Prime Partners

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MARKET INSIGHT

FEBRUARY 2020

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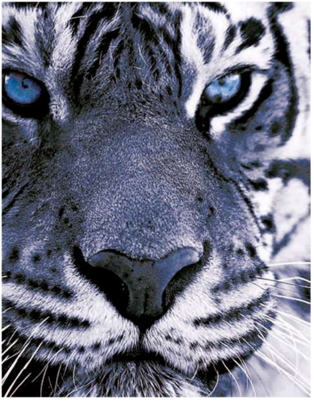

Market Analysis

February 2020

Does excessive anxiety stiffle fear? Part II

Last month we examined fear, the mechanisms that feed it and its impact on the financial markets. Given the friction between Tehran and the United States and the new coronavirus outbreak in China, January gave us much food for thought in this regard.

The desire professed by both Iran and Washington to limit the threat of escalation seems to have led investors to jump swiftly to the conclusion that once the risk was brought under control, there was no lasting reason for their intensified fear. This was illustrated by the VIX Index, which scarcely reacted to the turmoil in the Persian Gulf.

For that matter, the rise in risk assets in the first three weeks of January proved just how unperturbed market participants were, still driven by the improving macroeconomic outlook and favourable liquidity.

It was at this point that the threat of a pandemic in China, indeed the whole world, unsettled investors' (relative) tranquillity. From 20 January, a rise in volatility and the consolidation of and transfer from risk assets into safe-haven assets such as the Swiss Franc, gold and government bonds confirmed that the degree of uncertainty regarding this problem has increased sharply and that fear is once more a factor in the market.

Did we opt to beat a retreat: that is, to cut back such risk assets from our portfolios?

In a word: no!

We are still plotting the same course with regard to our investment policy, as it is very difficult to assess the impact of this new health scare.

First of all, this is because the comparison with the 2003 SARS epidemic is not necessarily clear, let alone correct. The facts available suggest that the 2020 virus is propagating faster, but that the death rate is lower than in 2003. What is more, far stricter quarantine measures have been put in place, and more swiftly, than those implemented 17 years ago.

Only time and more details will allow us to draw proper conclusions. So, in the meantime, we feel that it is wiser not to make any untimely moves in our investment policy, and to treat patience as a virtue.

Secondly, even though it is clear that the epidemic will in any event serve as a drag on growth in the first half of 2020, we should not overstate the importance of such a development. As in 2003, the chances are that growth will recover and will ultimately correct the initial downturn in the economy, provided that the spread of the virus has been brought under control in the next three months.

> "We are not inclined to change our scenario for the economy."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

In other words, for the time being, we are not inclined to change our scenario for the economy which is based on the assumption that global growth should make a soft landing over the next few quarters.

It is true that current events will lead to greater difficulties in making short-term economic forecasts, but we believe that this has already been priced in by the market, whose participants have to a large extent focused on the capacity for recovery in corporate earnings growth over forthcoming quarters.

We are quite aware that we have an incomplete picture of how long it will take to curb this threat of pandemic. On the other hand, there is nothing to say that, as things stand, the situation will not be under control in a few months' time.

We therefore feel that our choice not to deviate from our course on asset allocation is justified, first of all because the

fundamental trends are unchanged, and because the facts available to us on earnings (currently being published) bear out our expectations that they will enjoy a modest recovery in the medium term. All of these considerations allow us to be reasonably confident about market potential in 2020, given the recent valuation multiple expansion and the current phase in the economic cycle.

Our preference for emerging market assets, especially equities, is consistent with our overall choice to stay on course, although it must be acknowledged that the stock markets in these countries have suffered more in past weeks than developed markets. We foresee this effect as being short-lived in light of our overall medium-term view on the economy and financial markets.

Neither untimely boldness nor excessive fear: this is how we defined the course we were setting on investment policy last month.

This stance still stands and we are inclined to believe that the likelihood of a correction in equities remains low. Consequently, over a six-month horizon, increasing our stock market exposure in order to return to neutral levels remains our priority. Recent events concerning the Chinese coronavirus and developments over the next few weeks may have an impact on the timing of this process but will not call the principle into question.

Amid heightened turmoil in the markets, we should mention that two strategic options (a good allocation in liquid alternative assets, including gold, and avoidance of overloading equity and credit risk) provided something of a buffer against the upheavals of recent weeks.

We maintain our conviction that these cornerstones of our asset allocation should be kept in place over the forthcoming months. It is not too late to consider investments in different alternative products, given that interest rates will remain low, and even negative, for the next 6 to 12 months. As regards credit, we stick by our preference for equity risk, and do not recommend any haste in building positions in corporate names at current levels.

The fact that government bonds have benefited greatly from the health scare during the second half of January does not alter our recommendation that they should be underweight in a diversified portfolio. In fact, we see the recent fall in yields as excessive and unlikely to last over the next six months, in view of our assumption that economic conditions should gradually return to normal.

This being the case, as fears of an uncontrolled pandemic are lulled and uncertainty about world economic trends lessens, some profit taking should be considered.

In conclusion, it is never easy to stay calm when confronted by unforeseen events with unpredictable results. This applies both when one is overweight in risk assets, and the opposite, when one is underweight.

In a climate where the returns to be expected on diversified portfolios in 2020 are lower than last year (a view that we believe still looks reasonable) untimely action is all the more dangerous when it comes to investment policy! Wasted opportunities cost so much more when the prospects for overall returns are reduced.

Since December, we have been looking to use any stock market corrections to increase our equity holdings. Recent events might therefore be turned to our advantage to make such an adjustment. Nevertheless, this possible change should be understood in light of the broader context, in which we believe that it is not remotely advisable to be overweight on equities. Now is not the time to abandon risk management - far from it.

Geneva, 5th February 2020

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IMPORTANT INFORMATION