Swiss Enhanced Dividend Strategy (SEDS)

Yearly Review 2020

This document is intended for marketing purposes.

St. Gotthard
Fund Management

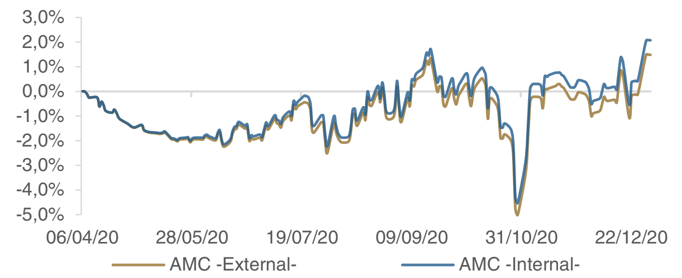
Market Review

2020 was a year that will not be forgotten for a long time. Having started on a bullish note, the negative news out of China regarding an outbreak of a novel virus were at first overlooked by the market – the 2020 Swiss equity market high took place on February 20. Market participants however rushed to the exit, leading to drawdown of more than 25% within a mere three weeks.

In the wake of substantial monetary and fiscal stimuli being announced, equity markets were able to find a bottom in mid-March and started to head north again, despite devastating lockdowns and an instant recession that sent the unemployment rate to levels unseen since the Great Depression in many countries. The governments decisive stance in quelling the negative consequences cushioned the effects on the real economy, while the longer term fiscal outlook is clouded by the enormous increase in government debt that we witnessed globally.

The prospect of vaccinations of large parts of society by mid-late 2021, enabled by the development of several different vaccines, has given a further boost to stocks. Valuation-wise, stocks appear expensive by themselves, but with the explicit support of central banks to keep interest rates at very low levels, even pricier valuations could be justified, based on the risk premium argument. Much will rest on the development of inflation rates – should they start to rise steeply, the party may be over sooner than many think. But for the time being, the punch bowl has not been taken away.

PERFORMANCE SINCE INCEPTION



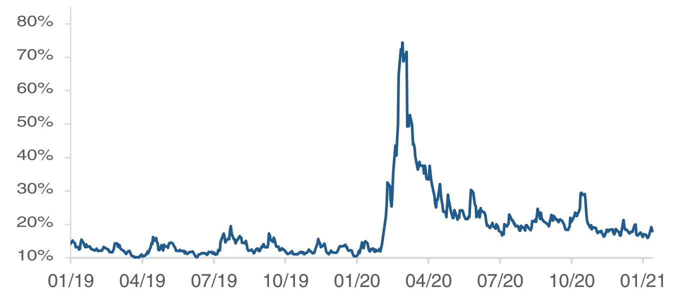
Strategy Review

We started investing the strategy in a very cautious manner, as we had expected markets to fall further in the wake of a real economy that ground to a halt in many sectors. With the markets continuing to rise, we started to open some positions in order to generate income from covered calls, while we decided to keep the cautious stance, insuring the portfolio against steep falls, which weighed on performance. During the month of May, the relatively high cash allocation (to be employed in a steep down-move) cost relative performance again.

During the months of June and July, we increased the exposure significantly (to a delta-adjusted level of 60%) and were able to reap the benefits of the option-writing strategy, as the market basically went sideways, with some income used to buy protective puts in case a significant drawback came. In the second half of July, a correction set in, during which Swiss equities shed 5%. The drawdown in the strategy was only half, displaying the cushioning effect of option writing.

September was similar with July, with the market rallying in the first half (until about the option expiration date), and then shedding all the gains into month end. The result was overproportionate premium income, thanks to the elevated volatility levels, while capital losses cost much of the received premia.

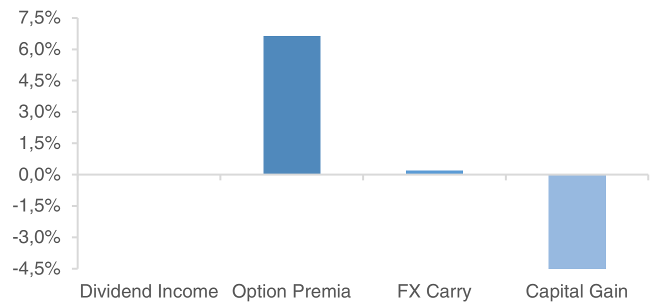
SMI IMPLIED VOLATILITY INDEX (VSMI)



Source: Bloomberg

The month of October, with its steep 8% down-move from mid-month until the second-last day, was difficult. Risk aversion rose steeply, as the US elections cast their shadow globally. Very steep moves within a couple of weeks as the one in October are a challenge to the strategy due to the fact that returns on covered-call positions by definition are capped, while the downside, while cushioned by a steady income, remains damaging. Over time, the impact of such events will diminish thanks to their relative rarity – the early November boost in the SMI in the order of more than 7% in a week statistically has happened only once every four years, while the drawdown during the last week of October (-4.4%) usually happens one and a half times a year, taking SMI data of the past 30 years as a basis (about 1600 weekly observations).

P/L CONTRIBUTION SINCE INCEPTION



From the trough in late October, the strategy again gained about 7% until year-end, ending the year some 2% above the level in April. The period of the mid-November to mid-December is instructive about the strategy's advantages: While the SMI (after a strong up-move during the first two weeks of November) lost more than 1%, the strategy stayed virtually unchanged.

Summarizing, 2020 was not the easiest year for our strategy (as for many others). Looking ahead, we expect somewhat less choppy waters, translating in a lower volatility for both the equity market and the strategy. This should help sharpening the call-writing approach's advantage of significantly lower historical volatility (while implied volatility to remain elevated), while over-proportionately keeping up with the returns of the underlying equities.

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