Prime Partners

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MARKET INSIGHT

MAY 2020

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2020

Market Analysis

May 2020

Why common sense matters amid persistent uncertainty

After the largest contraction in several decades in March, stock markets – and the S&P 500 in particular – saw the sharpest jump since 1991 in April.

These erratic shifts indicate a prevailing sense of uncertainty that may leave international investors wondering how to cope with what is a historic crisis in many respects.

When panic takes hold of the markets, as it was the case in February and March, we can tend to fall victim to it as well, or let inertia take its toll as we refuse to change our traditional way of thinking. We have avoided these pitfalls over the last few months, but it has not necessarily been easy.

Despite the rampant pessimism, we took a practical approach, based on two elements.

> "Now is not the time to rest on our laurels."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

First, we decided that rather than spending long hours discussing the bleakest possible scenarios, we had to base our strategy on the only actual example we have of managing COVID-19: China.

Then, because we quickly understood that the real threat to the markets came from liquidity and solvency (credit) risks, we decided to "bet" on unprecedented stimulus policies from monetary authorities and governments designed to help the economy recover from a unique kind of recession.

After observing the situation in China, we established a sequence of reflection in three phases: controlling the pandemic, implementing back-to-normal measures and the recovery of global growth.

This sequence determined how we managed our portfolios, focusing on a possible economic recovery in the second half of 2020.

We also paid particular attention to the decisions made by the central bankers and the governments. The measures announced have met, if not exceeded, our expectations.

The decisive nature of these interventions convinced us to maintain the general orientation of our investment policy, while adjusting a few specific elements.

Over the past few months, we felt it was necessary to re-evaluate each of the investment vehicles in our portfolios to determine their relevance in light of our medium-term scenario.

As the COVID-19 situation developed and our predictions were confirmed, we decided to increase some aspects of our allocation (increased holdings in investment grade corporate debt, greater exposure to convertible bonds and strengthened positions in gold, for example). On the other hand, we decreased our positions in Japanese stocks, reduced our exposure to equity ETFs in favour of more discretionary management and eliminated some products with disappointing performance over recent months.

This active approach aligns with our overall conviction that the panic in March was overblown.

Staying calm allowed the performance of our allocations recover significantly in April.

While we do not wish to boast, we did succeed in avoiding the worst outcome in asset management: taking permanent (and heavy) losses.

The COVID-19 crisis is difficult for us all, but it should not make us lose sight of our ultimate goal. For us, providing our clients with the best advice and staying true to the logic of our investment policy have kept us grounded

during these challenging months.

As we enter the second phase of the sequence, namely exiting lockdown after successfully controlling the pandemic, now is not the time to rest on our laurels. We are not out of the woods yet!

As we have been saying for several quarters in this monthly report, risk management is just as important as profit-seeking in portfolio management. That is why April's sharp stock market rally prompted us to hedge part of our exposure towards the end of the month.

This decision should not be seen as undermining our belief that the global economy will recover in the second half of the year. It is a purely tactical choice, i.e. we expect a consolidation of recent gains, which may be seen as excessive. That, again, does not mean that we believe the prediction that stock markets will once again test the lows seen in March.

Have we definitively shelved our plan to strengthen our equity holdings over the next few months, as set out in our previous monthly comments? Not at all!

We continue to seek out opportunities to increase exposure to risk assets when the time is right.

It seems very fashionable at the moment to hold forth on how the crisis will "fundamentally change" our behaviour. I have always been very reluctant to listen to poetic flourishes such as, "things will never be the same again". As the saying goes, "time will tell".

We can all be guilty of building castles in the air and thinking about the future is never a bad thing. However, we also need to be practical, particularly when it comes to investing.

In this regard, it is clear that the crisis will have far-reaching economic, political and social consequences. We do need to reflect on this and try to formulate opinions.

This does not mean, however, that we should abandon dealing with the present. For us, our challenge remains providing you with the advice that we judge to be the most pertinent in managing your assets.

We remain convinced of opportunities for investment in the credit space. Locking in yields, which spiked after the increase in spreads since February, remains an attractive option. It is nevertheless important not to end up with exposure to low quality issuers!

As for equities, in addition to our recommendation to favour well-managed discretionary investment vehicles over ETFs, it is important not to accumulate too much risk by selecting deep discounted value stocks.

Thus, we will always prioritise visible growth and cyclical equities with solid balance sheets. This crisis will, beyond any doubt, separate the survivors from the "zombies". As such, the coming months should not be spent fixating on growth in earnings, but on whether the companies will be able to survive. This is an essential factor in creating a diversified equity portfolio.

In terms of regional exposure, we increased the weight of the United States in our allocations, partly because we sold our investments in Japan. The US market is still the best way to gain exposure to the technology value chain, which should come out of the crisis on top. Similarly, we maintained the weighting of equities from emerging countries, particularly in Asia.

The recent weakness in the US dollar goes along the lines of our expetcations that the greenback should depreciate in the medium term. We still recommend reducing exposure to the dollar in a diversified currency allocation.

Gold has performed well over the past few months and we see the conditions for further appreciation. The search for safe haven assets and persistently low real rates should lead to an increase in the price per ounce in the next 18–24 months.

In conclusion, these difficult times are forcing us to demonstrate that we can make decisions as calmly as possible.

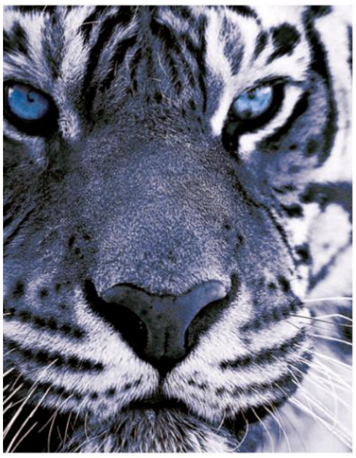
Far from saying that we have done everything right in the past few months, even less so that we have all the answers for the future.

However, as we have over the past 22 years, Prime Partners remains committed to showing you that we can handle whatever happens and react appropriately.

Once again, the global situation and its effects on the markets are requiring us to question our views and adjust. We have been facing this challenge since 1998, in order to provide you with advice in your best interest.

We are determined to continue to do so in the months to come.

Geneva, 2 May 2020



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