Monthly Pulse – Monday, 2 November 2020

Economic Outlook

While the pandemic has entered into the "**second wave**" stage across the world, beating some of the terrifying spring records, many European countries have responded with stricter measures from public gathering bans and night club closures to new curfews and lockdowns. Meanwhile, the world is closely watching the most influential and the least predictable anticipated event of this year: **the American elections**. The combined gravity of these two factors is so strong that even the unexpected news from the earnings report front have had relatively little effect on the markets – be the news positive or negative. Moreover, the political turmoil in the US is expected to continue for a while even after the first week on November, since neither party is prepared to lose without a fight.

Tactical Asset Allocation

Liquidity	Neutral
Bonds	Neutral
Equities	Neutral
Alternative Investments	Neutral

Macroeconomics

The third quarter of this unusual year revealed some optimism as many figures representing the period's output implied **positive growth** at a higher than expected level. On one hand, most companies that have reported Q3 earnings, managed to beat expectations. On the other hand, economic data showed significant growth from July to September 2020.

Namely, preliminary Q3 US GDP growth was 7.4% (reported as 33.1% annualized), and Eurozone preliminary Q3 GDP growth was 12.7%. Both figures mean high paced growth above expectations. However, the output still remains below the pre-pandemic levels, and, moreover, there are signs that the recovery has stalled. In particular, the unemployment rate in the US, while having dropped from the double digits in spring to 7.9% in September, is much higher than the long-term average and the pre-pandemic level of below 4.0%. Similarly, in Eurozone, unemployment rate remained at an elevated level of 8.3% in September. All this on top of the current pandemic developments underlines the dire need for **additional fiscal and monetary stimulus**.

After uplifting the public's hopes with intensified fiscal stimulus discussion, the American government failed to come up with a deal on a new package to help the economy. There is no doubt that new stimulus will arrive, but the after-election hustle might divert policy-makers' attention for a while.

At the same time, after the October meeting, the ECB hinted that new monetary stimulus might be introduced in December, and, in the UK, another round of much needed bond purchases is expected in November. Perhaps, this will be able give markets another push in the upward direction.

Fixed Income

It looks like October was a rather quiet month for Fixed Income as major levels did not change significantly. But this is misleading. The trading range in UST 10y was 20 bps. By mid-October investors anticipated a Democratic sweep and an agreement on the stimulus package. That is **why long-term US rates started to rise**, and yield curves continued to **steepen**. But renewed Covid worries and therefore falling equity markets pushed yields lower again.

Similar behaviour we saw in credit markets. HY spreads tightened (30-40 bps) till mid-October and widened sharply (40-50 bps) again in the recent equity-selloff. The reduced risk appetite was shown in a slowdown in HY primary market activity. Fund flows into HY assets were mixed with EM getting most of the inflows. The willingness of central banks to ramp up purchases of corporate bonds prevent credit markets to react in a more severe manner. So far, we have not seen a sell-off, just slowing demand from real money accounts. Short term we expect this trend to persist as the Covid-situation does not seem to improve and the election result needs to be clear on either way.

We are still **comfortable with credit** and would use a market overreaction as an entry point. The hunt for yield environment will not fade away. Although short-term volatility will persist. Therefore, we stay tuned and wait for buying opportunities in solid names.

Equities

Stock markets finished October **mixed**. The renewed fears of lockdowns around the globe were also mirrored in stock markets. Asia held up well whereas Europe and the US suffered losses of three to five percent. Sector-wise the energy sector suffered most due to lower oil prices. **Defensive sectors** such as utilities were among the top performers.

Equity Indicators

Valuation	Neutral
Momentum	Negative
Seasonality	Attractive
Macro-Economics	Positive

Brexit comes closer and drove valuation of UK equities even lower. UK equities have never been cheaper for the last 30 years. Both Europe and UK cannot neglect their focus on the old economy such as energy and financials and are therefore challenged structurally during this crisis.

One of the most important uncertainties – the US election – will fade away this week and markets are hopefully picking up their **long-term trend** again. Good fundamental data in the US and Asia should support that scenario. As a victory of the democrats seems highly probable not only in the presidential election but also in both houses, stimulus for the economy could be even higher and support further the risk-on mood. We therefore keep our **neutral allocation** in Equity markets.

Alternatives

The EUR could weaken against other currencies as the intensified measures against COVID-19 might lead to a further expansive ECB and economic support aid from the governments. However, momentum still plays in favour of the EUR and a further potential to outpace the other regions after relaxing the measurements are keeping it in balance.

Gold has stabilised around USD 1'900. Showing a positive correlation to stock markets and other risky assets, Gold seems to have **lost its safe-haven** characteristics. It might continue to go with risky assets as investors liquidate assets to raise cash and meet margin calls, a dynamic that played out in the March pandemic panic. The only way to be protected during the crisis was cash and cash is not yielding anything. Long-term speaking, economic stimulus and low interest rates should be supportive.

Oil might also pick up speed as recession fears seem to early as the outbreaks and lockdowns are kept on a regional basis and should smoothen the economic activities. Although Libya starts to export oil, it is still two thirds below its level before the civil war. Future markets are in steep contango indicating **further price increases**.

Hedge Funds and Private Markets are still in high demand. Investors should be cautious with the CTA strategies as they disappointed within the crisis. **Good long volatility** strategies are the right place to be.

Rebalancing Strategies

This month, we would like to give you some insight into what kind of logic can guide investors' portfolio allocation decisions. Below, we present and compare the performance of three fundamentally different strategies of portfolio rebalancing.

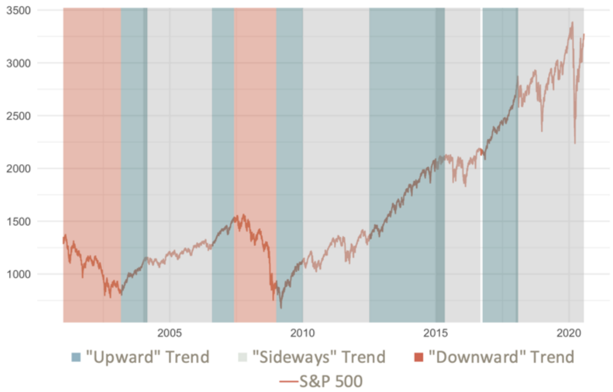
The first approach is the simplest one called **Buy and Hold**. Just as the name suggests, all you do is invest a desired allocation into certain asset(s) and hold it: you make no additional transactions during a certain predefined period of time. In this sense, it is a passive strategy since no consideration is given to rebalancing after the initial allocation is chosen. Asset weights in such a portfolio can change when asset prices change, even though quantities are held constant. To make it less abstract, suppose the initial investment of $100k is 60% into equities (an ETF tracking the S&P 500 index, for example) and the remaining 40% into a risk-free asset (a bank deposit, for example). Then suppose that over the next 6 months S&P 500 grew 20%. At the same time, the safe asset value (cash amount) has not changed. Thus, the weight of the risky asset in the portfolio increased by 12 p.p. (=20%*60%) and is now 72%. This process is exactly what investors call **portfolio drift**.

Another conceptually simple strategy is called **Constant Weight**. With this approach, a portfolio manager chooses a desired weights allocation for the assets in a portfolio, invests into this allocation, and whenever asset prices change, he or she buys or sells the assets to bring their allocation back to the desired level. The strategy differs from Buy and Hold, in that it allows quantities to vary so that their weights stay the same. Returning to the earlier example of 60-40 allocation, when S&P 500 index rises, causing its weight in the portfolio to rise as well, an investor following the Constant Weight strategy would sell some shares of the ETF and add the cash into the bank account, so that the resulting allocation is again around 60-40. This is an example of a contrarian strategy since it always does the opposite of the market movements: sells when prices rise and buys when prices fall.

The third basic approach is called **Constant Proportion Portfolio Insurance (CPPI)**. This strategy provides a guarantee against a downside risk. To do this, an investor chooses a minimum tolerable portfolio value called floor. Total portfolio value minus floor is called cushion. The amount invested into the risky asset is equal to cushion times a multiplier, determined by the aggressiveness of the investor. To make this concept clearer, let us return to the earlier example of an investment of $100k. Here the investor starts not with choosing the allocation, but with choosing the floor, of, for example, $80k. The cushion is then equal to $20k ($100k - $80k). Let us say, we have a mildly risk-averse investor with a multiplier of 3. Then the amount invested into equities is equal to $60k (3*$20k) and the remaining $40k is put in a bank. The numbers here are deliberately chosen so that the initial allocation is 60%-40% to make the example comparable with the other cases. So, when S&P 500 grows by 20%, the investment into the ETF grows by $12k to become $72k. Now the total investment is $72k + $40k = $112k. The floor is still $80k, meaning that the cushion is now $32k (=$112k-$80k) and the investor will increase the holding of the risky asset, which now becomes $96k (=3*$32k). Notice how whenever the market moves up, the manager following CPPI strategy invests more into equities, and whenever the market falls, he or she sells some shares, thus the strategy is trend-following. Moreover, only the floor and the multiplier are held constant in this case, while both quantities and allocation can change. The CPPI strategy is **momentum-driven**.

All strategies have their advantages and sound reasonable, so it would be interesting to see how each of them would behave in different market environments and with different rebalancing frequencies. To do that, we used S&P 500 data for the past two decades, which we separated into 3 types of periods: upward-trending market, downward-trending market, and sideways-moving market.

Figure 1: Different Economic Environments



We conduct the simulation using weekly rebalancing in each period (rebalancing costs are not accounted for). Allocations are the same as the ones described in the examples above. Below you can see graphs for each period.

In Figure 2, you can see the results for upward-trending market. In most periods, CPPI tends to outperform the other two strategies, while Constant Weight is the underperformer. This is not a surprise: as has been mentioned above, CPPI is a trend-following strategy, which means that it always behaves as though it expects the market to continue the trend. Meanwhile, Constant Weight is contrarian: after every market move, it expects a reversal. Therefore, during a pronounced trend, a trend-following strategy should theoretically outperform a contrarian strategy. And it does most of the time.

Figure 2: Upward Trend

In Figure 3, you can see similar results during downward-trending markets: CPPI again outperforms the others, while Constant Weight is lagging.

Figure 3: Downward Trend

Figure 4 shows results for the periods classified as sideways movement, without a strong trend. Now the picture is different: Constant Weight outperforms, while CPPI is the new laggard. Just as theory and common sense would suggest.

Figure 4: Sideways Trend

CPPI might seem like the winner of this "race", since it tends to outperform in two out of three scenarios. However, there is one issue to keep in mind with CPPI. It depends a lot on when you start to invest. If you are unlucky and in the beginning of your investment period markets crash, then the cushion might be eliminated, and you will be left with nothing or very little to invest into the risky assets, that bring the most returns. Thus, you might be stuck with low returns for a long time. You can see this for yourself: Figure 5 shows the results of weekly rebalancing accumulated over the past 20 years.

Figure 5: Total Performance

clarus capital

Market Overview as of Monday, 02 November 2020, 1:17 PM

Fixed Income

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	0.08	0.00	0.00	-1.46
USD 1y Swap	0.21	-0.01	-0.01	-1.56
USD 3y Swap	0.28	0.03	0.09	-1.41
USD 5y Swap	0.44	0.08	0.17	-1.29
USD 10y Swap	0.89	0.16	0.34	-1.01
EUR Overnight	-0.47	0.01	-0.01	-0.03
EUR 1y Swap	-0.53	-0.05	-0.11	-0.21
EUR 3y Swap	-0.54	-0.05	-0.11	-0.30
EUR 5y Swap	-0.49	-0.05	-0.09	-0.37
EUR 10y Swap	-0.27	-0.03	-0.04	-0.48
CDX Xover 5y	4.21%	0.17%	-0.12%	1.41%
iTraxx Xover 5y	3.68%	0.27%	0.09%	1.60%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.2%	0.5%	0.9%	0.9%
USD Aggregate 1-3y	0.0%	0.0%	0.5%	2.8%
USD Aggregate 3-5y	-0.1%	-0.1%	1.1%	5.0%
USD Aggregate 5-7y	-0.3%	-0.5%	2.4%	6.9%
USD Aggregate 7-10y	-0.7%	-1.3%	3.5%	8.6%
EUR Overnight	0.0%	-0.1%	-0.2%	-0.4%
EUR Aggregate 1-3y	0.1%	0.3%	0.9%	0.2%
EUR Aggregate 3-5y	0.3%	0.7%	2.0%	1.0%
EUR Aggregate 5-7y	0.5%	1.0%	3.2%	2.3%
EUR Aggregate 7-10y	0.7%	1.4%	4.2%	3.6%
US Corp. HY	0.4%	0.4%	11.0%	1.1%
EUR HY	-0.1%	1.1%	7.6%	-2.9%

Equity

	Price	P/E	D. Yield	FCF yield
MSCI World	6,812	22.5	2.2%	6.6%
S&P 500	3,270	23.8	1.8%	4.8%
NASDAQ	11,053	29.2	0.8%	3.4%
Euro Stoxx 50	3,002	19.5	3.1%	14.2%
SMI	9,632	18.5	3.2%	11.9%
FTSE 100	5,608	18.3	3.9%	20.9%
DAX	11,638	17.3	3.1%	11.1%
MSCI Asia Pacific	172	19.0	2.3%	3.9%
FTSE China A50	15,771	13.4	2.4%	9.1%
MSCI Emerging Market	1,103	17.6	2.3%	5.1%
PH Semiconductor	2,246	20.9	1.5%	3.9%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	-2.9%	-0.2%	15.3%	-1.4%
S&P 500	-2.3%	0.0%	15.5%	1.2%
NASDAQ	-1.8%	1.3%	26.8%	26.6%
Euro Stoxx 50	-5.9%	-5.4%	2.5%	-19.8%
SMI	-6.0%	-3.7%	0.0%	-9.3%
FTSE 100	-5.0%	-4.9%	-2.7%	-25.6%
DAX	-8.3%	-5.5%	7.1%	-12.2%
MSCI Asia Pacific	1.3%	4.3%	18.2%	0.6%
FTSE China A50	3.7%	3.2%	17.3%	9.6%
MSCI Emerging Market	2.0%	2.3%	20.4%	-1.0%
PH Semiconductor	1.1%	5.1%	36.6%	21.4%

Commodity

	Price	FCST 20	FCST 21	Δ Future
Gold	1,888	1776	1870	-1.3%
Silver	24.06	19.8	21.49	-11.2%
Platinum	859	871	916.25	-13.0%
Palladium	2,248	2152	2127.5	-23.4%
Crude Oil	34.97	38.3	46	-2.5%
Brent Oil	37.21	42.3	48.9	1.7%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	-0.6%	-4.5%	10.9%	24.4%
Silver	1.4%	-1.0%	62.8%	34.8%
Platinum	-2.5%	-6.7%	11.9%	-11.1%
Palladium	-2.8%	7.3%	20.9%	15.5%
Crude Oil	-6.3%	-15.2%	22.3%	-38.0%
Brent Oil	-6.5%	-16.3%	13.3%	-38.9%

Foreign Exchange

	Price	FCST 20	FCST 21	Δ Spot
EUR/USD	1.1647	1.1800	1.2300	5.5%
GBP/USD	1.2893	1.3000	1.3400	3.9%
USD/CHF	0.9172	0.9200	0.9200	0.3%
USD/JPY	104.85	105.00	106	1.1%
EUR/CHF	1.0683	1.0800	1.1200	4.7%
USD/RUB	80.25	76.00	72.84	-9.7%
EUR/RUB	93.46	89.20	86.25	-8.0%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	-0.6%	-1.0%	6.8%	3.9%
GBP/USD	-0.3%	-1.4%	3.6%	-2.7%
USD/CHF	0.4%	0.1%	5.2%	5.4%
USD/JPY	0.4%	1.0%	1.8%	3.6%
EUR/CHF	1.0%	1.0%	-1.5%	1.6%
USD/RUB	-2.6%	-8.9%	-6.8%	-22.8%
EUR/RUB	-1.9%	-8.0%	-12.7%	-25.6%

Source: Clarus Capital Group, Bloomberg

Disclaimer

This document has been prepared by Clarus Capital Group AG ("Clarus Capital"). This document and the information contained herein are provided solely for information and marketing purposes. It is not to be regarded as investment research, sales prospectus, an offer or a solicitation of an offer to enter in any investment activity or contractual relation. Please note that Clarus Capital retains the right to change the range of services, the products and the prices at any time without notice and that all information and opinions contained herein are subject to change.

This document is not a complete statement of the markets and developments referred to herein. Past performance and forecasts are not a reliable indicator of future performance. Investment decisions should always be taken in a portfolio context and make allowance for your personal situation and consequent risk appetite and risk tolerance. This document and the products and services described herein are generic in nature and do not consider specific investment objectives, financial situation or particular needs of any specific recipient. Investors should note that security values may fluctuate, and that each security's price or value may rise or fall. Accordingly, investors may receive back less than originally invested. Individual client accounts may vary. Investing in any security involves certain risks called non-diversifiable risk. These risks may include market risk, interest-rate risk, inflation risk, and event risk. These risks are in addition to any specific, or diversifiable, risks associated with particular investment styles or strategies.

Clarus Capital does not provide legal or tax advice and makes no representations as to the tax treatment of assets or the investment returns thereon, either in general or with reference to specific client's circumstances and needs. Recipients should obtain independent legal and tax advice on the implications of the products and services in the respective jurisdiction before investing. Certain services and products are subject to legal provisions and cannot be offered world-wide on an unrestricted basis. In particular, this document is not intended for distribution in jurisdictions where its distribution by Clarus Capital would be restricted. Clarus Capital specifically prohibits the redistribution of this document in whole or in part without the written permission of Clarus Capital and Clarus Capital accepts no liability whatsoever for the actions of third parties in this respect. Neither Clarus Capital nor any of its partners, employees or finders accepts any liability for any loss or damage arising out of the use of all or any part of this document. Source of all information is Clarus Capital unless otherwise stated. Clarus Capital makes no representation or warranty relating to any information herein which is derived from independent sources. Please consult your client advisor if you have any questions.

Impressum

Published by Clarus Capital Group AG, Gutenbergstrasse 10, CH-8002 Zurich, research@claruscapital.ch, www.claruscapital.ch

Editors Roger Ganz, Head Asset Management, Dejan Ristic, Head Equity & FX, Markus Mettier, Head Fixed Income, Olga Karpova, Junior Portfolio Manager