

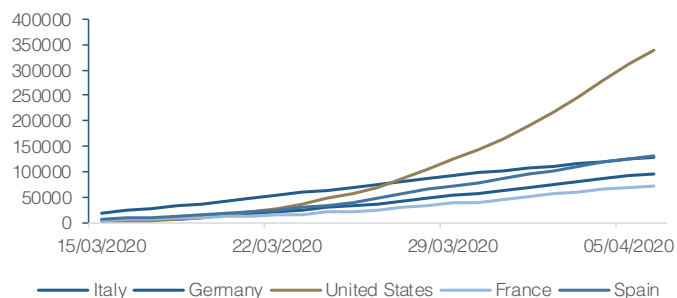
House View

April 7th 2020

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The pandemic continues to spread worldwide. While the rate of new infections in Europe is slightly declining, the USA has become the epicenter of the outbreak. The economic impact is enormous and increasing from week to week and the full extent of which cannot yet be predicted. We fear that the closure of schools, restaurants and unimportant shops will continue for weeks.

TOTAL CORONA CASES AS OF APRIL 7th 2020

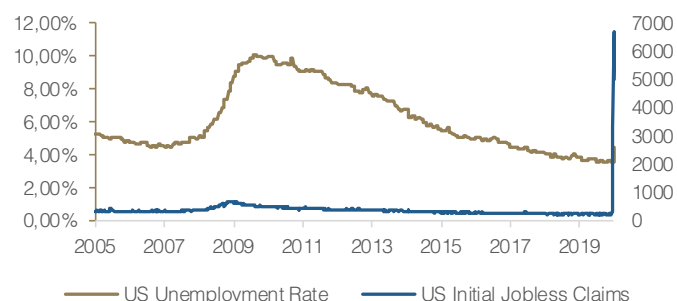


Source: European Centre for Disease Prevention and Control (ECDC)

The reaction of the governments was quick and massive. As expected in our last "House View", central banks and governments around the world have stepped up their stimulus and aid packages. The blow to national budgets and, consequently, the prospects of a massive increase in long-term public debt are already evident. Although there are initial signs of recovery, we believe it is still too early to expect a bottom to be behind us. Far too many factors are unclear at this stage, both the extent to which coronavirus infections are developing and the measures (and timetable) being taken by authorities around the world to slow their spread. The stagnation in many parts of the economy has led to a collapse in projected economic growth rates to a deeply negative level, well beyond the pace of decline of the 2008 financial crisis.

Workers around the world are suffering the initial shock of the coronavirus recession, with millions of jobs lost and social welfare claims already being made worldwide. Given the pain we see in the United States and Europe in the near future, this is unprecedented on this scale since the Great Depression. The number of Americans claiming unemployment benefits rose last week to a record 6.65 million, more than double the record set last week. The 9.96 million combined claims from these two weeks represent the total number for the first 6 1/2 months of the 2007-2009 recession. Goldman Sachs predicted that the unemployment rate will soon rise to the record level of 15%.

US UNEMPLOYMENT RATE / INITIAL JOBLESS CLAIMS



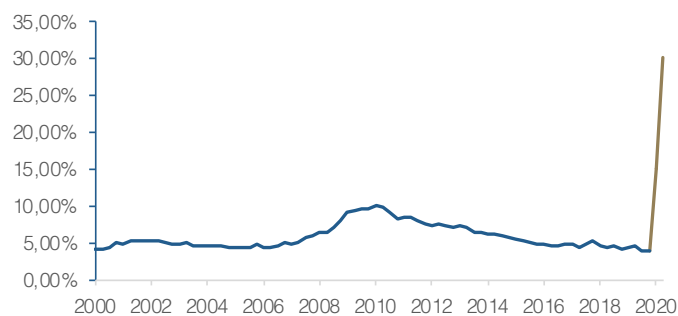
Source: Bloomberg

Unlike the financial crisis of 2008, when a flood of subprime debt sent house prices to astronomical levels before everything collapsed and terrified a whole generation of home buyers, this time the housing sector faces a far

more conventional problem: the sudden and unpredictable inability of mortgage borrowers to make their scheduled monthly payments, while the entire economy comes to a standstill due to the coronavirus pandemic. Unfortunately, the crisis will be even worse than 12 years ago, as Bloomberg reports, mortgage banks are preparing for the biggest wave of defaults in history.

Borrowers who have suffered loss of income due to the coronavirus can request that they suspend payments on government-backed mortgages for up to 180 days, avoiding penalties and a hit on their credit score. But as Bloomberg notes, it's not a payment holiday, and homeowners will eventually have to make up for everything. According to estimates by Moody's Analytics chief economist Mark Zandi, up to 30% of Americans with home loans - about 15 million households - could suspend payments if the US economy remains closed until the summer or beyond.

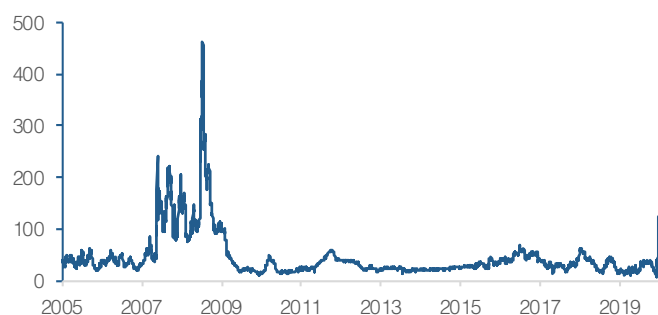
DELINQUENCIES AS % OF ALL MORTGAGES



Source: Bloomberg

The FED has launched an unprecedented program to purchase corporate debt. While this keeps bond spreads from rocketing higher which could trigger a financial crisis by itself, but it does not really help to save companies from bankruptcy. We still believe that there will be a massive number of loan defaults. The other problem is that the FED has so far only been allowed to buy investment grade bonds, but we are already seeing many downgrades by rating agencies. A prominent victim is Ford, whose outstanding debt amounts to about 36 Bio USD and is now rated as junk. Another worrying indicator is the TED spread, having reached levels unseen since the financial crisis.

TED SPREAD



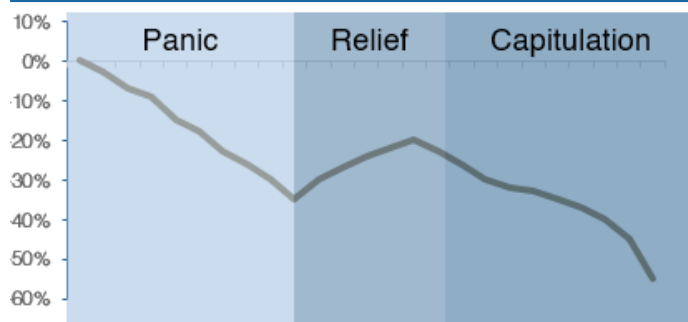
Source: Bloomberg

In our last "House View" of March 23rd, we outlined a number of different scenarios for the S&P 500. We still believe that the view expressed at that time is still valid. After experiencing its worst quarter for equities since Q4 2008, the S&P 500 rose by around 20% from its lows but is still around 25% below its highs. During bear markets, so-called fake head rallies are common-place and can at times be very strong. The entire set of policy news

(huge monetary bazooka, huge fiscal bazooka) appears to be priced in. The two things that are not priced in is the spread of the epidemic and how bad the economic news are going to be. We take the view that much good news are now being priced in, while the pandemic's consequences are still very much unclear.

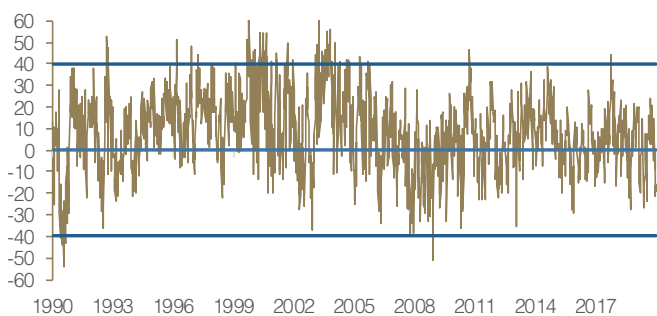
In a crisis, market participants tend to behave in a certain way, there are 3 phases in a market crash: panic, relief and capitulation. We believe that we have not seen the capitulation yet and that we will soon reach the end of the relief phase.

STOCK MARKET CRASH PHASES



When will we know that the capitulation has happened? We can never be certain, but one indication that has been quite accurate in the past is what is known as the bull/bear spread. These indices reflect the sentiment of individual investors towards the stock market over the next 6 months. Only twice in the last 30 years have we seen negative values of more than -40. Once close to the lows after the first Iraq war, after the stock market had fallen by almost 20%. The other time in early March 2009, almost at the lows of the financial crisis. At the moment we have a value of only -15.5, which we believe is another sign that the capitulation phase has not yet taken place.

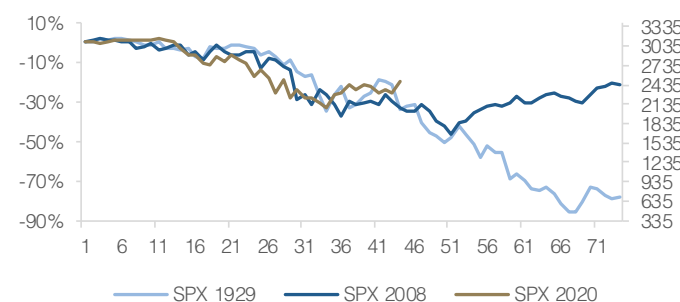
AALL US INVESTOR SENTIMENT "BULL - BEAR" READINGS



Source: Bloomberg

Two points may be observed when looking at the source of demand for stocks towards late March: The quarterly rebalancing led to a considerable buying demand, as passive funds, but also many active funds had to rebalance their equity quotas. In recent years, the largest net buyers in the US were companies that bought back their own shares. We have already seen a slowdown in share buybacks before the pandemic hit. The conditions for government support will likely suspend repurchase programs, before it is repaid.

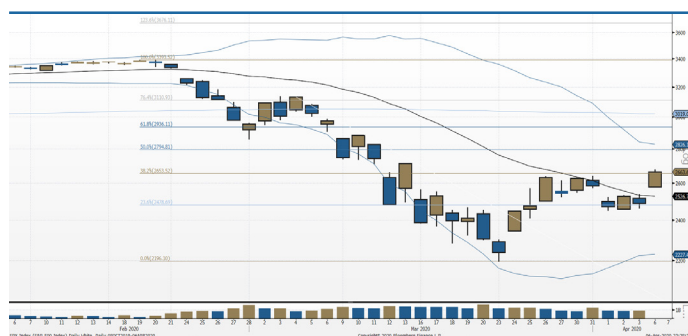
S&P 500 CURRENT SITUATION VS 1929 & 2008 CRISIS



Source: Bloomberg, Note: Forward Looking Data 2008 Weekly & 1929 Monthly adjusted

We believe that volatility will remain high for some time to come and most likely to jump again when the market enters the capitulation phase. The market rally retraced about 38.2% of the previous downmove. We believe that the downside from here is much greater than the further recovery potential.

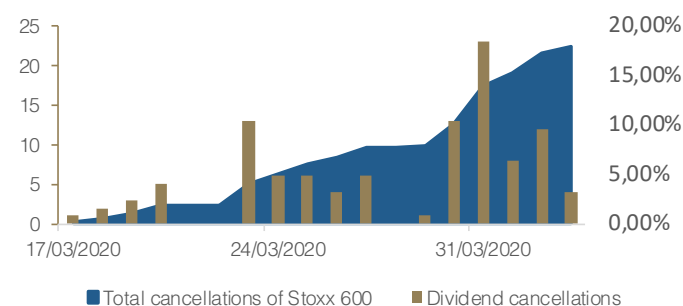
S&P 500



Source: Bloomberg

The damage to profits caused by the pandemic and the supervisory authorities' demands for liquidity protection has so far (as of April 3rd) prompted 107 companies in the Stoxx Europe 600 Benchmark Index to cancel or postpone their payouts. By comparison, only 10 S&P 500 companies so far have suspended dividends, and a further 21 are expected to reduce their payouts in the second quarter.

STOXX 600 - DIVIDEND CANCELLATIONS



Source: Bloomberg

We fear the current crisis to become a pivotal moment in history, as a number of economic areas will undergo a wave of deglobalisation: more tariffs, more protectionism, more defence of its own companies and its own workers, more domestic policies, more restrictions on trade in goods, services, labour, capital and technology. This is a massive negative supply shock for the world economy. With the announced stimulus, both fiscal and monetary in nature, the risks associated with the current policies at one point will be stagflation, with memories to the 1970s flashing up.

POTENTIAL TRIGGERS FOR A FURTHER MARKET RALLY THAT WOULD REQUIRE A REASSESSMENT OF OUR SCENARIOS

- ▶ Availability of effective drugs against the coronavirus.
- ▶ Discovery of a vaccine against coronavirus.
- ▶ Central banks including High Yield bonds and potentially even equities in their purchase programs (although at significantly lower price levels than at present).
- ▶ Earnings season: Less than expected damage to the companies and their forecasts.

POTENTIAL TRIGGERS FOR A RENEWED DOWNWARD MOVEMENT OF THE MARKET

- ▶ Second wave of infections in China, which would lead to another lockdown.
- ▶ New, stricter and longer measures, especially in the USA.
- ▶ Earnings season: Worse than expected impact on forecasts.
- ▶ Major companies filing for Chapter 11 or seeking negotiations with banks with the aim of renegotiating existing loan agreements.
- ▶ Market psychology: Market participants who bought now to catch the bottom will be forced to sell again if the market falls in an initial phase.

CONCLUSION

- ▶ The uncertainty clouding the outlook will continue in the coming weeks. The severity and the duration of the current shock are simply not yet conceivable.
- ▶ So far unknown how long it will take to get government support funds into hands of businesses
- ▶ It is unclear on how the economy will eventually be restarted
- ▶ The post-crisis changes to the economy are little known.
- ▶ We continue to view the downside risks to equity markets to clearly outweigh the short-term appreciation potential and therefore recommend to wait with adding to equity exposure in any large amount.
- ▶ If you still want to enter the equity market, we recommend that you focus on sectors and stocks that will benefit after the crisis. One route of action could be identifying sectors and companies and writing puts out of the money in order to profit from the high levels of implied volatility.
- ▶ Based on our inflation scenario, we recommend buying TIPS (Treasury Inflation-Protected Securities).
- ▶ In general, we prefer corporate bonds with a good credit rating over equities at this stage due to the coordinated actions of the central banks.
- ▶ The long-term prospects for gold are still bullish. If the capitulation phase comes as we expect, correlations among asset classes are expected to increase again (and gold therefore selling off in the short term as well). If we see this weakness building up, we suggest adding to positions.

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