BASTIONS PARTNERS OFFICE SA

Investment Review

January 2021

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Environment: 4th Quarter 2020

The last quarter of the year was quite volatile as the uncertainty about the US elections results was high. The victory of Mr. Biden was tainted by the refusal of President Trump to concede and the increasing cases of Covid in Europe and the United States. At the end, the markets decided to concentrate on the positive news of an upcoming global recovery, where China would play a leading role, and the approval of several Covid vaccines.

Environment: 2020 in a few words

2020 was a shocking year in many aspects but it ended as a positive year for both risk assets and safe havens. The way the pandemic accelerated and the severity of the lockdowns were beyond anyone's expectations.

The size of the government stimulus and the magnitude of the equity market rebounds were also unprecedented. Asset prices diverged from the real economy throughout 2020. Massive monetary stimulus led to very strong returns for almost all assets in the final three quarters of the year. Technology, and consumer discretionary, particularly social media and e-retailing, were the strongest equity sectors in 2020. These sectors saw their business models unimpeded, and in some cases rewarded by the lockdowns put in place to fight the pandemic.

Environment: 2020 in a few words

Oil saw increased production in the early months followed by plummeting demand once lockdowns began. This led to a short period where WTI prices moved into negative territory.

Government bond yields fell to record lows in the summer, as safe heaven demand increased and central banks made aggressive purchases.

The Nikkei outperformed the developed world in USD terms, and emerging market equities saw strong performance from China and Korea. UK equities were the significant regional laggard, hurt by an uncertain economic backdrop with Brexit unresolved until year end and the large weighting to the underperforming energy and banking sectors. Gold was up by 20% for the year and the euro was the strongest major currency rising 7% against the USD.

Outlook 2021

The promise of effective Covid-19 vaccines is a game changer. Despite the current dire situation, with high levels of new infections in the United States and Europe, it encourages us to anticipate a return to pre-pandemic activities. The combination of mass vaccinations, public health measures, massive government spending and monetary policy support should accelerate the economic recovery. A change in the US/China dialogue under the Biden administration should enable a revival in global trade and an improved business climate. This should encourage a strong upturn in emerging economies. China's recovery in activity and more domestically driven economy makes its equity markets increasingly uncorrelated to those of the rest of the world. The country and the world would of course be the earliest beneficiaries of any thawing of trade relations with the United States.

The initial months of 2021 may see muted growth as government imposed restrictions and a cautious population led to a contraction in January. However, fiscal and monetary stimuli and a range of Covid vaccines underpin our positive view.

Outlook 2021

Globally, we will be watching for a continued recovery in employment which should provide further impetus to household's consumption growth. We do not expect economies around the world to regain the level of employment it had in early 2019 for several years. The vast number of layoffs across so many industries may be longer lasting than expected. Many companies have realized they can do more with less during the shutdown.

Assuming these scenarios are set in motion, the challenges that we will face as investors will be on the asset allocation side as it will be more difficult than ever to find acceptable returns in the fixed income markets, a traditional preferred area for our clients. Fixed income has always been seen as the safest and less volatile portion of a portfolio, 2021 could be the year where investors might be disappointed. Indeed, we are already seeing signs of pressure on the interest front in the United States.

Outlook 2021

Money supply surge in 2020 was the largest in 150 years. The money created by the Fed in response to the Covid-19 crisis is not going only into excess reserves in the banking system. It is going directly into the bank accounts of individuals and firms trough the US Paycheck Protection Program, stimulus cheques, and grants to state and local governments. Inflation will run well above the Fed's 2 per cent target, and will do so for several years. It is inevitable that bond rates will rise and this is not good for bondholders. As a result, we are currently underweighted on the fixed income side.

On the contrary, we expect a supportive environment for risk assets. We believe a thematic approach to equity investing is appropriate at this stage of the market cycle. Sectors with clear regulatory tail winds, or benefiting from new technologies versus incumbents with broken business models are positioned to deliver outsized growth as the recovery matures. Clean Energy, Fintech, and 5G are themes that we favor in 2021. Clean Energy has a major role to play in the economic recovery and fiscal spending and regulatory tail winds should spur lasting growth in the sector. Shareholders emphasis on "ethical and green" also support share prices.

Outlook 2021

Fintech through mobile payments, e-commerce and infrastructure for crypto currencies is a sector growing rapidly. The traditional banking model is unprofitable without interest rate margin and disruptive financial technology companies are taking market share. Companies providing infrastructure for the 5G rollout, new smart phones and business models based on rapid connectivity are all positioned to deliver outsized growth on the back 5G high speeds and low latency.
Another theme in which we are participating in 2021 is industrial metals which are likely to enter a Supercycle with a surge in demand from spending in the low carbon economy. Gold will remain well bid and should outperform again this year.

On the currency front, the U.S. Dollar remains the top funding currency. According to the Bank for International Settlements, half of all cross-border loans and international debts are still denominated in USD and 61% of official foreign exchange reserves. But the USD is losing momentum. The return to a rules-based system of trade under a Biden Administration, a less protectionist White House, and a world recovery will be key ingredients for a USD decline.

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