Prime Partners

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MARKET INSIGHT

FEBRUARY 2021

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2020

Market Analysis

February 2021

January isn’t over yet and volatility is already back!

After a strong start to the year in terms of the behaviour of risky assets, the month ended with a return of greater volatility.

Some offer explanations for the more erratic conditions on the stock markets, all relating to system liquidity, which would have resulted in asset “bubbles”, in equities in particular.

The record number of IPOs in January, the boom in SPACs and the mergers/acquisitions associated with these structures, or the large-scale financing of companies in the high-yield debt market, are developments that cannot be ignored.

Both the recession triggered by the bursting of the tech stock bubble and the great recession following the sub-prime crisis were also affected at one point by the financial community’s expectation of an economic recovery.

However, one could argue that we are currently experiencing an “accelerated” version of the traditional process of improving expectations. This in turn may cause some concern, of which the recent return of volatility is perhaps only an early symptom.

This assessment would seem even more reasonable as we enter 2021 with mixed results, both in terms of controlling the COVID-19 pandemic and the effective roll-out of the vaccination campaign. This is a development that did not seem to worry investors in the first few days of the year.

> “We have not changed course in terms of our investment policy.”
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> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

As such, it is worth asking whether the price decline observed in recent days is a sign of a phenomenon that could gain momentum in the coming weeks, in light of the asset price inflation seen since Q4 2020.

Let’s try to put things in perspective.

The general consensus, which has factored in the possibility of an economic recovery in the medium term, may explain the continued improvement in risky assets over the first two weeks of January.

Indeed, a fear of missing the bull market and investor expectations should reassure us about the strong upswing in major indices over the last few months, and (perhaps) encourage us to let ourselves ride the current wave of momentum.

It is interesting to look at comparisons with the recent financial markets history. For example, it is surprising to see how quickly market indices recovered, following a strong correction in Q1 2020, when compared with what we saw in 2000 and 2008.

However, it is quite something to see stock market indices sporting such high valuations at an early stage of the economic cycle, or to see that the ratio of market capitalisation to global GDP is now higher than that seen during the 1990s tech bubble.

However, the Cassandra-like warnings of a rise in market exuberance, due to the speed with which we moved from “comfortable” territories to “optimistic” areas, have hardly resonated with the financial community. While there is no denying that recent and repeated warnings of bursting bubbles have weighed on trader sentiment, the resurgence of volatility on the stock markets at the end of the month remains limited and, for the most part, linked to specific phenomena (Reddit effect).

The disconnect between the real world and the financial sphere has perhaps never been so clear! This pervading feeling amongst the general population, while also facing the daily

impacts of COVID-19 restrictions, is perfectly understandable.

However, one important aspect to keep in mind in the above observations is the exceptional nature of the liquidity cycle initiated by central banks from spring 2020.

Otherwise known as the super-liquidity cycle!

We can never stress this phenomenon enough, which obviously reinforces the risk of a financial bubble, equities in particular. Has the scale of this already reached such levels that the rally observed over the last few months, as well as initial signs of a return to volatility, should be used to back away from the stock markets?

We do not think so, given that a strong recovery in the second half and the start of an expansion cycle in the medium term is possible, if not probable.

In our view, the disconnect between liquidity and the real economy does not initially appear to be threatened, and recent statements by the US Federal Reserve confirm this take; we remain convinced that the ultra-accommodating policies will not be called into question in the coming quarters.

And what about the economy? In this regard, it is worth asking whether investors over-anticipated a synchronised global economic recovery.

As it stands, there is no reason to believe as much, even if Europe's recovery is feared to lag behind that of China and the US, given its difficulties in managing COVID-19 and the challenges of its vaccine roll-out.

Nevertheless, this matter will require close attention in the immediate future; an inconsistent recovery from one region to the next may heighten investors' concerns about the apparent disconnect between financial markets and the real economy. We are not there yet, but we are keeping this scenario in mind.

Given what we have said so far, you will have gathered that we have not changed course in terms of our investment policy. We still consider equities an attractive asset in a diversified allocation.

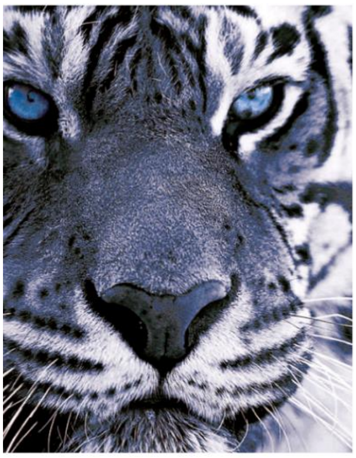
However, as mentioned last year, if the search for yield necessarily involves the stock markets in the current context, we must accept that this will also require putting up with greater volatility!

This point is key, as it is at the heart of our strategy for achieving our investment objectives.

As long as the probability of a sustained global economic recovery from the second half onwards remains predominant in our possible scenarios for the economy, we feel it is reasonable to prioritise equities in a portfolio. From a more strategic standpoint, this means that if the initial signs of consolidation of recent gains are confirmed, we will seize stock market opportunities. We feel especially comfortable with this plan given that we are not overweight on equities.

In keeping with the approach outlined above, at the end of the month we also added exposure to industrial metals in our portfolios. We are putting our words into action, in line with our outlook for growth and our concern about inflation in the medium-term.

Geneva, 29 January 2021



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