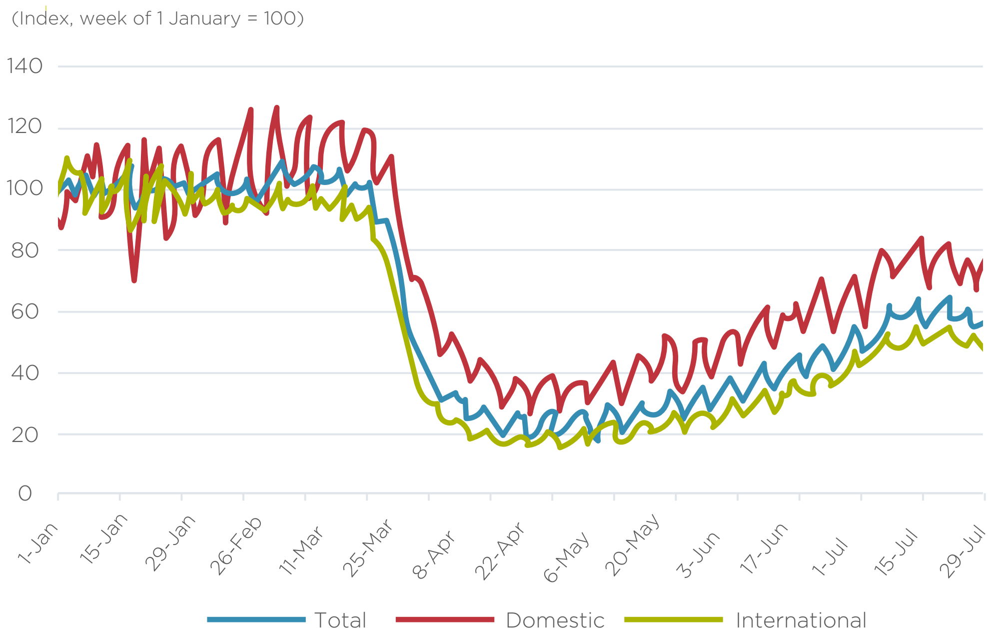
Perpetual Wealth Monitor

September 2020.

Executive Summary

- Our growth forecasts for 2020 (and 2021 in brackets) are as follows – World economy: -5% (+3.5%), US: -8% (+4%), EU: -9% (+5.5%), Japan: -6% (+2.5%), UK: -10% (+6%).
- In the short-term, the recovery in Europe and Asia looks set to outpace that in the US. This is because the restriction measures against Covid-19 in these regions were more successful and the quarantine measures stricter.
- The overall Purchasing Managers' index for the Eurozone fell from 54.9 in July to 51.6 in August. The recovery after the lockdown has slowed.
- Overall, business cycle indicators suggest that the initially V-shaped recovery has lost momentum. This conclusion does not only apply to Europe.
- Yields on government bonds are consolidating.
- Fed bond purchases are depressing corporate bond yields in the secondary market.
- The general equity market rally continues but market breadth is continuing to decline.
- Several factors are combining to put downward pressure on the US dollar.
- We continue to have a positive outlook on gold.

Volume of commercial flights, indexed, 1. January 2020 – 31. July 2020



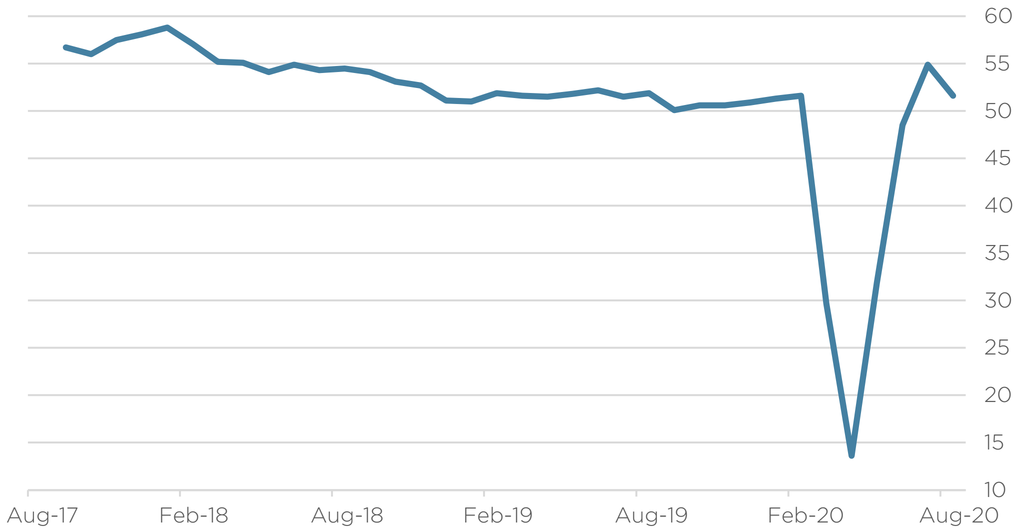
Source: OpenSky Network and WTO Secretariat calculations.

So far, no V-shaped recovery for world trade

- Contrary to the evidence for many countries provided by the Purchasing Manager indices, no V-shaped recovery in world trade appears to be taking shape.
- Commercial flight data also support this conclusion. Although there has clearly been some recovery, the volume of commercial flights is still around 30% lower than what it was at the start of the year.
- International air traffic has recorded the greatest decline. Many countries now only allow the transport of goods and not of persons. Also, countries that do allow passenger traffic often demand strict quarantine measures of up to 14 days on arrival. These measures are prohibitive for many would-be international passengers.
- The "Goods barometer" survey of the World Trade Organization (WTO), which aims to show the development of world trade in real time, fell in June to its lowest level since the survey's inception.
- The WHO expects world trade in goods to decline by 13% overall in 2020.

Business Cycle

Purchasing managers index for the Eurozone



KOF leading indicator for Switzerland, last 20 years

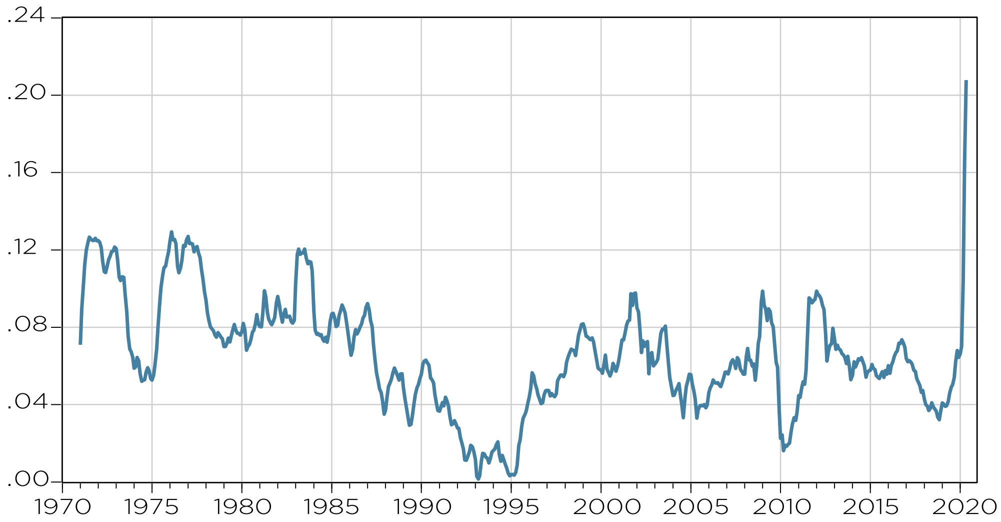
Source: Bloomberg Finance L.P.

The economic recovery is already losing momentum

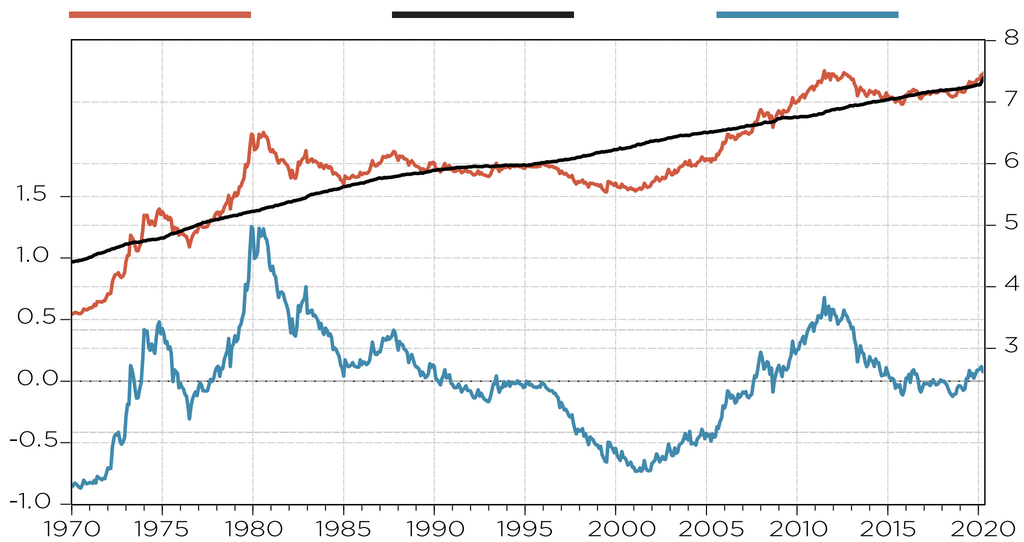
- Our growth forecasts for 2020 (and 2021 in brackets) are as follows – World economy: -5% (+3.5%), US: -8% (+4%), EU: -9% (+5.5%), Japan: -6% (+2.5%), UK: -10% (+6%).
- The corona virus is now spreading somewhat faster in Europe. But Germany and France want to do “everything” to keep the borders open. In France, schools are expected to resume as normal from September 1st.
- August data for the Purchasing managers’ indices in the euro zone were disappointing, but they remained above the mark indicating expansion. The overall index fell from 54.9 in July to 51.6, though the index for the manufacturing sector fell only slightly, by 0.1 to 51.6. A stronger decline can be seen in the service sector, where the index fell from 54.7 to 50.1. Provided these indices stay above the 50-point mark, the economy is on the “right track” to overcome the effects of the lock-downs.
- Overall, the economic indicators suggest that the initially V-shaped recovery is already losing momentum. This conclusion applies to regions across the globe, not just to Euroland.
- In the US, the “fiscal cliff” again threatens. To avoid this, the Federal debt ceiling must be increased soon. There are indications that ever-more US households are experiencing financial hardship because aid payments from the rescue funds have now been used up. Unsurprisingly in a pre-election season, negotiations between Democrats and Republicans in Washington are proving to be extremely tough. Nevertheless, we expect further aid packages to be adopted in the next few weeks and firmly believe that Congress will pass a new bailout package sometime in September. The special unemployment benefit of US $ 600 per week expired at the end of July but has been extended for a few weeks by decree. The next rescue package should enable a spending subsidy, at least temporarily, for the unemployed and economically weak. Thus, generous unemployment benefits should prevent a collapse in consumption. In order to forestall a rise in interest rates, the Fed is financing a large part of the net Federal debt being created. This is the path the US has chosen.
- America has chosen one path, Europe a different one. European governments have tried to prevent mass layoffs by subsidizing jobs through loans to the business sector. Here too, the ECB was able to help, financing a large part of the net new debt created and thus preventing a rise in interest rates.

Monetary Policy

Year-on-year growth in US monetary aggregate M2 since 1971



Gold price, logarithmic scale; estimated fair value; % deviation from "fair value"



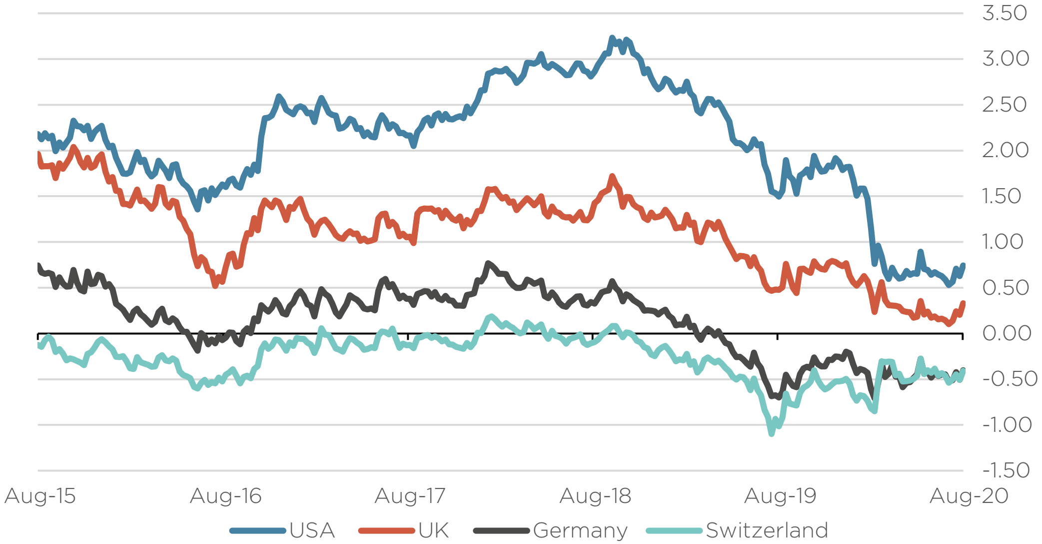
Source: Thomson Reuters & Datastream, own calculations

Central banks will continue their policies of monetary devaluation

- Central bank policies are distorting competition enormously and damaging long-term potential growth rates. Consider the following: (i) Central banks as "Lenders of Last Resort" can temporarily delay corporate bankruptcies. But, if companies are fundamentally unviable, bankruptcy cannot be put off forever. One solution is for central banks to become owners, thereafter subsidizing unprofitable business models indefinitely (as the GDR did with its state-owned companies). Under such a policy, other (profitable) business models are heavily disadvantaged, the allocation of resources deteriorates continuously, and trend growth rates shrink. (ii) Small firms do not have direct access to central bank liquidity. At best, they can benefit indirectly and after a lag from central bank measures to support banks. In contrast, large corporations can benefit directly and immediately if central banks buy their bonds. Thus, central bank interventions tend to favor large companies and to disadvantage small ones.
- The Fed and other central banks are rethinking their inflation targets and intervention philosophies. We expect a general move by all central banks in the direction of permanent structurally loose monetary policy, regardless of the economic cycle. This increases the so-called "monetary debasement risk". Monetary debasement is the process whereby legal tender is devalued due to its overproduction, in other words the volume of money increasing in relation to everything else.
- The US monetary aggregate M2 money supply is now growing at an annualized rate of over 20%, the fastest rate recorded since 1971 (see upper graph). M2 comprises M1 (currency held by the public and transaction deposits) plus savings deposits, small-denomination time deposits (less than $100'000), and retail money market mutual fund shares.
- Roughly speaking, in equilibrium and if everything else stays the same, a hundredfold increase in the money supply should result in a hundredfold increase in the price of gold. The graph below shows the logarithm of the gold price in dollars per ounce in red and the estimated "fair price" for gold in black. The current estimate for the "fair price" is $ 1'750 per ounce. The blue line on the left-hand scale shows the implicit under or overpricing of gold in percent. Relative to $1'750, gold is now slightly overvalued. As the central banks continue their policy of monetary depreciation, the equilibrium and actual price of gold will continue to rise.

Asset classes – Equities and bonds

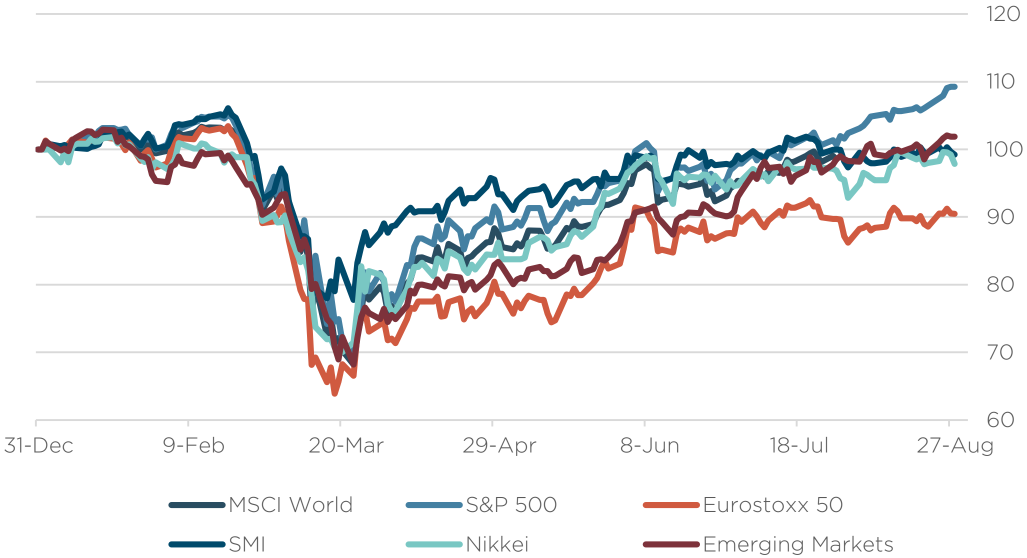
10 year government bond yields in %, last five years



Bond yields consolidate

- Yields in the most important government bond markets are consolidating at low levels. On the demand side are the central banks and, increasingly, institutional investors who are again looking for "safe havens". The supply side is set to expand massively in coming months because of the need to finance massive fiscal programs of economic support. It will be interesting to see how supply and demand will be balanced in today's "managed markets".
- In corporate bond markets, credit spreads have not moved much. For example, yields on investment grade US dollar bonds are currently around 1.3%. The large wave of corporate refinancings in the first half of the year has broadly run its course but the Fed is still active in the secondary market with purchases of investment grade bonds. These purchases depress the returns available to investors.

Equity markets, indexed performance, year to date



Source: Bloomberg Finance L.P.

The equity rally continues, but market breadth is decreasing

- The rally in the equity markets continued in August. The winners' list is topped by the tech-heavy Nasdaq Index, which has now gained around 25% in value since the beginning of the year. The more representative S&P 500 index is now also showing with a positive year-to-date return.
- The huge tech companies are the main drivers of the gains on Wall Street and market breadth is continuously decreasing. Whereas the S&P 500 index now shows a 5% year-to-date gain, the equivalent performance if all stock components are weighted equally is a 5% decline. Defensive markets such as the Swiss stock market have not managed to keep pace with Wall Street.
- "Short interest" in the S&P 500 has now sunk to its lowest level in 15 years. In other words, many bears (investors who expect prices to fall) have capitulated and liquidated their "short" positions. This is strongly reminiscent of the year 2000, as is the very high level of retail investor activity in call options on individual stocks.
- US corporate earnings plummeted nearly 35% year on year in the second quarter. However, this was less savage than the decline expected by analysts. In Europe, the numbers look a bit worse, with the energy sector having a major negative impact on the overall outturn.

Asset classes – Currencies and other assets

EUR/CHF, last 2 years

US dollar under pressure

- The US dollar has come under increasing pressure, setting new lows against many currencies. Rising US twin deficits and the resulting sharp increase in the US money supply are putting pressure on the “greenback”. For the first time in many years there are warnings of escalating inflation in the US. Moreover, the continued decline in real US interest rates will tend to further undermine the dollar.
- The ailing US dollar poses a dilemma for central banks outside the US as their currencies are appreciating. This is unwelcome in an economic world in which growth seems to require competitive currency devaluation.
- Europe is now “out of the headlines”, so demand for the Swiss franc is only moderate. The EUR / CHF rate is currently trading just below 1.08.

Gold price, US dollars per ounce, last 2 years

Gold is consolidating around $2’000 per ounce.

- Gold was in a strong upward channel, breaking the $ 2’000 per ounce mark in a spectacular way, but has since entered a consolidation phase. Further declines in real interest rates as well as the significant weakening of the US dollar have provided general support for the positive development of precious metal prices.
- But the discussion about the physical availability of gold continues. It is alleged that the Comex in New York is having an increasing problem, as more and more investors could demand physical delivery for their “long” positions in gold futures.
- The recent decline in real interest rates is almost exclusively due to a rise in inflation expectations, as nominal interest rates have remained broadly constant. The real interest rate for 10-year US Treasuries is currently -1%. Price developments for this critical asset will be decisive for the future performance of precious metal prices.

Source: Bloomberg Finance L.P.

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