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Tuesday, May 12, 2020

Markets – Add to Cash

Over the last month and a half equity markets have recovered substantially from the worst of the bear market sell-off during the ides of March. The S&P500 Index in the US has rallied some +31% from the low and is now trading on over 20X price-earnings ratio, if earnings can be forecast that is. The graph below shows the V shaped price recovery of the All World stock ETF managed by Vanguard and highlights the steep ascent in world stock markets as the worst of the COVID-19 pandemic is perceived to be behind us.

Graph 1 - Vanguard All World ETF Performance 01 Jan - 12 May 2020

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There seems to be a disconnect between what is happening on "Main Street", with the worst unemployment report in US history last week, versus the price action on "Wall Street" which is reacting to extreme monetary accommodation. The premise widely accepted is that job losses and business cessation will be very temporary and that the economy will bounce back in the second half of the year. We wonder however if the snap back will be quite as fast as many predict. Some lasting damage is being done today and there is always the likelihood that countries will have to restrict movement again and go through some open-close-open scenarios as the virus flares up again unexpectedly. Just look at Seoul, Wuhan and Schleswig-Holstein in Germany where the reproduction rate "R" has jumped up to 1.13 over the weekend. These new hotspots of infection may be curtailed by suppressive tactics as we have seen before. Governments are now in a better position to know how to react and citizens also now take virus announcements more seriously than at the start of the outbreak.

New outbreaks may, however, put a dent in the all-important consumer sentiment that is needed to drive the global economy back to running speed. Put simply, people may just feel more cautious about everything even if allowed to go out and to have more freedom than they have seen since February. A recent UK poll showed somewhat surprisingly that the vast majority of Britons don't want to get out there and would like to see an extension of lockdown measures. It's a mixed story though, with some in the southern US states launching demonstrations to open up the economy as soon as possible, showing the different opinions between the federal government and local assemblies. In some parts of the world such as South America it is feared that a failure to recognise the pandemic will create even more damage. The president of Brazil has repeatedly played down the virus threat but with 5,632 new coronavirus cases in the country on Monday it is possible he has risked everything with his stubborn strategy of denial.

All of this points to an unsteady re-opening of the global economy and probably not the V shape recovery many expect. It is more likely to be a more gradual acceleration over the next six months, with some lurches between optimism and fear as we find out how the control of the virus really plays out. The WHO believes vaccines will only be ready in 2021. Mass testing is vital but hard for many regions to achieve. Thus the global economy is re-opening the shutters but only tentatively and with the possibility of closure again if R numbers creep up above 1.

In our model portfolios, we think that adding a little cash from equities makes sense at this point. The rally has been surprisingly strong and may now be running ahead of the reality on the real economy. That is not to say we are turning bearish, but on the whole as we head into the next phase of the coronavirus crisis it is prudent to manage risk and to prepare for investor reactions to second waves of virus infection as populations move on from lockdown.

At the same time, we are recommending taking some profit from our 'big tech' strategy basket which has seen a rise of +27% since launch on 24th March. Again, there is long term value in the e-commerce strategy and this will in our view remain an important theme for the next decade and beyond, however taking some profit makes sense. We already closed the S&P500 long call recommendation for advisory portfolios with a +70% profit just prior to the Easter long weekend.

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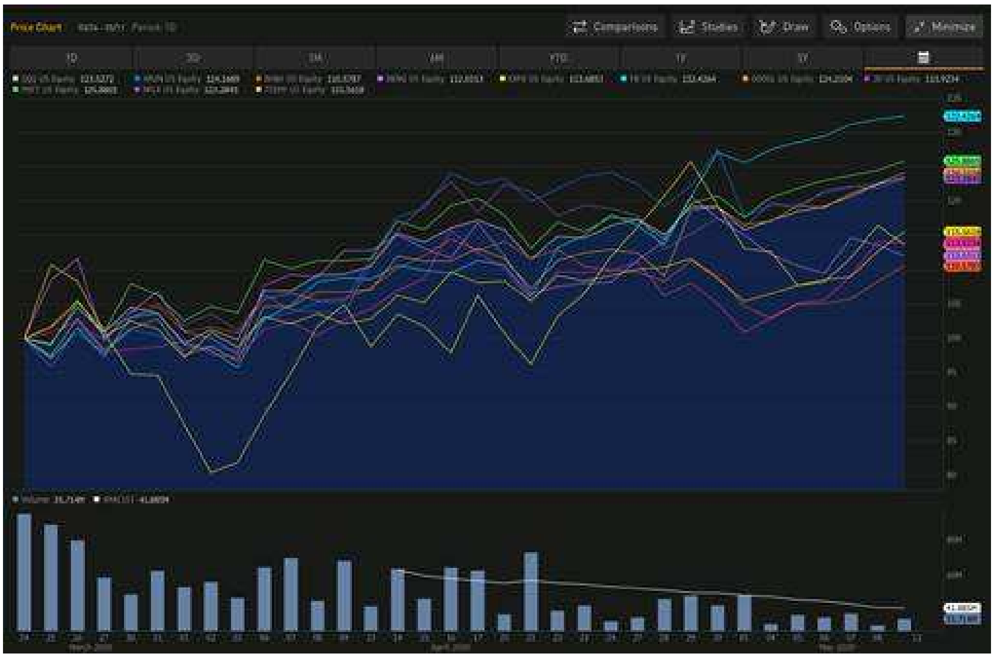

Graph 2 - E-Commerce Basket Performance 24 Mar - 12 May 2020

Making sense of the earnings outlook is very hard at the moment and even CEO's of public companies are dropping guidance for investors. That makes forecasting something of a guess. At the macro level it looks like the coronavirus crisis will pass just like all other crises have done so before. The best long-term vehicle to grow wealth is through holding a diversified portfolio of equities and this remains the central theme today. As a manager of multi-asset portfolios we also highlight the alternatives in times of stress and see opportunities in other asset classes (including adding to gold in the current environment) to balance risk and reward.

Lorne Baring
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