KEHRLI & ZEHNDER

INVESTMENT COMMENT

May/June 2020

- **Stay defensive on Equities**

  Equity markets have rebounded sharply since the sell-off despite the U.S. unemployment rate reaching 14.7% in April (up from 4.4% in March). To put this into perspective, the loss of 20.5 million jobs in April is 25x the peak monthly job loss during the financial crisis in 2008/09 and the worst monthly loss since the Great Depression.

  Equity protection has come from fiscal stimulus (amounting to 13% of U.S. GDP), while bonds do not offer an attractive alternative given low yields. President Trump sees the S&P as one of the yardsticks of his success (critical to his re-election bid) and has used political rhetoric to calm people's fears. Q2 earnings are widely expected to be horrific and consumer confidence is plummeting. In our view, the current level is at least 10% too high. A big upside earnings surprise would be needed to support this valuation. We recommend to use current levels to selectively take intra-crisis profit and keep the dry powder to invest when the correction comes.

- **What Warren Buffett is telling us**

  During last weekend's Berkshire Hathaway's annual shareholder meeting, Warren Buffett explained why he uncharacteristically sold all his airline shares into weakness, locking in a loss of billions of dollars. He had already lost billions in airlines back in the 1990's. Good to know that geniuses like the "Oracle of Omaha" can also get it wrong (twice!). But the more important lesson here is to avoid certain stocks regardless of how cheap they get. Also noteworthy is that Berkshire Hathaway is sitting on $137 billion in cash and has not made any investments during the current downturn – the opposite of its behavior during the global financial crisis in 2008/09.

- **Focus on digital**

  One reason why the S&P 500 has held up so well is the five largest companies – Microsoft, Apple, Amazon, Alphabet (Google) and Facebook – all benefitted to varying extent from the current situation: COVID-19 has accelerated the trend toward a more digital world. Together these five now make up 20% of the index. We suggest to strategically over-weight investments that benefit from digitization and automation and to use market corrections to build up exposure.

- **Quality in Fixed Income is key**

  Our view is the recovery will not be V-shaped. We are in a health and economic crisis (hopefully not a financial crisis) and also a demand crisis. Consumer behavior has changed; buying will not resume fully until a vaccine is widely available; demand will take much longer to come back than supply. Measures addressing these fears will be bureaucratic, expensive, cumbersome and long-lasting. With historically low yields, we would recommend to use the current recovery to reduce exposure to lower quality fixed income and emerging market debt.

- **Gold continues to shine**

  Gold remains a safe haven. We have increased our exposure to gold to a slight overweight allocation. Low oil prices have the effect of a large stimulus even though it has caused severe damage to the sector itself. As countries around the world slowly exit their lockdowns, demand for oil will pick up and prices will rise again.

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