Prime Partners

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MARKET INSIGHT

JULY 2020

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ASSET MANAGERS
2020

Market Analysis

July 2020

Consolidation in June in an “exceptional” quarter for equities!

In essence, the general situation has not changed over the past few weeks.

On the economic front, the signs of recovery remain in place, endorsing our view of a sharp upturn in activity in the second half. As for economic policy, monetary authorities and governments are holding firm on providing unwavering support. And lastly, the health crisis: even though COVID-19 seems to be under control, the resurgence of infections in some regions, especially the US, demonstrates that this phase of the pandemic is not over yet.

Nevertheless, risk assets suffered weeks of increased fluctuation in June, after two months of steady gains.

How can we explain the disjuncture between fundamentals and markets?

As we pointed out last month in this column, the strong rally in risk assets during April and May was the precursor to the consolidation phase that we predicted. True enough, the combination of market psychology that had veered “too far” towards the positive, and more expensive market valuations, was enough to motivate profit-taking. We are not overly surprised by recent equity movements.

We had maintained a defensive stance in May, in the conviction that the market had rallied too swiftly. Accordingly, we took advantage of the downturn in prices at the beginning of June to partially reduce our equity hedges.

This adjustment follows the rationale we have voiced for several months: any consolidation in the markets should provide opportunities for repositioning. This has also led us to strengthen our holdings in certain equity investment vehicles with attractive long-term prospects. As the old adage goes: put your money where your mouth is!

That said, it does not mean that we have radically amended our risk management policy. Consequently, other changes to our allocation (higher gold weighting, partial profit-taking on convertible bond positions) bear witness to our constant vigilance on risk assets. In addition, we maintain a slightly underweight equity position against our benchmark in preparation for the rapidly approaching Q2 season of earnings announcements.

Considering the stock markets do not promise any major improvement on the highs recorded in May, the priority is still to seek entry points during consolidation phases.

> “The summer should be a period more conducive to a sideways channel for the stock markets.”
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

We remain focused on this tactical approach, and are poised to seize opportunities to increase our equity exposure, should they occur. Even so, we do not envisage that this will mean our portfolios will be overweight in equities for the next 6 to 12 months.

Once again, we are holding steady to the course that we have been on since the March “fall”. Indeed, it is our view that the summer should be a period more conducive to a sideways channel for the stock markets, trading in a 10% range around a pivot point of, for instance, 3,000 on the S&P 500 (2,850-3,250).

Learning to live with greater volatility than we have seen in the recent past will be an essential requirement for braving stock market conditions with serenity during the forthcoming quarters. In a climate of massive injections of cash, it is reasonable to expect unpredictable

ups and downs in investor sentiment, which will feed into higher volatility.

Against the background of the strong financial repression that has been implemented, it is not easy to identify assets capable of offering decorrelation with the stock markets.

The virtues of government debt are extremely relative when we bear in mind the low returns, or even negative yield.

While gold looks like a prime candidate to serve as safe-haven asset – we have recently increased our positions – the appeal of quality corporate debt in the current situation should not be forgotten; in fact, it is likely to provide a satisfactory return while the central banks maintain their considerable support for this asset class.

In general, our bond allocations remain overweight in credit, with a preference for good quality issuers. We added to our positions during the month of June.

While high yield debt is still attractive, and all the more so following the widening of spreads in recent weeks, we recommend a preference for less risky segments, with a view to a healthy diversification of risk and its stringent management.

As we come to the end of a turbulent first half, both for the markets and for the economy, it seems very apt to close this monthly review by asking: will the summer allow us to rest easy?

We know that injections of cash are set to last, given the recent announcements from the central banks and various governments. So it can be assumed that the "liquidity driven market" is here to stay.

The issue of the COVID-19 pandemic presents further uncertainties, such as its continued advance in some regions of the world (for instance, Africa, India, and Latin America), or the fears of a possible "second wave" in countries that have begun – or even largely completed – lifting lockdown.

The markets seem to be of the opinion that "COVID-19 is under control" and that even the resurgence of a few local hotspots is unlikely to cause the same mayhem that occurred in the winter and spring of 2020. However, recent events have shown that such "convictions" are not unshakeable, given the return of volatility to the markets following the scare in Beijing or the rise of infections in some US states.

It would be a mistake to shrug off COVID-19 and not give it any further thought during the summer break. True, one might feel that lessons have been learned from recent experience and that the risk of another general lockdown is unlikely. But the fact remains that there are still too many unanswered questions for us to not believe that investors must keep this health crisis in mind, whether they choose a walking holiday or the seaside for the weeks to come.

Then there remains the question of the economy and its recovery. Only a few weeks ago, it was still almost unthinkable to talk of a sharp recovery. Majority opinion hovered between an L-shape and a U-shape to describe the course of growth in forthcoming quarters.

Then it sufficed for a few indicators to be published (PMI, US unemployment, retail sales) to put pessimism in the wrong. The collapse in business activity that we have faced since March has been so unique in its extent and suddenness that it is hard to find fault with forecasters.

What is more, we should not turn a blind eye to the fact that the "green shoots" that have appeared in the economy are yet to be confirmed, and in no event can they justify denial that for a long time world growth will be lower than it would have been without the pandemic. But this point isn't going to change over the summer break. On the other hand, it would be extremely troubling if the positive economic signals of recent weeks were not borne out during the next two months.

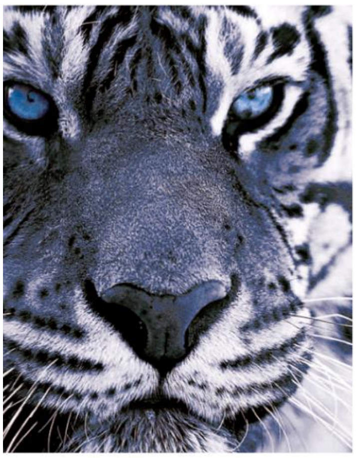
If that were the case, there would be the danger of swiftly seeing the cash injection-driven risk asset rally meet the unmoveable wall of fundamentals.

In other words, the forthcoming summer break should not encourage us to lower our guard on asset allocation!

We are fully aware of this and will stay vigilant, in a world where uncertainties abound and where it is wise to revisit, each day, the conclusions of the day before.

We wish you a good summer, despite current circumstances that are likely to make a bit peculiar.

Geneva, 30 June 2020



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IMPORTANT INFORMATION