STGFM Insight

Days of Decision

30.10.2020

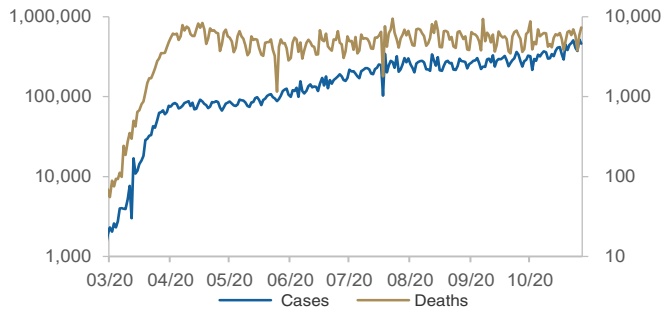
This document is intended for marketing purposes.

St. Gotthard
Fund Management

The year 2020 has to date brought a remarkable set of events. In the coming weeks, however, we will experience another period that could shape the coming years in a decisive way. Both the second wave of the worst pandemic in a century and the federal elections in the US on November 3 (including a likely period of heavy battling in the courts that could last several weeks or even until early January) will have repercussions that will be felt for a long time and hence could define financial market trends for years.

Covid-19's second wave in many countries has already reached worse levels in terms of the global number of infections (400'000 daily vs. about 100'000 during the April/May period), while the number of SARS-CoV-2 related deaths remains below the first peak (5'000 today vs. 10'000 in early April). With last four weeks' steep increase in infections especially in Europe, but also in parts of the US and other areas, mobility restrictions are being reinstated in many places, with the effect of another strong disruption of the real economy. This time around however, a complete production halt in many industries should be avoided, but only time will tell whether the impact on economic growth will be contained relative to the situation in the second quarter of this year.

GLOBAL NUMBER OF COVID CASES AND RELATED DEATHS



Source: Bloomberg

We had feared that a second wave could strike in fall (STGFM House View, 2.6.2020), but the current situation is morphing very rapidly into a high-risk scenario in which a stabilization of infection numbers needs to be seen shortly, otherwise another risk-off wave on financial markets must be braced for. It is striking how optimistic investors appeared to be, considering the all-time highs of US equity indices that were reached in early September while the plunge in economic activity during Q2/2020 (and possibly again in the coming two quarters) was the biggest since the Great Depression. As we had written, the stock market valuation now has reached levels (based on 2021 estimates) not seen since 2002, whereafter markets plunged by about a third to the subsequent lows. But that was in a time when 10-year Treasuries yielded around 5% p.a. – compared to today's 0.80%.

10-YEAR US TREASURY YIELD AND S&P500 EST. P/E 2021

Source: Bloomberg

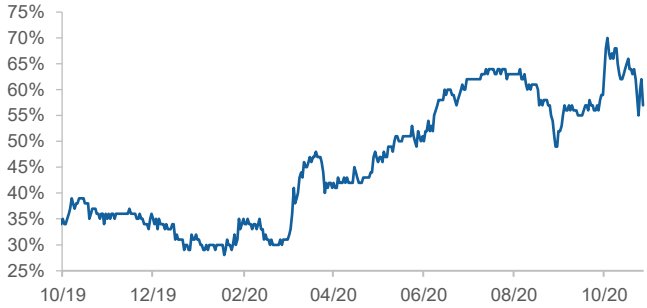
This brings the loose monetary reins into focus, offered by the generosity of central banks worldwide. So long as the liquidity taps keep flooding, investors feel reassured of the lenders of last resort having their back, should any major shock (such as the raving pandemic) happen to weigh on the real economy. Central bank leaders around the world herald their ongoing support whilst calling for further fiscal stimulus, i.e. government expenditures. In many countries, Treasury departments are continuing to dole out support payments to the battled economies and consumers, however some programs have expired and there appears to be more reluctance to jump in again in a number of nations, among them the U.S. There, stimulus talks between the White House and the Democratic House Speaker Pelosi have stalled. With the prospect of a disinclined Senate Majority in the hands of the GOP, and the elections only days away, a bipartisan agreement looks increasingly impossible, leaving the real economy at risk of contracting heavily.

MAJOR CENTRAL BANKS BALANCE SHEET GROWTH RATE P.A.

Source: Bloomberg

The result of the elections in the US, as open as they appear at this point, will be felt globally. Whether we see another four years of semi-isolationist Trump or a more multi-laterally oriented Biden administration, will have repercussions on many global issues such as trade, climate policy, security alliances and many more. We take the view that major infrastructure projects and a further generous payment scheme to unemployed workers could be achieved under both presidents. More important will be the Senate majority, as it can block legislation to a high degree. With "the power of the Purse" in the hands of Congress, both chambers need to pass fiscal stimulus, leaving the Senate in a very powerful position.

PROBABILITY OF DEMOCRATIC SENATE MAJORITY



Source: Bloomberg, www.predictit.org

Many polls hint at some form of a blue wave, i.e. the Democrats' taking of the White House and both chambers of Congress, and that is also what markets appear to expect, considering the meteoric share price rise of some renewable energy sectors such as solar energy (outperforming the US market by more than 90% since June). With the possibility of a result that

once again defies the polls, several industries, among them energy, financials, and the materials sector in general, could leave their long-term downtrends and move to new highs, in case we see another four years of a Trump administration (seconded by a Republican Senate).

Should a blue wave materialize in November, likely dragging on for at least days, green energy stocks will continue to thrive, but one group of shares seems to have been missed by investors: cannabis stocks. These are lagging the market, in spite of vice presidential candidate Harris touting a federal legalization of marihuana within three months after the inauguration. In the case where the Democrats take power, we expect a significant rise in volatility, not only on equity markets, but also in fixed income and commodities. A blue wave would in our view lead to new levels of government stimulus, both fiscal and monetary, leading to the clearest "reflation scenario", i.e. the swiftest economic recovery thanks to heavy government support. How markets were to take this, is another question, as inflationary pressures are likely to emerge quickest in this scenario, leading to an upward pressure in yields in the medium term. Sector-wise, the fossil fuel-based energy sector will continue to underperform, while financials will have to cope with new regulation, weighing on the sector for years. The IT sector could face strong headwinds as well, despite the fact tech companies are leaning more towards Democrats. Commodity prices, on the other hand, should remain well bid, both due to a more environmentally-focused regulation limiting supply and the expected rise in demand thanks to the economic recovery once the pandemic has passed. Also, precious metals should see continued strong demand as the risk of a stark rise in medium-term inflation looms most in the event of a Democratic victory.

SOLAR ENERGY ETF RELATIVE TO S&P 500 (REBASED)

Source: Bloomberg

What if President Trump were not to accept the results? Judging from his many tweets deriding mail-in-ballots and accusing his opponents of "rigging the election", there is a chance that the results – if suggesting him to lose – will be disputed by the Trump administration. Such a scenario, especially if dragging on for weeks, could weigh strongly on investor sentiment. We do not fear a civil war breaking out, but there is a possibility of social unrest which, in view of the many armed and trained militias in some states, could for a certain period bring tension to a number of regions within the U.S. A strong sell-off in connection with such a scenario could be used to build up positions as we do not see the US democratic institutions ("the checks and balances of the Constitution") that have been in place for almost 250 years, to simply crumble and disappear.

Covid will continue to dominate the headlines for several months. A vaccine is being developed by a number of different joint ventures and some clinical tests have shown very promising results. In view of the lengthy process of permitting a new vaccine (even in fast track mode), the ramping up of production and distributing it to the population, it is highly likely that only in spring will we see the beginning of the end of the pandemic. A return to normalcy would then be possible in the third quarter of next year. We must therefore brace for difficult months ahead, with restrictions in many countries to be ramped up in the coming days and these to remain in place until spring.

CONCLUSIONS

- A bumpy road for financial markets lies ahead of us. While we do not expect a move similar to the one in March, when markets plunged precipitously, we currently recommend a cautious investment strategy.
- We expect some form of a return to normalcy only in the summer of next year. Therefore, we deem it too early to sell the winners of the pandemic and buy shares in battered sectors such as tourism.
- The elections in the US on November 3 have the potential to rock markets, especially in the case of a contested election dragging on for weeks.
- We place emphasis on the Senate majority, as in the case of a remaining Republican majority, chances are high that the legislative process will be blocked, not boding well for the necessary additional stimulus.
- A Biden presidency implies further pressure on fossil fuel-producing companies and also the financials sector. The booming tech sector could see its wings clipped by new anti-trust regulation as well.
- Should Trump be re-elected, we expect a strong up-move in energy stocks and materials in general.
- A blue wave, as expected by the majority of pollsters, should lift inflation hedges such as gold and other real assets like commodities. With purchasing power to be eroded in the coming years, we can see another leg up for the cryptocurrency complex.

Disclaimer

This document is for information and advertising purposes only provided by St. Gotthard Fund Management AG ("STGFM"). For further information, please consult the documents which are available at www.stgfm.com or contact STGFM. STGFM is domiciled and regulated in Switzerland. The above figures refer to a simulated past performance and simulated past performance is not a reliable indicator of future performance. A gain in value in the past provides no guarantee of positive performance in the future. The above figures are presented gross of fees. Before investing in a product please read the latest product docu¬ments (e.g. this teaser, factsheets and prospectus) carefully and thorough¬ly. The documentation is available free of charge in English and, where rel¬evant, in one of the local language(s) where the product is registered. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or develop¬ments referred to in the document. Members of STGFM may have a position in and may make a purchase and/or sale of any of the securities or other financial instruments mentioned in this document. The product mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States and other countries. Please contact your tax and legal advisor. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments.

The risk of price and foreign currency losses and of fluctuations in return as a result of unfavourable exchange rate movements cannot be ruled out. There is a possibility that investors will not recover the full amount they initially invested. The performance data do not take account of the com¬missions and costs incurred on the issue and redemption of the product. Commissions and costs have a negative impact on performance. The in¬formation in this publication is intended for information purposes only and does not represent an offer, solicitation of an offer, public advertisement or recommendation to buy or sell any investment or other specific prod¬uct. It is recommended that advice be obtained from a qualified expert. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient. The details and opinions contained in this document are provided by STGFM without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of STGFM. Source for all data and charts (if not indicated otherwise): St. Gotthard Fund Management AG. The place of performance and jurisdiction is at the registered office of STGFM.

CONTACT US

Gotthardstrasse 14
6300 Zug
Switzerland
+41 (0) 41 544 91 20
info@stgfm.com
www.stgfm.com

St. Gotthard
Fund Management