January 2021 | Issue no. 120

Briefing from the ARVEST Investment Committee

Despite all the turbulence in the financial markets, many asset classes were able to close 2020 with a positive return. Crucial factors behind this development were the unabated aggressive supply of liquidity by central banks and the fiscal programs in the U.S.A., Europe, China and Japan. In reaction to the recessionary shock in March and April 2020, triggered by a wide range of mobility and economic restrictions to combat the Corona pandemic, governments around the world adopted far-reaching support measures in favor of the population and businesses.

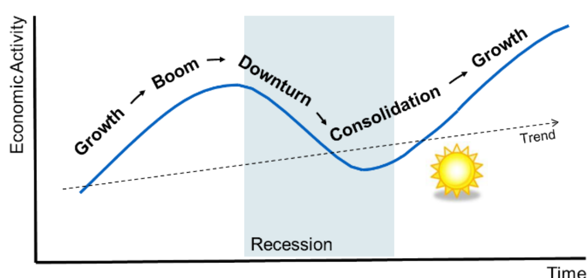
However, as the liquidity obtained in this way was not immediately needed in full, a considerable part of it was saved for the bad days ahead. This is consistent with the usual behavior during recessions. This time, however, in view of low or even negative interest rates on bank accounts, this cash pile flowed straight on to the stock markets. Particularly in countries with a strong equity culture and liquid financial markets, the Corona crisis thus acted as an amplifier. The stock market crash and the recession, as far as technically measurable in economic data, lasted only a short time. Investors did not throw their conventional beliefs overboard, according to which, for example, double-digit profit growth for many leading US companies would be assured for many years to come. This was different in previous recessions. Usually, there was a shift in thinking during periods of upheaval. Last year, growth stocks that had already posted strong gains before the pandemic benefited most from the sustained euphoric investor sentiment, regardless of their exorbitant valuations. Despite a weak U.S. dollar, U.S. technology stocks were the most successful performers. After the outcome of the US elections became apparent, the world press was increasingly less concerned about economic policy risks. Thanks to rapid successes in the development of several vaccines against Covid-19, confidence in a real economic recovery also rose since November 2020. These hopes for a more upbeat 2021 fueled the year-end rally in cyclical assets that had previously lagged.

Volatile asset classes such as precious metals and speculative cryptocurrencies were also in demand. But even the already very expensive bonds were able to record further price gains. The continued increase in financial repression

by central banks led to bonds with poor credit ratings being in demand again very soon. After all, investors can hardly make any more money with investment grade bonds, as one-third of these securities worldwide already have a negative yield to maturity.

Future Prospects

We started 2020 with a rather low equity allocation. In particular, the high valuations of leading companies made us cautious. After the price crash in February and March, we kept the equity allocation stable by adding cyclically sensitive securities. This paid off particularly in the fourth quarter, when we also slightly increased the equity allocation, which we opted to do as the technical recession was likely over.



Even if many of the measures taken will only have a negative impact on the economy in the future, more confident sentiment indicators and the ability and willingness of central banks to steadfastly provide liquidity to markets and governments should consolidate the immediate recovery. Fortunately, the scenario envisioned in last April's Investment Commentary of a brief recession and an equally rapid economic recovery has come to pass.

However, we believe that the high valuations of leading U.S. growth stocks are a major threat to rising stock prices across the board. As a general rule, the level of valuations of equities, as measured by fundamental company data, is of little relevance to the short-term price performance. In the long term, however, this becomes the most important factor for investment returns.

A critical time often comes when market participants begin to expect tighter monetary and fiscal policies. Then it may become clear whether we are already effectively back in bubble territory, where short-term hopes collide with long-term truths. A drying up of government financial injections or even higher than desired inflation would be relevant warning signs. Also, the supremacy conflict between the U.S. and China is likely to continue to preoccupy us. There is therefore a real risk that the current growth phase will be shorter than in the last three economic cycles, which lasted more than five years each.

We expect financial markets to remain volatile, as the high valuations leave little room for disappointing developments. As the supply of equities remains tight compared to bonds, we remain convinced of good quality equities with reasonable valuations in the long term. We continue to see considerable recovery potential for more attractively valued cyclical equities. However, we will continue to build up the equity allocation only with a high degree of discipline.

14 January 2020
On behalf of the Investment Committee
Stefan Kimmel
Chief Investment Officer ARVEST Funds AG

This report represents opinions expressed by ARVEST Funds AG, is exclusively for informational purposes, is not an offer to invest in investment products and does not make any claims related to completeness. The investments or strategies mentioned in this report are subject to suitability testing and do not replace a competent advisor. Investments may include significant risks. The value of an investment may go up as well as down. Past performance is not indicative for future results. Units of investment funds mentioned in this report may be restricted with respect to certain jurisdictions. Investments in funds are made exclusively on the basis of the official fund documents. These may be downloaded at www.arvest.ch.