Prime Partners
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MARKET INSIGHT

MARCH 2021

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2020

Market Analysis

March 2021

One month seems indistinguishable from the next...

The return of market volatility, which we featured in last month's Market Insight, remained unchecked in February.

Pressure on the VIX index in the last few days of February was admittedly much more limited than that which upset the markets last month, but this must not be overlooked, as it supports our prediction of volatility being higher in 2021 than it was prior to the outbreak of COVID-19.

Another similarity between the past two months on the markets was the persistent strain on bond yields. In contrast, the rise in real rates was specific to February, and raised many questions.

This development was caused by market operators getting fully on board with a scenario of a global economic recovery from H2 2021; this trend was accentuated by the US government's commitment to fostering massive fiscal stimulus, which stoked fears of economic overheating, a rise in inflationary risk and expectations of a rapid shift in the Fed's monetary policy.

Operators no longer rule out the prospect of the US 10-year treasury yield reaching 1.75% at the end of the year; as we based our market view on such a hypothesis as of end-2020, this is of no concern to us.

Generally speaking, the last few months were tricky for fixed-income assets, thus confirming that we made the right choice to underweight this asset class in our portfolios.

The recent rise in bond yields should not induce to pounce on opportunities. We advise to keep a limited fixed-income exposure in a diversified portfolio, to remain underweight government debt and to favour tactical strategies.

On the equity front, tension on yields weighed more heavily than in January on growth stocks and technology shares in particular.

We were aware of the high valuations in this market segment, leading us to rebalance our portfolios towards value stocks for several months now. Recent market behaviour has proved that this was the right decision.

This trend leads us to two conclusions. Firstly, we have been arguing for several months that there is a significant risk of P/E compression in 2021, in light of our view of long-term rates and our prediction that the global economy will undergo a sustained recovery in the next 18-24 months.

> "The rise in real rates was specific to February, and raised many questions."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

In such conditions, the market's consolidation and the drop in P/E were "positive" events, as they came at a time when the recovery in earnings growth was gaining momentum, as reflected in Q4 2020 earnings publications.

We should not be unduly concerned by multiple compression, as long as profit growth is able to pick up.

Secondly, dismissing central banks' statements may be a dangerous game to play. They have clearly staked out their positions in this regard: now is not the time to change course on monetary policy, which will remain accommodative and support the recovery.

Jerome Powell was again peremptory in this respect when he recently testified before Congress; this follows on from the decisions of 2020 which highlighted the Federal Reserve's new policy framework, based on average inflation rather than a simple 2% target.

In a nutshell, it remains our view that the Fed will only reduce

asset purchases in 2022 and that US rates will rise in the latter half of 2023.

Monetary policy will not derail the profit recovery, which we have always considered to be a key factor underlying our view of market gains in 2021.

In a nutshell, the volatile environment for equities, the tension on long-term rates and the first signs of P/E compression came as no surprise to us. These developments are in line with our forecasts, and they in no way induce us to change the course of our investment policy.

At a time when expectations are subject to frequent changes and as some investors are already trying (wrongly to our point of view) to look beyond the economic recovery that still has to materialize in the second half of 2021, it is all the more important to stick to our guns.

We have been stressing the importance of being able to withstand a more erratic market context in 2021. This means that investors must be able to cope with consolidation phases on equity indices without losing sight of the medium term, which we believe is still promising for stocks. Staying focused on what is important without shutting oneself away in an ivory tower, oblivious to daily market developments, remains our key challenge.

Our belief that risk assets – equities in particular – have not exhausted their upside potential for the coming 12 months has not stopped us from adjusting some of our exposure in the past few weeks.

For example, in light of the indices' rise in the first 10 days of February, we decided to hedge some of our equity exposure.

This tactical decision does not undermine the positive views expressed above.

Similarly, given the significant gains in convertible bond prices since the beginning of the year, we decided to reduce our exposure to this asset class, in order to book some profits and limit total risk within our portfolios. However, we keep our recommendation to overweight these instruments but in a more restrained fashion.

Finally, in order to rebalance our equity allocation towards value at the expense of growth, we adjusted some of our exposure to European stocks. This will soon be extended to US shares.

Once again, we would reiterate that these changes should not be construed as us picking sides between growth and value stocks. Rather, they come from a desire to create more diversified portfolios.

In conclusion, the core of our strategy, which assumes that the equity markets retain their attractiveness with a 6- to 12-month time horizon, is unchanged.

Similarly, our desire to approach allocation decisions tactically holds firm, in light of the risk of stock market consolidation that must not be overlooked. In other words, although the principle of buying the dips or removing equity hedges still applies for the coming months, we hope to do so at a more opportune time.

By the same token, our determination to not become overwhelmed by an excessive accumulation of risks leads us to take profits (e.g. on convertible bonds) when we deem appropriate.

Meanwhile, we are retaining significant exposure to liquid alternative assets, which provide decorrelation in normally-functioning financial markets, as we expect to be the case in 2021.

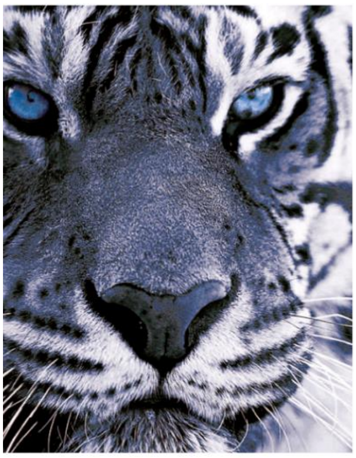
In other words, these products should replace bonds in a post-COVID world, cushioning the volatility of the stock market and providing annual returns of between 2% and 4%.

Last month, we ended our report on the important question of the (likely) durability of the economic cycle synchronisation and how that guides an investment strategy. We said that this issue was central to resolving the apparent dichotomy between the real economy and the financial markets. We continue to believe so and we take note of the fact that the past few weeks have not invalidated our assumption of a synchronous global recovery in 2021.

The erratic movements seen on the markets in recent months are again related to the (necessary) transition from a period of multiple expansion driven by liquidity to one of markets influenced by a return to profit growth.

This trend will continue in the coming months, with its fair share of hesitation and questioning.This perspective should not prevent the main stock market indices from posting a positive performance in 2021.

Geneva, 25 February 2021



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