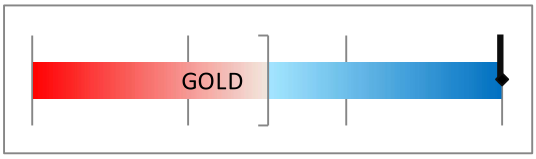
Currencies



Bonds



Commodities



*Negative view / Positive view

MARKET OVERVIEW AS OF 30TH DECEMBER 2020

EQUITIES (local ccies)	Level	5D	MTD	YTD	2019
MSCI WORLD	2 686,06	1,34%	4,12%	16,35%	28,44%
GERMANY DAX	13 718,78	0,97%	3,22%	3,55%	25,48%
FRANCE CAC40	5 599,41	1,30%	1,63%	-4,14%	30,45%
UK FTSE100	6 555,82	0,93%	4,81%	-10,14%	17,23%
BELGIUM BEL20	3 663,06	0,20%	-0,01%	-5,54%	26,22%
SWISS MARKET INDEX	10 703,51	2,80%	2,20%	4,30%	4,30%
EUROPE EURO STOXX 50	3 571,59	0,91%	2,33%	-2,07%	29,36%
US S&P500	3 732,04	1,16%	3,17%	17,62%	31,48%
NASDAQ 100	12 845,36	1,52%	4,76%	48,38%	39,46%
RUSSELL 2000	1 979,99	-1,31%	8,93%	20,24%	25,49%
JAPAN TOPIX	1 804,68	2,36%	2,96%	7,40%	18,12%
MSCI EMERGING	1 289,03	2,47%	7,06%	18,29%	18,82%
BRAZIL IBOVESPA	119 017	1,03%	9,30%	2,92%	31,58%
MEXICO MEXBOL	44 693,96	2,52%	7,08%	4,63%	7,58%
RUSSIA MICEX	3 289,02	1,23%	6,35%	14,82%	38,45%
CHINA CSI 300	5 113,71	2,13%	3,10%	27,46%	39,19%
INDIA SENSEX	47 746,22	2,80%	8,17%	17,15%	15,66%
KOREA KOSPI	2 873,47	4,14%	10,91%	31,55%	9,96%
HONG KONG HANG SENG	27 147,11	3,05%	3,07%	-0,54%	13,01%
AUSTRALIA ALL-SHARE	3 723,98	1,17%	5,29%	-8,50%	19,09%
SAUDI ARABIA TADAWUL	8 760,08	0,48%	0,18%	7,53%	10,92%

US: Sectors	Level	5D	MTD	YTD	2019
COMMUNICATION SVCS	219,79	1,12%	2,09%	22,43%	32,69%
CONSUMER DISCRETIONARY	1 302,76	2,14%	2,54%	33,32%	27,94%
CONSUMER STAPLES	690,80	0,96%	0,97%	9,87%	27,61%
ENERGY	288,48	-0,24%	5,25%	-33,14%	11,81%
FINANCIALS	484,02	0,67%	4,85%	-3,05%	32,09%
HEALTH CARE	1 309,08	0,96%	2,71%	12,13%	20,82%
INDUSTRIALS	744,99	0,21%	0,57%	10,37%	29,32%
INFORMATION TECHNOLOGY	2 284,47	1,36%	5,42%	43,46%	50,29%
MATERIALS	453,88	1,37%	2,09%	20,20%	24,58%
REAL ESTATE	225,04	1,48%	0,14%	-3,48%	29,00%
UTILITIES	314,09	1,62%	-0,87%	-1,05%	26,35%

EUROPE: Sectors	Level	5D	MTD	YTD	2019
BASIC MATERIALS	2 670,42	0,32%	6,84%	10,00%	25,03%
CONSUMER GOODS	3 826,19	1,98%	3,54%	1,40%	28,59%
CONSUMER SERVICES	1 282,79	2,37%	2,91%	-4,64%	27,27%
FINANCIALS	648,91	0,35%	1,45%	-15,22%	22,90%
HEALTH CARE	2 837,35	2,04%	0,04%	-2,11%	32,10%
INDUSTRIALS	2 908,42	0,69%	2,74%	7,06%	36,67%
OIL & GAS	951,01	-0,13%	3,92%	-26,52%	10,29%
TECHNOLOGY	1 265,23	1,77%	4,70%	18,16%	35,82%
TELECOMS	542,54	0,33%	-0,49%	-12,13%	1,68%
UTILITIES	2 057,32	1,59%	3,05%	17,07%	31,50%

WORLD: Styles	Level	5D	MTD	YTD	2019
QUALITY	3 220,74	1,66%	3,42%	21,89%	36,08%
MOMENTUM	3 412,02	0,87%	4,28%	28,23%	27,67%
VALUE	9 659,89	1,08%	3,15%	-1,55%	21,75%
GROWTH	8 007,06	1,58%	5,04%	33,96%	33,68%
VOLATILITY	7 445,83	1,51%	3,55%	10,93%	27,16%
SIZE	7 206,75	1,23%	4,15%	12,33%	25,35%
DIVIDEND	4 023,00	1,37%	3,23%	5,32%	26,79%

FIXED INCOME	Level	5D	MTD	YTD	2019
Pan-Euro 3-5 yrs IG	218,20	0,07%	-0,02%	0,68%	2,88%
Euro Aggregate	275,35	0,25%	0,14%	4,04%	5,98%
Pan-Euro HY Hedged Eur	403,21	0,14%	0,75%	2,33%	11,36%
Global Inflation hedged EUR	273,86	0,50%	0,34%	7,97%	5,36%
US Corp High Yield	2 264,90	0,54%	1,85%	7,08%	14,32%
EM USD Aggregate TR	1 260,87	0,24%	1,43%	6,43%	13,11%
EM Aggregate TR Local Ccy	152,02	0,76%	2,45%	5,42%	9,47%
EUR Banks CoCo Tier 1	149,70	0,37%	0,92%	6,14%	17,23%
EU GOVT HEDGED EUR	261,78	0,48%	0,35%	5,32%	6,42%
U.S. Treasury	2 554,99	0,20%	-0,33%	7,90%	6,86%

COMMODITIES	Level	5D	MTD	YTD	2019
GOLD	1 894,39	1,15%	1,44%	24,86%	18,31%
COPPER	354,90	-0,08%	16,11%	26,89%	6,31%
OIL WTI	48,40	0,58%	33,81%	-20,73%	34,46%
OIL BRENT	51,34	0,27%	36,36%	-22,21%	22,68%

CURRENCIES	Rate	5D	MTD	YTD	2019
EURUSD	1,2298	0,91%	3,11%	9,68%	-2,22%
GBPUSD	1,3625	0,98%	2,27%	2,78%	3,94%
USDJPY	103,1900	-0,37%	-1,07%	-4,99%	-0,98%
USDCHF	0,8813	-0,80%	-3,04%	-8,82%	-1,58%
AUDUSD	0,7686	1,47%	4,66%	9,47%	-0,40%
USDRUB	74,4128	-0,91%	-2,59%	4,22%	-11,08%
USDCNY	6,5232	-0,27%	-0,85%	-0,83%	5,28%
USDKRW	1 086,35	-1,92%	-1,81%	-1,55%	4,22%
USDINR	73,31	-0,62%	N.A.	-0,99%	9,15%
USDIDR	14 050	-1,06%	-0,50%	-0,28%	7,42%
USDBRL	5,1920	-0,26%	-3,12%	28,82%	4,02%
USDTRY	7,3841	-3,38%	-5,62%	24,08%	12,51%
USDZAR	14,6093	0,06%	-5,55%	4,35%	-2,42%

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