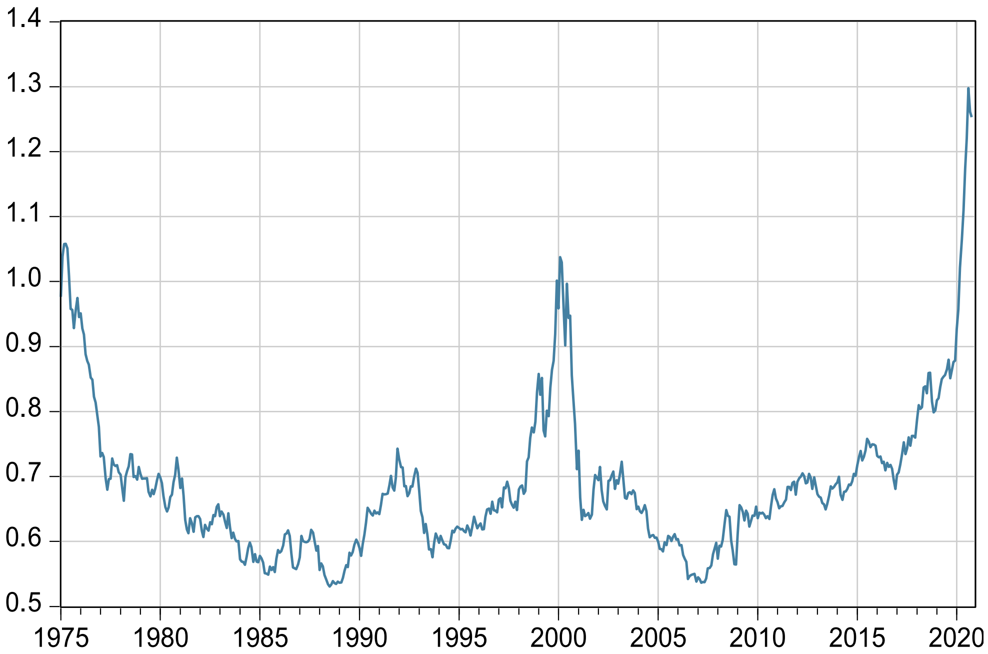
# Perpetual Wealth Monitor

December 2020.

# Executive Summary

- We expect negative global economic growth of -4.5% in 2020, followed by a recovery of around 4.5% next year.
- The second wave of the pandemic and resulting lockdown measures will cut economic growth in the short term.
- Chances are good that vaccines with efficacy rates of 80%-90% will be available for large-scale vaccination programs within a few months.
- A foreseeable end to the pandemic, coupled with aggressively stimulative monetary and economic policies, mean that a very strong economic recovery is in prospect for the second half of 2021 at the latest.
- Yields on government bonds have traded within a narrow range in recent months.
- Government bond yields remain on low levels. Globally, 17.4 trillion US-Dollar worth of bonds are trading with a negative yield.
- Equity markets reacted positively to the results of the corona vaccine trials and are overbought in the short term.
- The US dollar continues to trend sideways but is expected to remain under pressure.
- Precious metals prices have corrected significantly.

**Performance of MSCI USA Growth versus MSCI USA Value since 1975**



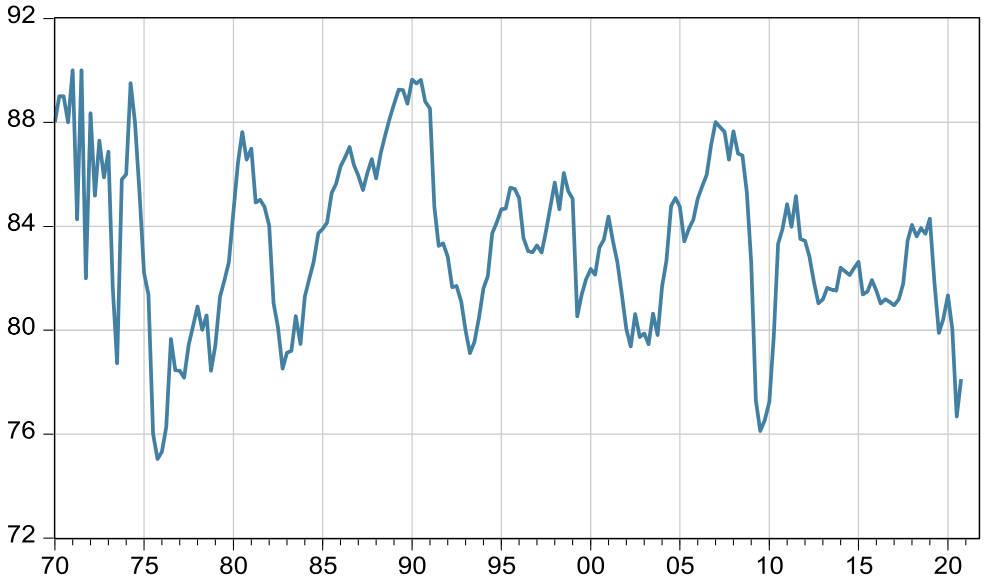

**Source: Thomson Reuters / Datastream**

**Expected mass vaccination programs trigger a rotation of investment styles**

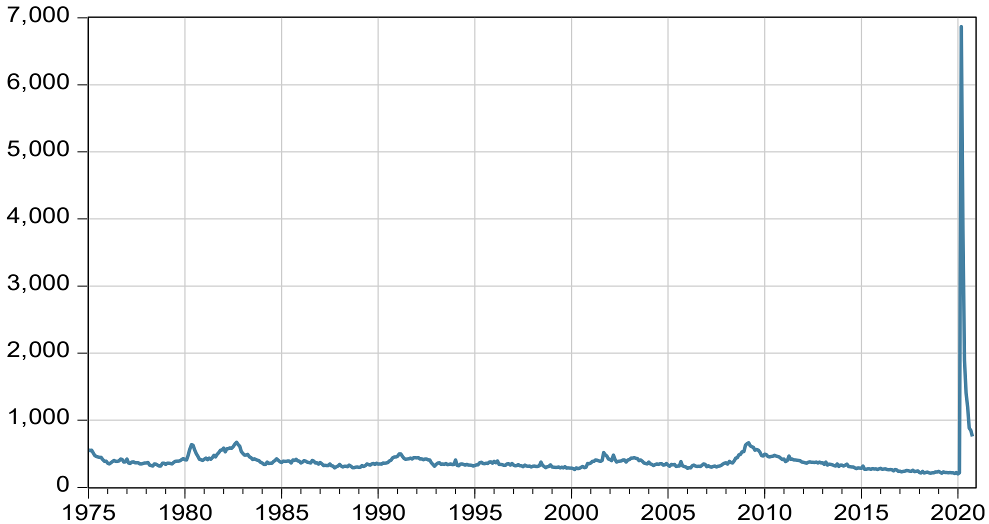
- Three vaccine manufacturers (Pfizer & BioNTech, Moderna and AstraZeneca) have announced that their vaccines have efficacy rates of up to 90-95%, significantly higher than traditional influenza vaccines.
- This news is very positive and gives reason to hope that the pandemic can be brought under control before the end of 2021. It should be emphasized that, due to the high effectiveness of the vaccines indicated by trial data, so-called "herd immunity" can be achieved with only about two thirds of the population being vaccinated.
- In general, it can be said that the fear, both in terms of health outcomes and potential economic damage, is significantly lower in the second wave of Covid infections than in the first. It also now appears that the extent of Covid-19 related bankruptcies will be much lower than previously feared as many companies in the most affected sectors (e.g. restaurants, hotels, tour operators, airlines and oil producers) will be able to return to normal operations by autumn 2021. Given this, many lenders will likely be willing to discuss bridging loans.
- On the stock exchanges, the losers and winners have swapped roles. Many investors have rotated from the Covid-19 winners to the Covid-19 losers, resulting in a significant outperformance of "value" stocks and small and medium-sized companies, while technology stocks and "large caps" have recently tended to lag. Gold and gold equities have also come under pressure.

# Business Cycle

**KOF series for Swiss capacity utilization, since 1970**




**USA: Initial unemployment claims, since 1975**



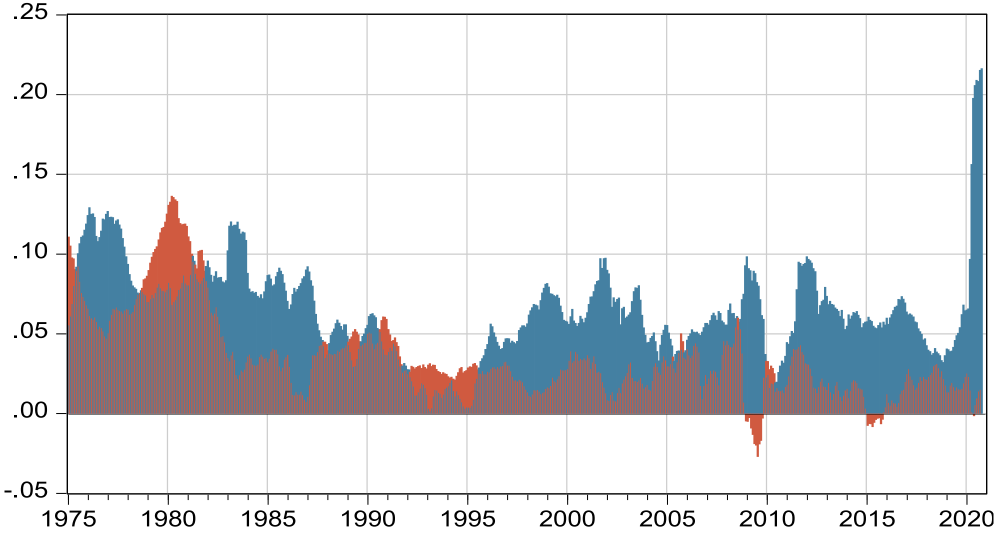

**Source: Thomson Reuters Datastream**

**Light at the end of the tunnel**

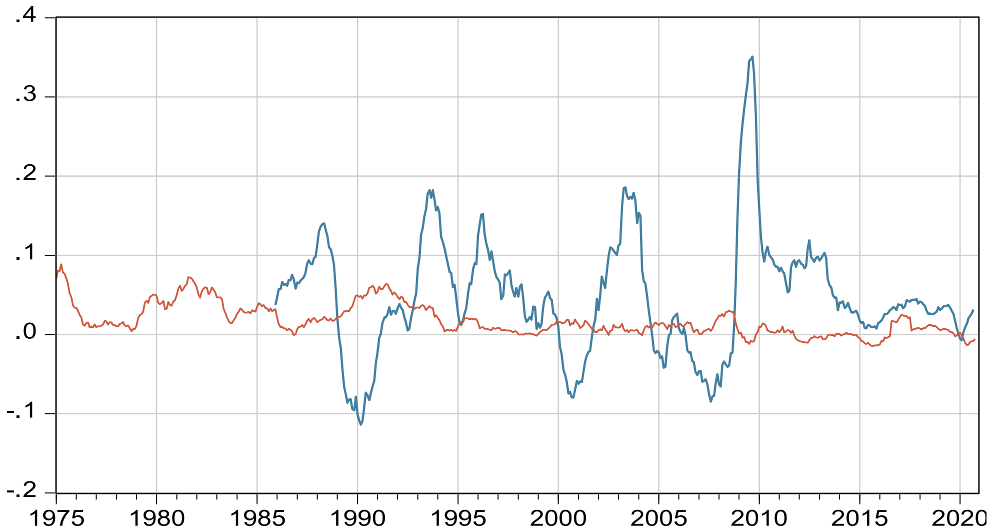
- For 2020 (and 2021 in brackets) we have the following growth forecasts – World economy: -4.5% (+4.5%), USA: -6.5% (+4%), EU: -7% (+5.5%), Japan: -5% (+2.5%), UK: -8% (+6%) Switzerland -5% (+3%).
- After a very strong recovery in the third quarter, northern hemisphere economies are expected to be much weaker in the last quarter of 2020. This reflects the renewed rise in Covid infection numbers and the social restriction measures that have followed. The IHS Markit Composite Purchasing Managers' index for France fell to 39.9 points in November. This suggests a decline in European GDP of 3 - 4% compared with the third quarter.
- In Switzerland, as elsewhere, capacity utilization is still far below the levels of recent years, as can be seen from the upper chart.
- The US is currently still showing very robust growth. For example, the IHS Markit Purchasing Managers' index for the manufacturing sector jumped from 53.4 in October to 56.7 points in November (versus an expected 53). This suggests that US manufacturing is now growing at rates last seen in late- 2014. Also, the confidence component of this index jumped to its highest level since 2015. Unfortunately, it is likely that the US will have to follow other countries in implementing significantly tighter lockdowns. The hitherto-V- shaped recovery should soon turn into a W-shaped one here as well.
- But progress on the vaccine front "trumps" the bad news on the pandemic and its impact on the economy. There is light at the end of the tunnel.
- In the short term, the prospect of mass vaccination programs before long may encourage politicians to adopt stricter lockdown measures. Now that an end to the pandemic is in sight, voters might think it irresponsible if there are not serious attempts to save as many lives as possible over the next few months.
- Pent up holiday and consumption demand will be released when the pandemic ends. From the third quarter of 2021 at the latest, the global economy should grow strongly thanks to re-openings, pent-up demand and ongoing fiscal and monetary policy stimuli. It is important to note here that the fiscal packages will serve less to stimulate demand than to act as "insolvency preventers". Without these packages we would see a wave of bankruptcies among companies most affected by the pandemic. Such companies must be kept alive until the pandemic is over, and the economy can open up.

# Monetary Policy

**USA: M2 money growth rate and consumer price inflation since 1975**




**Switzerland: M2 money growth rate and consumer price inflation since 1975**



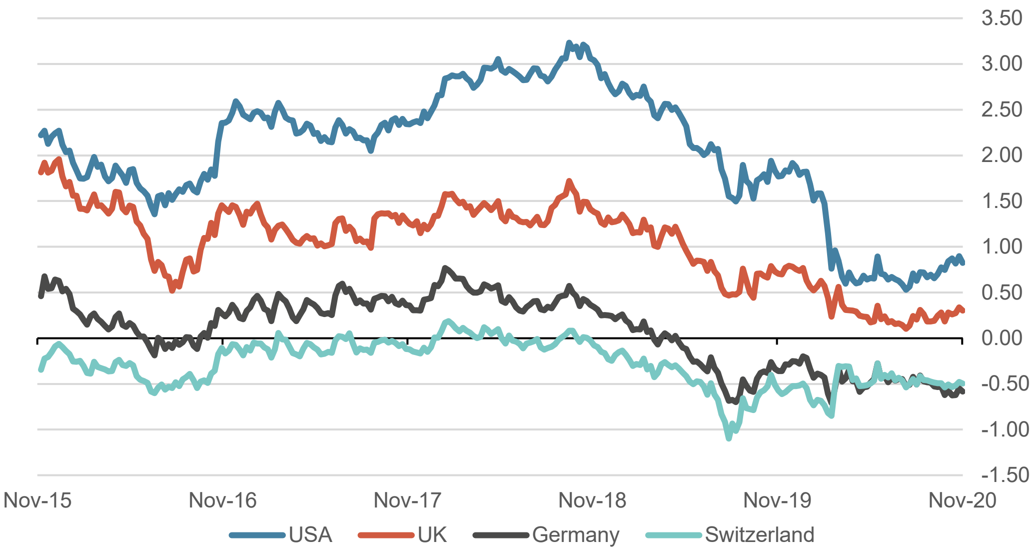

**Source: Thomson Reuters Datastream**

**Monetary policy makers call for increased government spending**

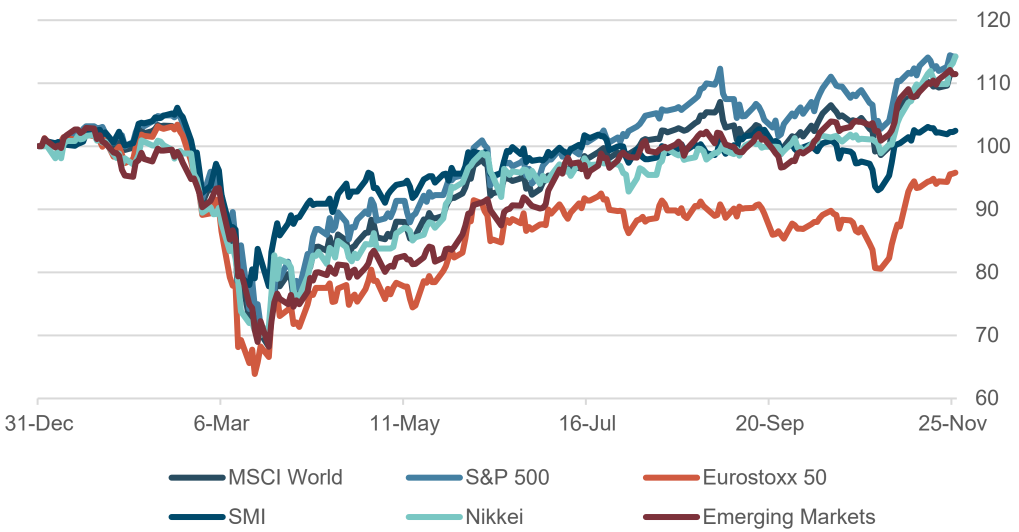
- US President-elect Biden will appoint former Fed Chairman Janet Yellen as the new Treasury Secretary.
- This is more than symbolic. It is a clear sign that fiscal and monetary policy are increasingly merging. Ms. Yellen has particularly good connections with the Fed and is considered a "dove" ( i.e. an advocate of stimulative monetary and fiscal policy). She has already come out in favor of rapid, generous aid packages (financed by the Fed). Cooperation with Fed Chairman Powell should work very well. In a speech in 2014 she argued for a "high-pressure" economy, whereby simultaneous stimulation by the Administration and the central bank causes the economy to grow so fast that aggregate demand exceeds aggregate supply. Despite a Congress likely to be Republican-controlled to a significant extent, today's market expectations of additional (and simultaneous) fiscal and monetary support should come true.
- For decades, it has been common for central bankers to call upon politicians to be moderate and disciplined when it comes to spending and rescue packages, and to try and incentivize them by threatening interest rate hikes in response to escalating deficits and rising public debt.
- But for several months now those central bankers have been turning that world upside down. More and more openly, the ECB and the Fed demand that stimulative monetary policy be supported by stimulative fiscal policy.
- They are about to get what they want. As the presidency of Joe Biden approaches, a new rescue package in the order of $1'000 to $1'500 billion is expected to be put together in coming months. EU member states will also launch further rescue packages.
- It is likely that, prior to President-elect Biden's inauguration and probably as early as December, the Fed will start a new "Operation Twist" in order to prevent an excessive increase in the gap between long-term and short-term interest rates.
- The graphs on the left show that over the medium term there is only a weak correlation between inflation and the growth rate of M2 money (currency as well as demand and time deposits). And in Switzerland there is practically no discernible correlation. The reason for this is the slump in the velocity of money circulation due to "anxiety" or precautionary saving and the fact that a large part of M2 money flows into the financial markets instead of being used to finance consumption or investment.

# Asset classes – Equities and bonds

**10 year government bond yields in %, last 5 years**




**Equity markets, indexed performance, year to date**




**Source: Bloomberg Finance L.P.**

### Yields remain at low levels

- Yields on government bonds in the main regions seem at variance with equity markets that are pointing to an economic upswing with slightly rising inflation. If the equity markets are right, bond yields should be rising faster, or at least yield curves should be steepening. Right now, this is not happening.
- The general assumption that central banks will increase their securities purchase programs (QE) in December could be one reason why yields remain so steady. At all events, the trend in yields implies that bond markets do not share the rosy, economic growth scenario being discounted in the equity markets. It also implies that the huge amounts of new debt that will fund many yet to be announced fiscal programs can be easily financed (by the central banks?).
- Overall, yields in all major currencies and in most segments of the bond markets are negative in both nominal and real terms far out along the yield curve, making the bond asset class as a whole unattractive. This is the result of the behavior of the central banks which have relieved the markets of their pricing function.

### Stock markets are euphoric

- In recent days stock markets, especially in the US, have succumbed to euphoria. One reason for this is that uncertainties concerning the election look to have been resolved in an orderly manner with a widely accepted result. Secondly, various manufacturers have reported breakthroughs in the development of Covid vaccines.
- The stock markets seem to have concluded from the vaccine news that "corona will soon be no longer an issue" and that levels of economic activity at the start of 2020 will be regained within a few months. In addition, the distribution of roles and responsibilities between new US Administration and the US Federal Reserve will be such as to provide permanent liquidity support to the markets.
- All this has triggered a rapid stock market rotation, such as has not been/ comparable with anything seen in the last 20 years, with the previous winners (technology) losing out and cyclical stocks (industry, banks) making strong gains.
- To a certain extent, the reaction of the stock markets can be understood, as "TINA" (there is no alternative) still applies to the equity asset class. But this euphoria has driven up sentiment indicators to levels that indicate near-term risk. For example, the Bull-Bear Indicators, Call-Put Ratios and the CNN Fear & Greed index are all back at levels much like those in February.

# Asset classes – Currencies and other assets

**EUR/USD, last 2 years**


**Gold price, US dollars per ounce, last 2 years**


**Source: Bloomberg Finance L.P.**

**US dollar not much affected by recent events**

- Like the bond markets, the US dollar reacted only marginally to the news on the US presidential election. A new US fiscal support package may now be more likely but, given the make-up of the next Congress, could well turn out to be smaller than earlier estimates. That and the worsening corona crisis (something which makes the need for fiscal support yet more urgent) are keeping the greenback under pressure. In the medium term, however, we expect the sharp rise in the US money supply will serve to devalue the US currency. This in turn will pressure non-US central banks to try to devalue their currencies as well.
- It is interesting to follow the renewed rise of digital currencies, among which Bitcoin has the highest profile. Worldwide, there are increasing comments from central bank officials to the effect that digital central bank money may be the best suited to address the world's current economic problems (excess debt, economic weakness etc.). In contrast to the bull market of 2017, institutional investors now seem to be active in digital investments.

**Precious metals significantly weaker**

- The narrative driving the stock markets has led to a sharp correction in precious metals markets. The gold price has lost around 12% since its peak in August, and mining stocks have also come under heavy pressure.
- Surprisingly, this correction occurred without any significant movement in the USD and without any real movement in the direction of "less negative" real interest rates. In other words, inflationary expectations have fallen only marginally as nominal yields are almost unchanged. Interestingly, crypto-currencies have behaved in exactly the opposite and, in our view more "logical", way given the explosive growth of the money supply.
- Current precious metals prices therefore represent a buying opportunity. Our view here is reinforced by our expectation that sooner or later all central banks will become increasingly active in trying to depress real interest rates (in order to raise inflation expectations and facilitate debt servicing). A general loss of confidence in "fiat" currencies in this context should boost substantially the prices of precious metals, which as "real currencies" represent alternatives to nominal ones.

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