perpetual wealth

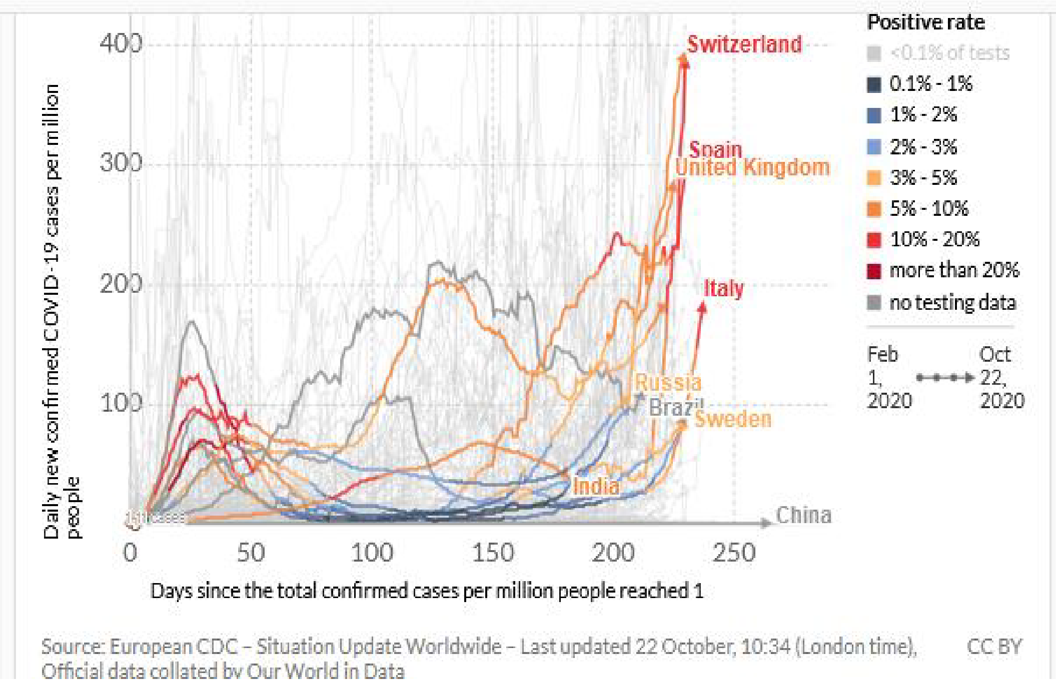
Perpetual Wealth Monitor

November 2020.

Executive Summary

- We expect the world economy to contract some 4.5% in 2020 but forecast the recovery will produce around 3.5% growth in 2021.
- Most countries were able to show strong growth rates in the third quarter. But fourth quarter growth rates will be negatively affected by the second wave of corona virus which is now developing powerfully.
- Behavioral changes on the part of the consumer look set to dampen economic growth, even if further lookdowns are avoided.
- Unfortunately, the mass use of anti-corona vaccines is probably several months away (at least). As a result, the previously expected V-shaped recovery may turn out to be more W-shaped.
- Yields on government bonds have traded within a narrow range in recent months.
- The US third quarter corporate reporting season has begun. Analysts expect earnings to fall some 16% on a year-on-year basis.
- We expect political developments in Washington and the course of the corona virus will be the most important near-term factors influencing the equity markets.
- The US dollar has fallen back once again.
- Although the gold price has declined recently, we remain positive on the precious metal over the medium-term.

7-day average of daily confirmed new Covid-19 cases per million inhabitants



Source: https://ourworldindata.org/coronavirus

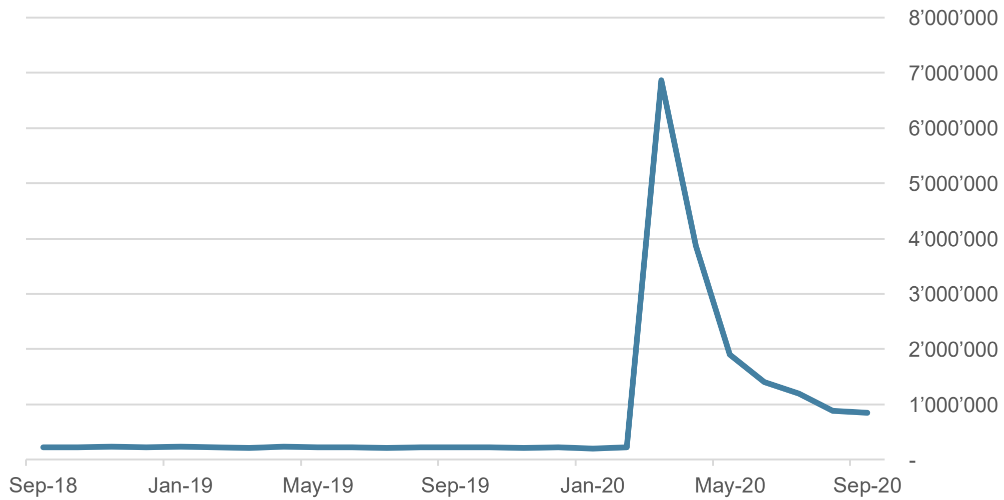
The "second wave" looks set to undermine the economic recovery

- Independently of related government restrictions, the renewed rise in Covid-19 is leading to behavioral changes, particularly among older people. This age group has elected to reduce its social interaction - for example, by cutting down on visits to restaurants, stays in hotels or going to the movies. The business situation in many industries and sectors is now precarious and, unless governments decide soon to implement additional support measures, a wave of insolvencies threatens.
- The rise in the number of new infections in Europe is particularly concerning, not least because of the time of year. Asia is least affected. There are almost no new infections in countries such as China, Thailand and Vietnam.
- In less authoritarian, more open societies, it is much more difficult to keep Covid-19 under control. Switzerland is a good example. On average, 0.04% of all residents are getting infected every day. At this rate,1.2% of all residents will be newly infected in a month. Nevertheless, an obsessive focus on combating Covid-19 can be counter-productive, as the side effects of restrictive measures are also very serious. To put it bluntly: poverty also kills.
- The widespread use of corona vaccines is at least several months away. There have been repeated delays and setbacks on the vaccine development front. For example, AstraZeneca and J&J have both had to pause their series of experiments as "test subjects" fell ill or died. And the causes of these outcomes had to be clarified prior to a resumption of trials. Prospects for the Trump Administration-initiated "Operation Warp Speed" are far from clear.

Business Cycle

Deutschland: IFO Geschäftsklimaindex, 5 Jahre

USA: Initial unemployment claims, 2 Jahre



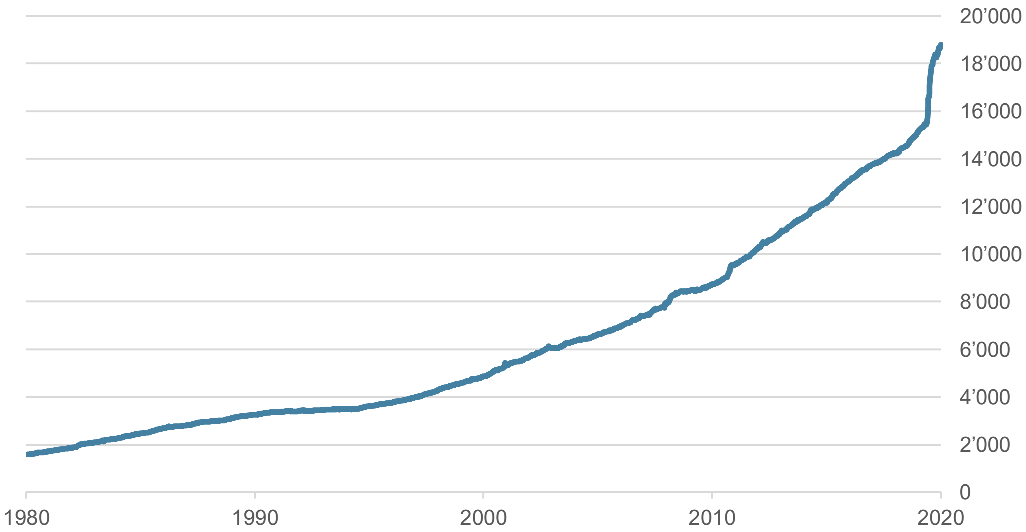
Source: Bloomberg Finance L.P.

Darkening prospects for the fourth quarter

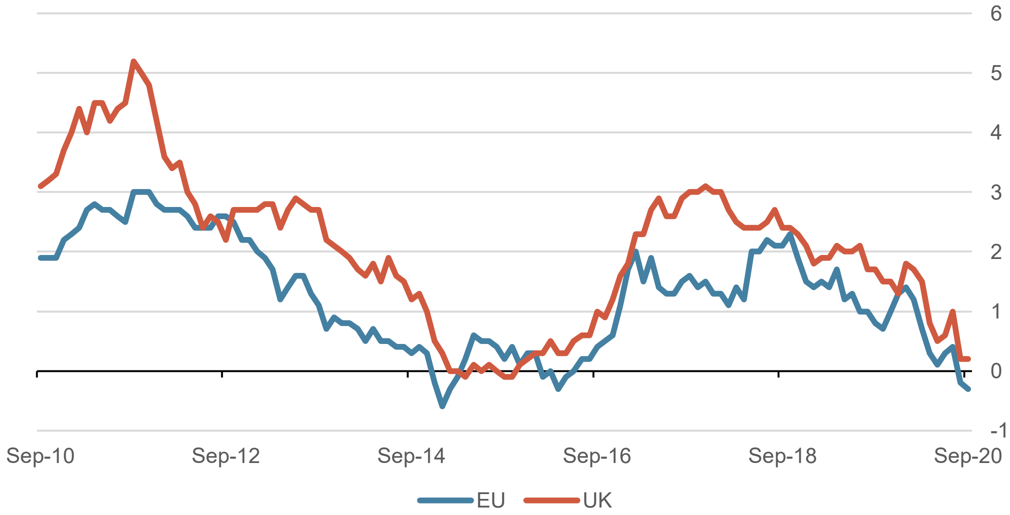
- Our growth forecasts for 2020 (and 2021 in brackets) are as follows – World economy: -4.5% (+3.5%), US: -6.5% (+4%), EU: -7% (+5.5%), Japan: -5% (+2.5%), UK: -8% (+6%), Switzerland: -5% (+3%).
- The third quarter was characterized by a marked but far from complete recovery in the global economy. The fourth quarter will be more difficult due to the second wave of Covid-19.
- Smaller companies around the world are exposed to a high risk of bankruptcy. A McKinsey survey found that over 50% of European small and medium-sized companies believe they have a high risk of becoming insolvent within a year.
- Given this background we firmly believe there will have to be additional state aid, and not only in Europe. Public borrowing levels are therefore set to continue to rise on a worldwide basis.
- The US Presidential election will take place on November 3rd. What investors most fear right now is uncertainty and unrest in the country following the vote. Although Donald Trump continues to trail in the polls, we think there is a high probability the election result will be very close. And the latest data suggest Donald Trump is cutting his opponent's lead, especially in the crucial, so- called "battleground states". It is now very likely that the next bailout package will not get passed until after the Presidential election. Both parties have signaled that, even were a bi-partisan agreement to be reached before November 3rd, a vote would not take place until after the election. If there is no clear winner immediately following November 3rd, the next rescue package would likely be delayed even further. In this respect, a clear election result could be very positive for the economy and the stock markets.
- There have been some "positive surprises" out of the US. In the week to October 17th, initial jobless claims fell from 898,000 to 787,000 (versus an expected: 870,000). This is the lowest figure since March. Meanwhile, continuing jobless benefit claims (i.e. those who have applied for benefit for at least two weeks in a row) fell from 9.4 million to 8.4 million - significantly better than the over-10 million figure expected.
- But Asian countries are doing best. Their strong, arguably repressive, policy response to the pandemic has largely kept it in check. Chinese GDP rose 4.9%, year on year, in the third quarter.

Monetary Policy

US: M2 money stock in bn. US-Dollar, since 1980



Inflation rates in Europe, in %, 10 years



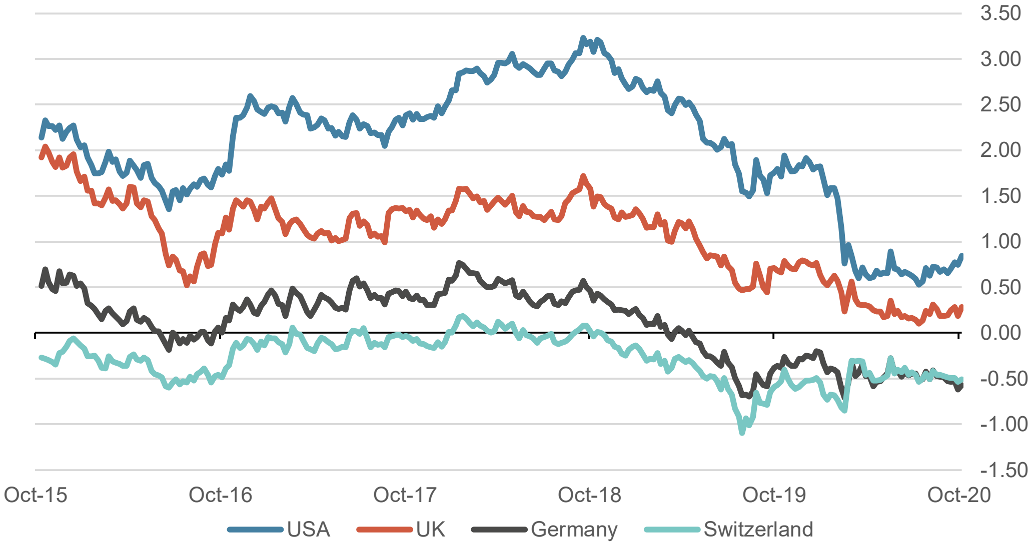
Source: Bloomberg Finance L.P.

Central banks will continue their policies of monetary devaluation

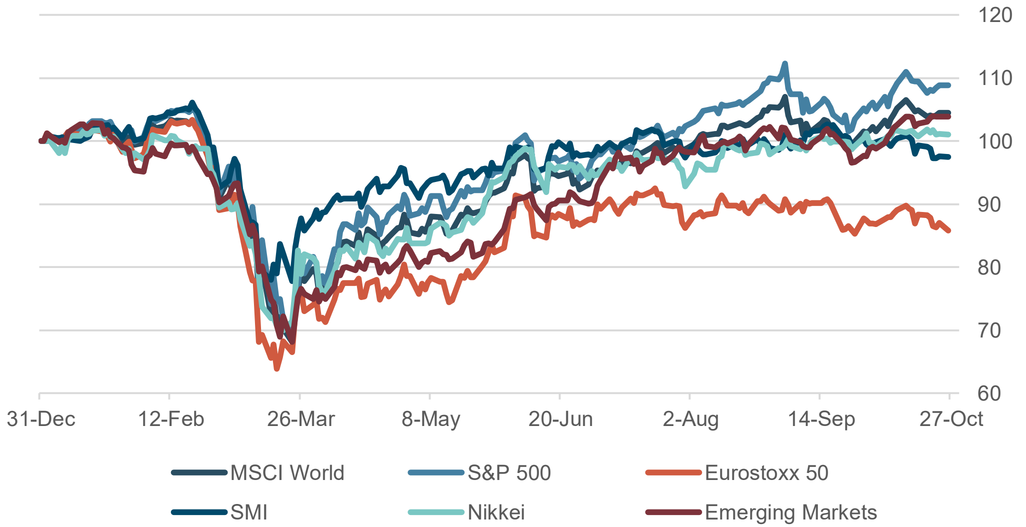
- In future, government responses to the weak demand situation are likely to focusmoreonfiscal,andlessonmonetary,policy. WeexpecttheUSbudget will show a deficit of around 3 trillion US dollars in fiscal year 2021 (which ends on September 30, 2021) and believe it is likely to remain above the 10% of GDP mark in the following years.
- But fiscal policy needs to be supported by monetary policy as exploding government debts mean governments must do all they can to avoid higher financing costs. In other words, central banks around the world need to diligently buy up government bonds so that interest rates don't move into the "no longer financeable" range. An end to the expansion of central bank balance sheets and to the accelerated growth of the money supply is therefore not in sight.
- In September 2020, M2 money supply in the US increased by 24.2%, year on year. This is the highest value since 1959. Prior to the Covid-19 pandemic, growth was below 7%.
- The Fed is "pausing" while waiting for the next rescue package to be passed. Due to the US Presidential election, we think its adoption will likely be postponed until January or February 2021. By then at the latest, the Fed should be stimulating at full throttle once again. In the meantime, "powder is being kept dry". Should Joe Biden be elected, and the Democrats take control of the Senate, a rescue package of the order of 3 trillion US dollars is likely. A large part of the net new Federal debt that will result will have to land on the Fed's balance sheet.
- The Bank of England is likely to take additional measures as early as November. UK inflation has been well short of the Bank's inflation target of 2% for around 6 months. In addition, Brexit uncertainties are having a significant impact on the economic recovery.
- The ECB will also have to help finance the next corona virus-related rescue packages. According to surveys, many companies now believe that they have too many employees. Therefore, short-time working programs will probably be expanded and extended. In addition, governments are being called upon to prevent a wave of bankruptcies. In the EU, too, expansionary fiscal policies are forcing the ECB to take more and more government debt onto its balance sheet.
- Even should the economic situation in Switzerland turn out better than elsewhere, the SNB would still have to follow the expansionary monetary stance and balance sheet expansion policies of the Fed and the ECB in order to fight against an appreciating Swiss franc.

Asset classes – Equities and bonds

10 year government bond yields in %, last five years



Equity markets, indexed performance, year to date



Source: Bloomberg Finance L.P.

Yields trend sideways

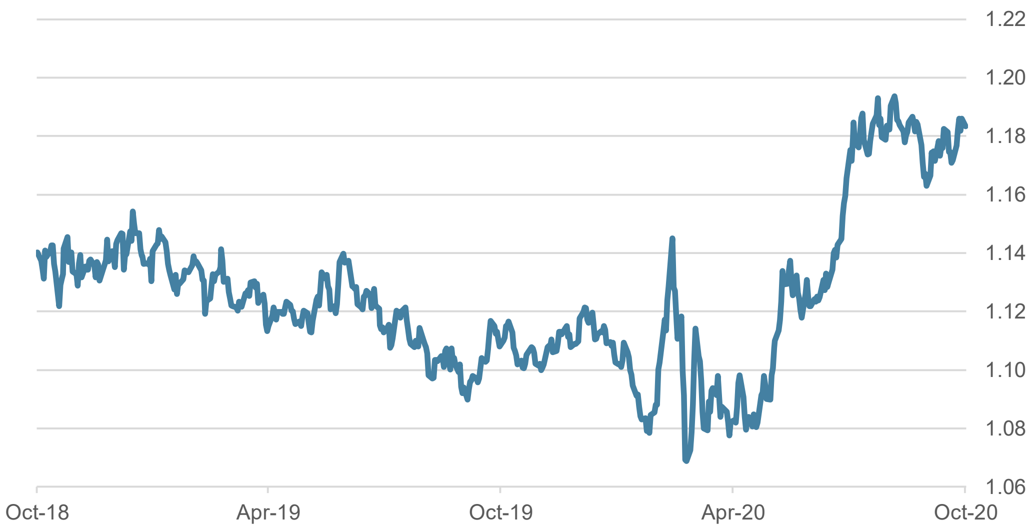
- Government bond yields in the main regions have remained rather stable. On the one hand, there is demand from central bank bond purchase programs. On the other, institutional investors looking for "safe havens" are again buyers, due to increasing uncertainty (Covid-19, US elections). Governments, having to finance their gigantic fiscal programs through the market, are the principal counterparties.
- But returns in all currencies are now clearly negative in real terms, even in maturities quite far out along the yield curve. Thus government bonds are clearly unattractive.
- In corporate bonds, the major refinancing wave of the first half of the year is over. But the Fed and other central banks are still active in the secondary market with purchases of investment grade corporate bonds, thus depressing returns in this area as well.

Rising tension ahead of the US election

- Since the beginning of the fourth quarter stock markets have traded less strongly. Right now, there are too many "question marks" for the previous upward trend to continue. The US election, with its possibly contested outcome, represents great uncertainty. So do the second wave of Covid-19 and the still- pending Brexit.
- All these issues are putting a strain on stock markets and this is reflected in increased volatility, both for the indices and for individual stocks.
- For the near-term we anticipate a difficult period for the markets but think these areas of uncertainty will ultimately be resolved in a way that produces a positive reaction in the markets. Markets loathe nothing more than uncertainty; once this is eliminated, one normally sees a reduction in volatilities and a resumption of the previous trend.
- Furthermore, we are near the start of the third quarter earnings reporting season. Expectations have been ratcheted down in advance and it will be interesting to see how prices react to the published reports. So far, the reporting season has been a success; 85% of the 135 companies that have published results to date have exceeded analyst expectations.

Asset classes – Currencies and other assets

EUR/CHF, last 2 years



Gold price, US dollars per ounce, last 2 years

Source: Bloomberg Finance L.P.

The dollar is again under pressure

- The short interlude of a slightly appreciating US dollar has already come to an end. Near-term difficulties in putting together another US fiscal support program and the worsening corona crisis (which probably indicates a need for even greater support measures) have put the greenback under renewed pressure.
- Central bank representatives worldwide are commenting that projects and experiments with digital central bank money are taking shape. This could be another reason why "traditional" fiat money, with the US dollar in the front line, is coming under pressure.
- In principle, however, all central banks face a problem when their currencies appreciate. Currency appreciation is not welcomed in an economic environment where growth can only be generated with the help of competitive devaluation.

Precious metals weaker

- During the correction on the stock markets ("risk off"), gold has also been affected by profit-taking. This is a consequence of the positive correlation between the two asset classes that has been observed in the trading patterns of late summer.
- Somewhat "less negative" real interest rates have recently put precious metal prices under pressure. This effect has come about primarily through rising nominal rates as inflation expectations have trended sideways.
- Since we anticipate that sooner or later all central banks will be forced to become more active in depressing real interest rates (either by bond purchases or through a rise in inflation expectations), we remain positive on precious metals.
- But we see a great danger in the current behavior of the central banks. Their competition to secure a weak currency (competitive devaluation) could trigger a general crisis in confidence in currencies or in fiat money. This would be very hard to reverse and would put all "nominal" assets under great pressure. Gold and other "real assets" should appreciate strongly in such a scenario.

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