CONCEPT
VERMÖGENSMANAGEMENT

Vote of Confidence

Prospects

July 2020

VOTE OF CONFIDENCE

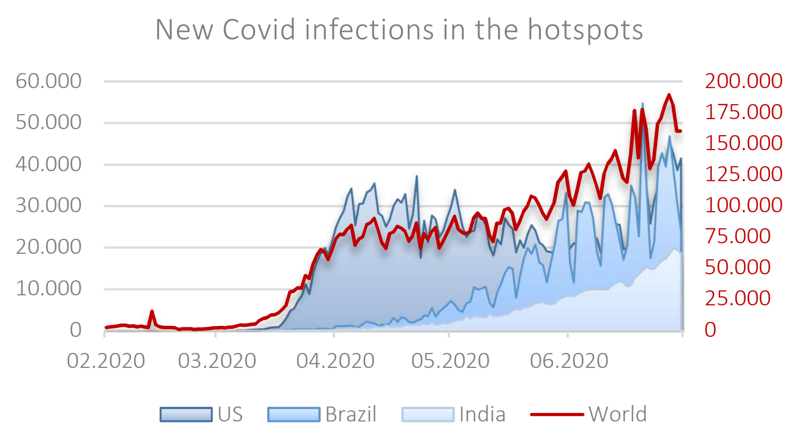
Over 10 million people have now become infected with the Corona virus. As a result, the global economy has suffered a managed slump like no other since 1940. Nevertheless, around 4,000 people worldwide are still dying every day of or with Covid-19 and the number of new infections is currently twice as high as the perceived peak of the pandemic at the end of March this year. Regardless of this, the world stock exchanges, which previously suffered a downswing of over a third, have now almost recovered to the pre-corona levels in many places, and even surpassed them in some cases. Not only astonished ordinary people are asking how this can be.

The doyen of the stock market Kostolany liked to use the metaphor of someone walking a dog when describing the interactions between the economy and the stock exchange. The dog is sometimes ahead and sometimes behind, but they are both always travelling in the same direction. Right now it seems that the dog has slipped its leash and headed for the hills, out of sight of its walker, because the discrepancy between the stock market and economic developments has rarely been greater than it is today.

We do not know whether the dog is waiting over the crest of the hill, running ahead or whether the walker will now hurry to catch up with his dog. However, we consider it likely that both will keep going in the direction the dog was headed when it disappeared. At this point, we should preface with the conclusion of the following report: The economy will recover; corresponding indicators from the sphere of labour and capital are unmistakable, although it is unclear how long the recovery might take. However, the stock exchange has already anticipated a very large-scale, V-shaped (i.e. very fast) economic turnaround, and at a much faster rate than many investors (including we) would have expected. There will thus probably be less positive surprises in the 2nd semester of 2020. In this respect, the stock exchanges could gear down to a quieter pace and – to continue the metaphor – stop and wait, take a breather, occasionally backtrack to see where the walker has got to.

Anticipate stock exchanges V-shaped recovery.

The number of new infections continues to rise worldwide



Source: European Centre for Disease Prevention and Control

DETERMINING LOCATION

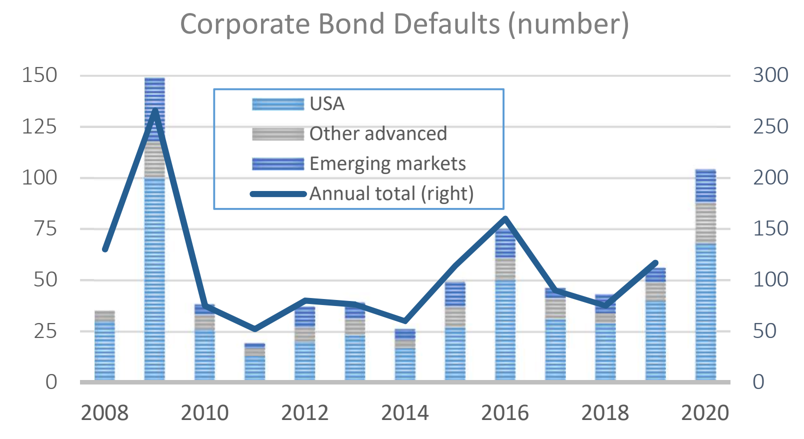
The economic vista currently resembles an expanse of rubble:

- In its most recent analysis, the International Monetary Fund estimates a worldwide slump of 5% this year, followed by a 5.4 % increase in 2021. This would result in roughly the same annual economic output as before the crisis on average for 2020/21, i.e. zero growth over the next two years. In its February forecast, the IMF was still assuming an average annual growth of 2.5%. But now the global economic losses in 2020/21 will possibly amount to $ 9 trillion [1]. The effects are far more severe than during the financial crisis a good 10 years ago. In 2008, global economic growth shrank by just 0.1%, while growth of 3% arrived again the following year, an increase of 2.9% over two years. The loss in global GDP in comparison with the original forecasts for the period was $ 4 trillion [2].

The effects are more serious than during the financial crisis.

- In just over two months, the US unemployment rate has skyrocketed from a fifty-year low, to just under 20%. This level was last reached in 1932, when the GDP fell by 15%. The development in Europe is similar, where the threat of unemployment is only compensated for by short-time work.
- Consumer spending has declined more sharply than ever before since records began in 1959.
- The world economy has been put under administrative pressure, while corporate balance sheets – even before Corona – were showing historical all-time high levels of debt. The debt dynamics are gaining additional momentum with the acquisition programmes of the central banks, which are now also buying less high-quality corporate bonds. Junk bond issuers are also more active than they have been for the past three years. In the USA in particular, the tipping point for thousands of companies with business models that can only function if extremely cheap financing is available can be triggered by the slightest touch.
- Over 100 corporate bonds worldwide had defaulted by May, i.e. had not been repaid. This figure was only exceeded in 2008.

Corporate finance is falling through more often



Source: IMF (pillars: up to and including May, line: respective full year)

THE STOCK EXCHANGES SEEM TO HAVE BEEN DECOUPLED

And the stock market does not seem to want to know anything about it. The race to recovery has been almost as rapid as the drastic fall in prices in March. At MSCI World, about ¾ of the price losses have already been made up for. Many were surprised at the speed of the recovery. Some are acting rather cautiously in view of the severity of the crisis (the worst economic collapse since the 2nd World War II) and uncertainty over the duration of the pandemic (no vaccine in sight that could be used billions of

[1] Source: IMF

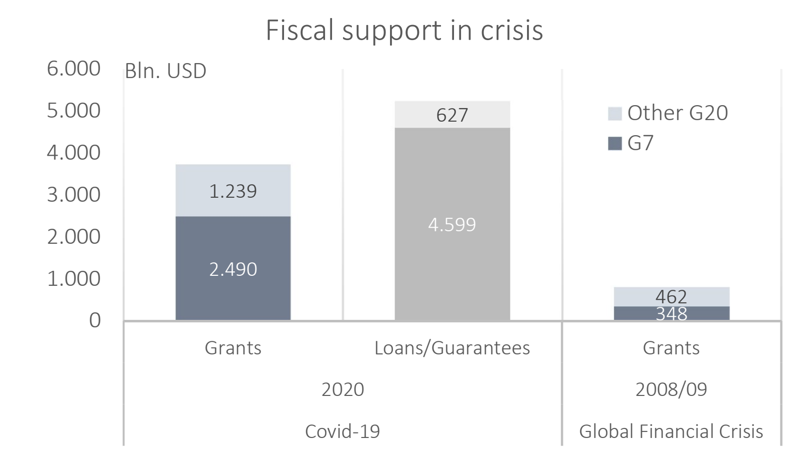
[2] Source: Deutsche Bank Research

times). Such people are currently lagging behind.

The cause of the change in mood was – as ever – fresh money, which was figuratively poured in bucketfuls over the economy and the people. Never before have states and central banks decided to grant so much financial support in the form of grants, loans, guarantees and purchase programmes. The G10 central banks injected nearly $ 6 trillion in liquidity into the system in two months, equivalent to the total of the previous six years. The volume is about twice that of the financial crisis when $ 2.6 trillion was injected within six months. In contrast to the time when austerity was enacted, at least across Europe, governments have now reached deep into the public coffers. According to the IMF [3], G20 direct state aid is currently expected to reach $ 9 trillion, both through direct grants and loans, equity investments, or guarantees. The associated budget deficit (new debt) will exceed 10% of the respective GDD on average.

Never so much support in so short a time.

Governments draw generously from public coffers



Source: IMF, Fiscal Monitor April 2020 (loans/guarantees for 2008/09 have not been researched)

TREATING SYMPTOMS ...

According to all serious analyses by public and private institutes, these stimulants will not be enough to prevent the aforementioned economic downturn. It is already foreseeable today that not only the unemployment figures but also corporate insolvencies and bond defaults will peak and are likely to exceed those of 2008/09. Nevertheless, the state funds are suitable to alleviate the symptoms of those affected and to avoid chain reactions, albeit at the price of soaring government debt, which was at a peak even before these measures were taken.

... WITH SIDE EFFECTS

In contrast to fiscal stimuli, which mostly act with a time delay and may also prove to be partially misguided or even fizzle out in certain cases, monetary adrenaline apparently still has a very reliable (re)vitalising action on capital markets. This regardless of the imponderables that affect the sales and profit prospects of companies. Investors are looking across the economic divide that politicians and central banks have spanned with a bridge of banknotes and hoping that the construct will hold up. The first thing to have a stabilising effect is the currently low interest rates now in the US, as well as some improving mood indicators. The purchasing managers indices are rising significantly worldwide, and the German IFO business climate index is also rising at a faster rate than ever before .

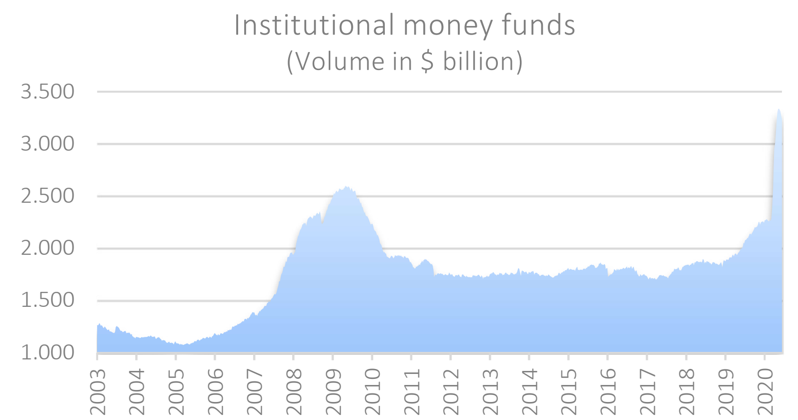
Investors look very far ahead.

[3]https://blogs.imf.org/2020/05/20/tracking-the-9-trillion-global-fiscal-support-to-fight-covid-19/

SEEING THROUGH THE CRISIS

Nevertheless, it is not certain that the stock exchanges will now play the post-corona scenario; there are too many risk factors involved. As long as the stock markets jump 4% on one day to lose 3½% on the following day (individual values do

Record liquidity in the markets

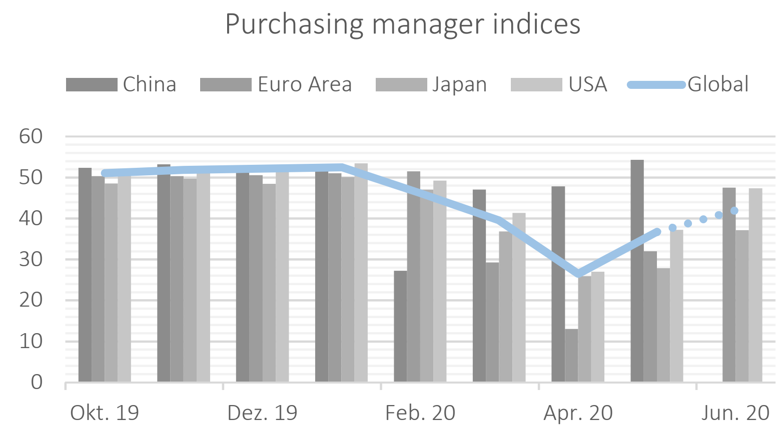


Source: FED

well with double-digit percentage jumps), there are obviously enough arguments for both risk-seeking and conservative investors. It is argued that the stock exchanges can see through the crisis and are playing out the scenario beyond it. Obviously, however, "beyond" is still not very clearly recognisable, which is why the volatility index VIX has not yet returned to its original level after the quake has settled, but remains relatively high, an indication of nervousness. So perhaps we are facing an April-like stock market summer, where in the midst of gorgeous sunshine a shower can suddenly pour down:

- On the sunny side, we are seeing record-high liquidity, which is looking for alternative investments due to the low interest rates and to some extent empty bond markets.
- While interest rates on corporate bonds usually rise in recessions, this time there has been no effect because the central banks also targeted 3rd and 4th series bonds. This secures financing for the companies (for the time being) and ensures investors attractive returns in this market segment.
- Stock marketers love the second derivative: More important than absolute sales or profit is their growth and even more important is their acceleration, albeit modest. If the lockdowns continue to ease, sales and profits could accelerate with unprecedented speed, causing the low basis from which the growth will take place to be forgotten, and the absolute figures to remain below the previous year's data for some time.
- Although the purchasing managers indices in most countries are below 50 and are thus (still) not signalling growth, the upswing has been remarkable. Statistically speaking, breaking through the growth threshold of 50 is often followed by a good stock market climate.
- Fund managers around the world are watching the market development mistrustfully. According to the latest Bank of America survey, 57% of participants believe that the current development is only an upward movement in the overall downward trend. More participants than since 1998 believe the market is currently overvalued. Regardless of how one feels about these as-

Confidence indicators are looking bright



Source: Tradingeconomics.com

sumptions, it is safe to assume that the majority of people surveyed are not very heavily invested and that if they had to make up for rising prices their forecast would not tally.

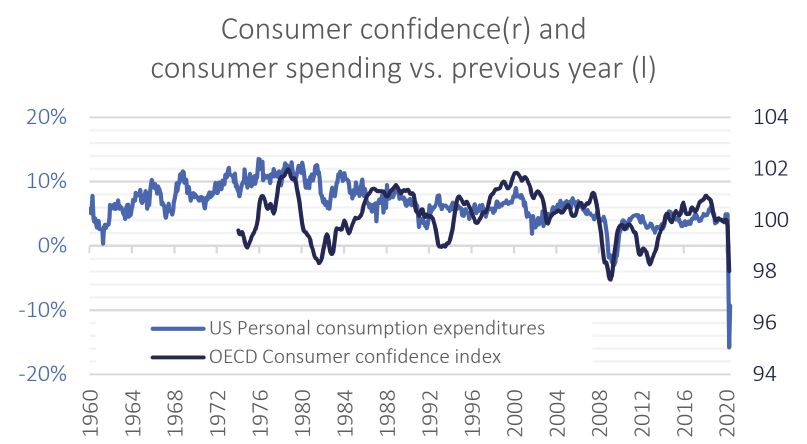
UNCLEAR PROSPECT

As has often been the case in the past few years, we are in the midst of historically unknown circumstances that do not offer any landmarks for orientation. On the negative side, the current priority is the risk that the pandemic will flare up again, even in regions where it has already subsided. Corona is not over as long as a vaccine has not been found and administered or else entire populations have been infected. In America, India and Brazil, more new infections are currently being reported than ever before, which is a very clear sign that there is a continued high risk of renewed global spread.

> The pandemic is not over. A new outbreak would be extremely challenging.

- Nationwide lockdowns, although they have been welcomed by citizens in most countries, should not – one almost wants to say *cannot* – happen again. After the emerging psychosocial and economic consequences, it is to be expected that citizens will be unwilling to countenance this. The state budgets, which are already extremely strained, would probably not permit further interventions of this nature. Managing a new outbreak could therefore prove to be extremely challenging.
- Regardless of government support measures, many economic researchers expect long-term consequences, such as bankruptcies and persistently higher unemployment. At least the current data justify the scepticism, because although the lockdowns have been relaxed almost everywhere, short-time work and unemployment rates have so far decreased only slightly, while the number of bankruptcies is already on the rise. In this respect it must be taken into account that, particularly in Europe, more than half of the fiscal programs are not grants but loans, combined with the obligation to service interest and repayments.
- Consumer confidence, which remains low, has so far not justified the positive expectations of purchasing managers. Actual consumer spending has declined more sharply than ever before since records began in 1959; neither have Amazon et. al. been able to avert this. Business analysts, such as the IMF, have so far been expecting investment, trust and consumer spending to only return gradually.
- Actual results in terms of sales and profits could be slightly lower than the expectations of companies and the "markets". Thus far, the consensus expectations for the MSCI World have been a 20% decline in profit s in 2020 (in Q2: minus 50%). However, during the financial crisis of 2008/09 companies in the S&P 500, for example, reported a drop in profits of more than 70% over the year [4]. In this context the question also arises as to how sustainably bridging loans taken out now are refinanced, taking

Consumer spending at a 60-year low



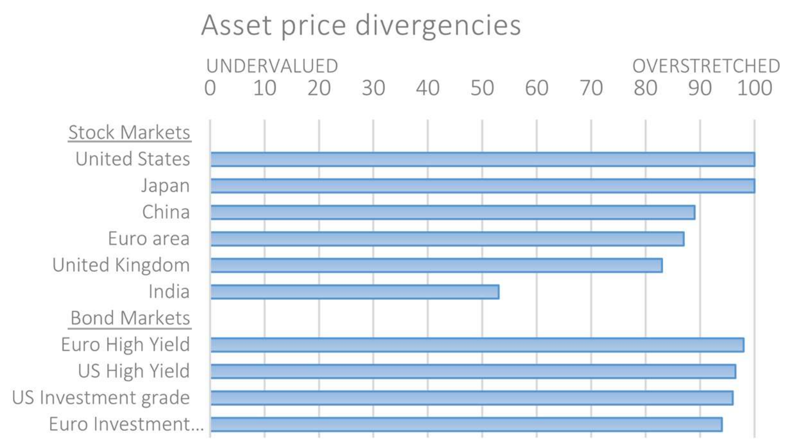
Source: OECD, FED

[4] Source: Multpl.com

into account that corporate debt worldwide had reached an all-time high before the pandemic began.

- Exchanges compensate for the future development of the economy. For this reason the dog is often a few meters ahead of the walker and there can be a perceived contradiction between economic and stock market developments. According to an analysis by the IMF, this divergence is currently extremely pronounced in historical comparison. This especially taking into account the fact that the economy had started to falter before the pandemic broke out and the US slid into recession in February [5].

Overstretched assessment levels



Source: IMF calculation

- Last but not least, it should be borne in mind that the United States is moving towards the presidential elections in November. A decision in favour of the Democrats (who could then dominate both houses) is becoming more likely. This would probably not be appreciated by the stock market, since Trump has shaped a very capital-friendly policy (taxes, health), which could be partially reversed if Biden were to win the elections.

A QUESTION OF TRUST

Under these circumstances, the stock exchanges may struggle to find direction in the coming weeks and months and volatility is likely to remain high. Trust in a revitalisation and bolstering of the economy (if not rapid, then nevertheless reliably expected) would be fundamentally important for investors, consumers, employees and the self-employed. Perhaps there is still a lack of political commitment here and there not to leave any companies stranded through no fault of their own. Perhaps there is still a lack of courage here and there to carry out the easing as consistently – and comprehensibly for the citizens – as there was to slow the economy down a quarter of a year ago. And, of course, good strategies are needed to contain new sources of the virus and to communicate them transparently. Then people will come out of their home offices, they will be happy to go shopping again, go to restaurants and travel (even outside their home country). Our economy is essentially based on consumers and their trust in their jobs, their incomes and their opportunities for development. The partially disruptive effect of the measures taken has shaken this trust, while the creative energy it aroused has still not been fully realised. The trend towards digitalisation, the connectivity of industry and services, and the critical assessment of resource consumption was already in place before Corona and has now been accelerated by the pandemic. Socio-economic change will take place faster than before. History shows that there will be a greater variety

> Courage, consistency and transparency are the order of the day.

[5] Source: Source: National Bureau of Economics

of options and solutions, not less. This also applies to the traditional corporate sector, provided that it opens up to new technologies.

NERVOUS SUMMER

One can safely assume that capital markets will not be too bold: Corona will be overcome or absorbed at some point, while the money remains in the system. And so interest rates will remain at near-zero levels longer than was apparent before Covid-19. Liquid funds continue to look for investment and should keep the prices for real assets high, although perhaps with greater fluctuations, and may drive them up further. If interest rates are close to zero, in many cases this also means a negative yield for bonds, especially after inflation has been deducted. Thus, in the longer term, bonds should continue to play a role in assets, if only because it would be unwise to expose the amassed liquidity to the risk of a bank account.

Regionally, a rotation of interest towards Europe is conceivable in view of the US election and the lower dollar attractiveness due to lower interest rates and raw materials, especially since the valuations appear more favourable here in the entire market spectrum. With regard to the choice of sector, the trend-enhancing effect for the technology sector will still be taken into account, where highs have now been reached. Our Aurelia Global CONCEPT benefits greatly from its future-oriented approach. It is conceivable that the recently oversold values of the classic manufacturing and service industries are now catching up, because on the one hand people will regain trust in their analogue everyday life and on the other hand, digital expansion also requires classic infrastructural components and services.

The decision in favour of the major direction on the capital markets – if the impact of a "second wave" can be avoided – will probably turn towards tangible assets and drive the stock markets further. For the opposite scenario, money just seems too readily available. We prefer a neutral weighting of equities in order to be able to use temporary periods of weakness for selective purchases.

Bielefeld, 3 July 2020
Matthias Steinhauer