MARKET COMMENTARY

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MANOEUVRING THE CRISIS: US LARGE CAPS PLUS GOLD

Before the global economy can breathe easy again, the air will first become even thinner. That being said, Bergos Berenberg's capital market strategist Till Budelmann is somewhat more optimistic about 2021. This optimism seems to have already become a reality in markets. He still prefers US equities. The economy there has often proved to be better at recovering from a downturn. Moreover, the sectors that have benefitted the most from the crisis are strongly represented there. A gold overweight is a natural hedge against the great uncertainty surrounding the expected recovery.

The economic forecasts are indeed not very promising: Bergos Berenberg estimates that the US economy will undergo a mid-single-digit contraction in 2020. And for the Eurozone, the independent Swiss private bank anticipates a GDP contraction of almost ten percent. Germany will suffer the least of the major European economies, with a GDP contraction of eight percent.

No doubt, the economic outlook is devastating. However, equity markets have been rising again recently. Till Budelmann does not consider this to be unusual: "The stock market is a huge discounting machine. It does not look at the present, but always to the future. The stock market today is nothing other than the mirror reflection of all discounted corporate profits from now to perpetuity." That being said, Bergos Berenberg's capital market expert was rather surprised by how resilient the market has been in the last few weeks. Disappointing profit expectations have been punished less severely than usual. The S&P 500 is now roughly at the level where it was a year ago even though the situation has completely changed in the meantime: Unemployment has exploded, leading economic indicators have nosedived, oil prices have collapsed, and volatility has multiplied. Budelmann: "Many market participants seem not only to be looking to the future, but are completely disregarding all the problems and are acting as though we were already in the middle of the recovery phase."

ECONOMY AND EARNINGS GROWTH TO RECOVER IN 2021

After the weak first quarter of 2020, Budelmann sees a much weaker second quarter before the economic recovery begins in the second half of the year. He expects positive growth rates to return, in both the United States and Europe, in 2021.

And corporate profits, which will probably decline by 20 to 30 percent for the S&P 500 Index, for example, should rise significantly again in 2021 – provided that the pandemic does not worsen again. "A renewed lockdown of economic activity would be devastating. The equity market has definitely not priced this in", Budelmann said.

Despite the great uncertainty hanging over markets, Budelmann considers equities to be attractively valued compared to bonds. The earnings yield of equities is still substantially higher than bond yields. Another argument in favour of equities is the enormous liquidity being provided by central banks and fiscal policy across the world. "The markets are being flooded with money. Policy makers want to prevent a major financial crisis at all costs", Budelmann said. Investors are poised to jump in: "Money market investments have soared in the last few weeks. All this money is ready to be invested again at some point", Budelmann said.

US EQUITIES: DECISIVE FED, MEGA FISCAL PACKAGE AND STRONG WEIGHTING OF CRISIS BENEFICIARIES

His preferred market is still that of the United States. In particular, he sees the best opportunities in large corporations. "The US central bank reacted to the crisis very quickly and much more decisively than the European Central Bank", Budelmann noted. Moreover, US companies have already proved to be more resilient to past crises and have recovered more quickly afterwards."

He sees another advantage in the fact that many US companies generate most of their revenues domestically: "The latest monetary policy measures and the fiscal package, which at 13 percent of gross domestic product is the world's biggest, will benefit the US economy." Moreover, the US equity market enjoys a structural advantage: Its sector composition is less cyclical than that of Europe or emerging markets. In the United States, those sectors are dominant that are currently benefiting the most from the crisis: technology, healthcare and the new communications sector created in 2018, which also happens to include Netflix as the clear winner of the crisis.

Budelmann currently sees a risk in a possible escalation of the trade conflict with China. Recently, the tone has become much more belligerent. "This would be an exogenous shock that markets would have a hard time coping with in the current situation. However, both sides are presumably aware of this risk."

GOLD DIVERSIFIES AND PROTECTS

Budelmann considers gold to be the ideal portfolio complement to US equities: "The precious metal is a good diversifier and has served as a natural hedge in our balanced portfolios for some years now." Gold is proving its safe-haven strength precisely in the current environment of falling real interest rates. The US Dollar price of gold has risen by more than 14 percent since the beginning of this year. However, it also suffered a setback in March. When markets began to plummet, investors sold all quickly sellable investments, including gold, to meet their short-term liquidity needs. Now that central banks have provided enormous amounts of liquidity, however, the price of gold has risen again. A similar development could be observed in the 2008/2009 financial crisis. "We consider US large caps plus gold to be the ideal mix to manoeuvre this unprecedented crisis", Budelmann concluded.

TILL CHRISTIAN BUDELMANN

As capital market strategist of the private bank Bergos Berenberg, Till Christian Budelmann regularly comments on events on the international capital markets and examines them in the context of economic and political trends. Since 2004, Budelmann has been responsible for various investment strategies and sits on the bank's Investment Committee. He has been Managing Director since 2013.

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