Perspectives
Financial Markets

SwissLife Asset Managers

June 2020

Interest rates & bonds
Central banks cannot print jobs

USA
- Most states in the US have started to ease lockdown measures, which led to an improvement of sentiment indicators despite a continuous rise in unemployment numbers.
- On the back of the US Fed's unprecedented asset purchase programs, which include high yield bonds, market liquidity has improved sharply despite a significant decline in US Treasuries purchases since the end of March.

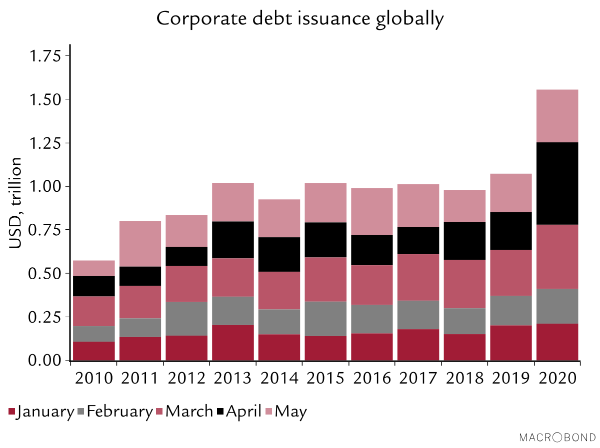
Eurozone
- Most countries have seen a sharp decline in infection numbers and subsequently dialed back on lockdown measures. Sentiment indicators are improving but are still in recessionary territories.
- The proposal of a EUR 500 bn European recovery fund and expectations of more monetary stimulus by the ECB led to a strong bid for risky assets.

UK
- While first-quarter data has come in better than expected, survey data imply an unprecedented drop in activity in April and May.
- The BOE will likely increase its asset purchase programs, and negative rates are an option if more stimulus measure were necessary.

Switzerland
- So far, Switzerland has been very successful in flattening the infection curve, which will likely help it to recover more swiftly than other nations.
- Save haven flows continue to force the SNB's hand as it tries to stop a rapid appreciation of the CHF.

Japan
- Japan has been in recession since October 2019, and the worst is yet to come in the second quarter 2020.
- The Bank of Japan has removed bond purchasing limits and has initiated a corporate financing support program. Stimulus aimed at helping SMEs could be next.

Surge in debt issuance despite severe recession



Lockdown measures are being lifted as infection numbers are declining in most developed countries. Every week, we get more news about another potential vaccine starting clinical trials and sentiment indicators are tentatively improving. Looking at the performance of risky assets, one could be tempted to believe that we are ready for that V-shaped recovery, amplified by trillions of central bank money and unprecedented fiscal stimulus. However, we remain somewhat cautious about the rally we have witnessed over the past two months. Arguably, the liquidity injections have helped to avoid a market turmoil and the fiscal response, although uneven, has been swift and in size to avoid a collapse of the global economy. Yet, the cracks will start to show with defaults already on the rise and unemployment numbers skyrocketing. Corporate debt levels are sharply rising with record high debt issuance over the past few weeks, while earnings will almost certainly decline. That leaves most companies in a weaker position to face a world with weaker consumer demand. On top of that, we are also seeing renewed tension between the US and China. In short, a gradual U-shaped recovery is much more realistic, in our view. We therefore keep a defensive positioning in credit, although we see pockets of value in certain sectors and issuers. Meanwhile, 10-year government bond yields are expected to decline over the next month.

Equities

How durable is the stimulus-based optimism?

USA

- The easing of the COVID-19 linked restrictions has had a positive impact on the equity market. Markets celebrate the stepwise elimination of the restrictions on social and economic life and the supportive monetary policy, while ignoring the souring Sino-US relations, the chances of a second wave as well as the gloomy economic prospects.
- Even considering the above and a significant increase in valuations since March, we continue to expect the US market to perform marginally better than most other equity markets, in particular thanks to the supportive stance by the Fed.

Eurozone

- Eurozone equity markets have participated in the recovery but have underperformed the US market.
- While comparably more severe lockdown measures might have played a role, the main reason for the underperformance is the underrepresentation of the internet sectors in this region.
- Intensifying tensions between China and the US, as well as the conflict between the US administration and social media companies are however eroding this advantage, allowing the Eurozone to catch up.
- Nevertheless, we continue to expect a slightly weaker relative performance of this market for the time being, as the impact of monetary policy is limited and fiscal policy coordination difficult.

UK

- UK stock markets were supported by monetary and fiscal policy but fundamental problems are mounting, despite an easing of the lockdown measures.
- The grim economic outlook and resurfacing uncertainties about Brexit lead us to expect an underperformance of this market.

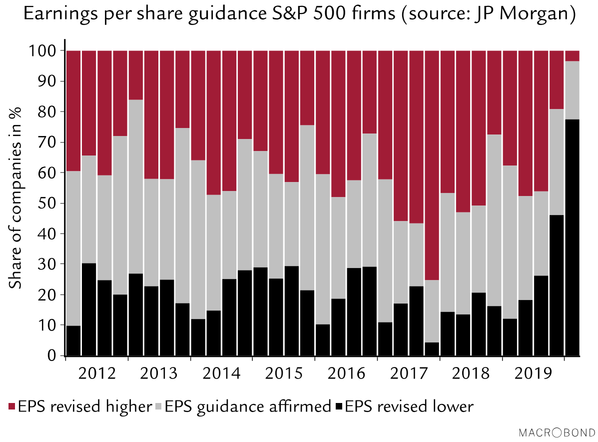
Switzerland

- The defensive nature of the Swiss stock market has helped it to do relatively well during the crisis.
- Now that sentiment has turned less negative, we expect this market to underperform in relative terms.

Japan

- The situation in Japan is easing somewhat as indicated by the removal of the emergency status in Tokio.
- Our neutral view remains in place.

US: quarterly earnings estimates revised lower



Considering that we currently undergo one of the deepest recessions since the great depression one would expect stock markets to be in free fall. Markets, however, have already significantly revived from their March lows, basically for two reasons: first and foremost, central banks doing "whatever it takes" and second, equity markets being forward looking. While the first argument is a strong argument to buy into the rally, we have some doubt about what markets are foreseeing. While Corporate America usually tends to revise earnings estimates higher, this time is different. In fact, most of the companies comprised in the S&P 500 have lowered their earnings estimates or even dropped them. Hence while the stock market is pricing in a rosy future, the fundamentals are blurry, and earnings might surprise negatively in the future, leaving investors with only the central bank put as the major holding argument. In our view, as long as central banks can continue to take their accommodative stance, the medium-term downside risk indeed seems calculable.

Currencies

We expect renewed EUR depreciation

USA

- Amid a very risk-friendly market environment, the USD weakened in May, most notably against cyclical currencies such as EUR, AUD or emerging market currencies. The major exception among the cyclicals was GBP, which depreciated against USD.
- While we believe that the world economy will enjoy a gradual recovery in the months ahead, we think that financial markets are pricing in a too optimistic economic outlook. Hence, risk aversion might give a comeback, and we thus prefer a positive view on the USD over the next few weeks.

Eurozone

- In May, the EUR was boosted by the announcement of an EU recovery plan and appreciated against USD, CHF, GBP and JPY.
- We believe that the plan will face a reality check soon, which might dampen the optimism and lead to renewed EUR deprecation. Also, economic prospects for the Eurozone are still much worse than for the US or Switzerland, which might put additional pressure on the EUR in June.

UK

- The political, economic and medical news flow out of the UK was negative in May, putting pressure on GBP exchange rates.
- In addition, "Brexit" risks will likely intensify as no meaningful progress has been achieved so far in EU-UK negotiations. We have a negative one-month view on GBP/USD.

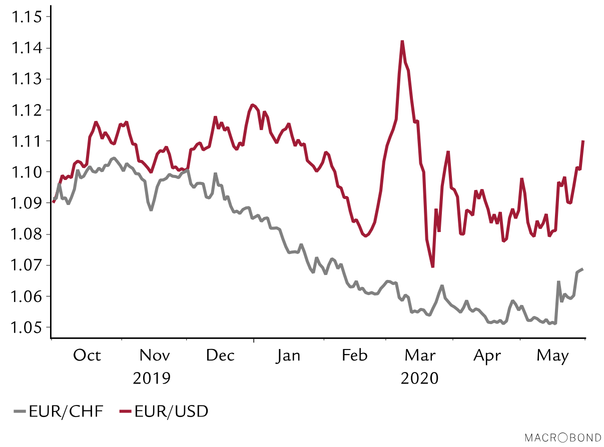
Switzerland

- While the SNB kept intervening in currency markets, the announcement of the EU recovery fund brought a welcome relief in May. EUR/CHF even approached the 1.07 levels at the time of writing.
- We expect the recovery in EUR/CHF to have been short-lived, as risk aversion will likely give a comeback amid elevated political risks and an uncertain economic outlook.

Japan

- Amid the general "risk-on" sentiment in May, JPY depreciated on a trade-weighted basis.
- As we are becoming more constructive on the USD again, we change our view on USD/JPY from negative to neutral.

The Merkel-Macron plan revitalizes the EUR – temporarily



The first half of May was relatively uneventful on currency markets. Implied volatility had been steadily declining since its peak in mid-March, and most currency pairs had been trading in a range since beginning of April. Then finally, things started to move. The most significant move pertained to the EUR, which rallied in the second half of the month and even broke through the upper bound of the 1.08-1.10 trading range against the USD. The initial trigger was the announcement of the Merkel-Macron plan for a EUR 500 bn European recovery fund, which would be financed by common debt issuance. EUR/CHF also recovered, which should bring a temporary relief for the SNB that had been intervening relentlessly to prevent the exchange rate from slipping below 1.05.

Nevertheless, we do not share the excitement and expect the EUR to depreciate against USD and CHF in June. First, the proposed EU recovery fund will face numerous obstacles and the disagreements among EU member that have already emerged will likely intensify over the period ahead. Second, economic prospects for the Eurozone remain more muted than for Switzerland or the US, as sovereign debt risks persist in Europe's periphery and France only seems to be getting out of its economic paralysis very slowly. The UK economy is the other laggard in Europe, suffering from a protracted epidemic, late easing of lockdown measures as well as Brexit uncertainty since trade talks between the EU and UK are not showing any meaningful progress. We expect GBP to depreciate against USD in the coming month.

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