PRIO PARTNERS

BODMER CETTIER

Zurich, February 25, 2021

IC No. 23 – March stop and status report

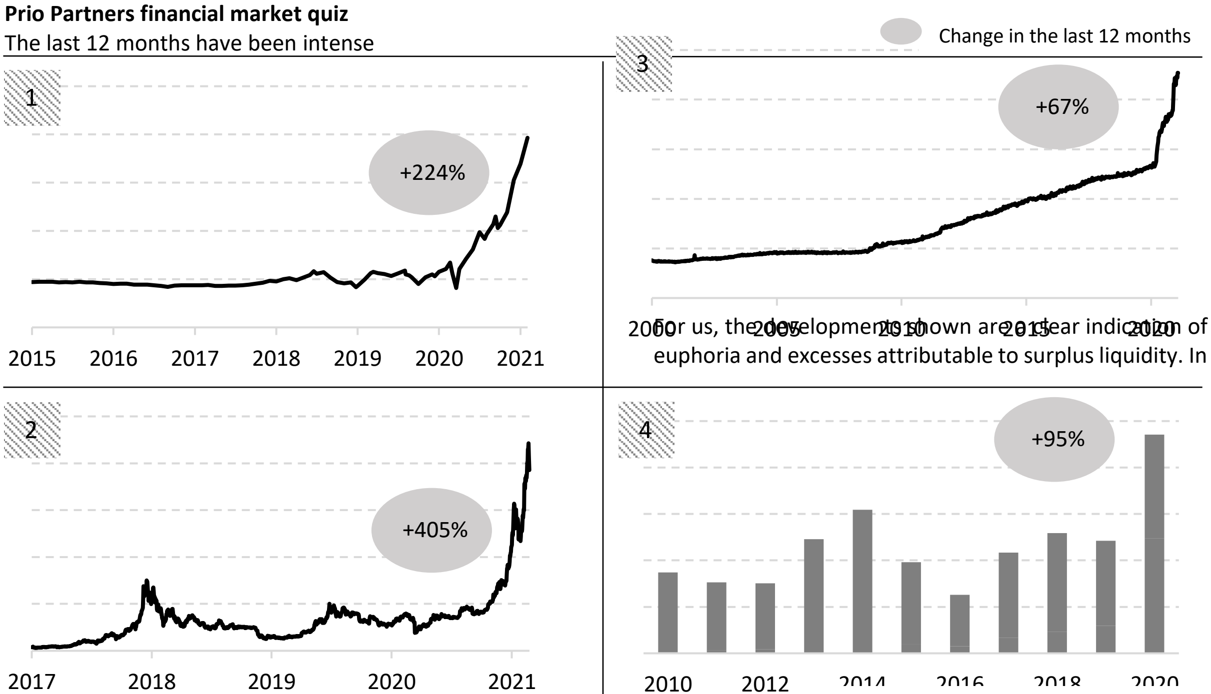
In our last *Investment Commentary No. 22 - Outlook of Outlooks*, we summarized the capital market assumptions for 2021 from a large number of banking institutions. All in all, there was consensus on the developments to be expected. Now it seems that one of the central assumptions of market participants is starting to wobble: a persistently low inflation rate. This is based on the assumption that, despite the greatest efforts of central banks, inflation will not materialize and that the deflationary developments of the past, such as in Japan or the euro zone, can also be transferred to the rest of the world, and in particular to the USA. Inflation expectations are of central importance to investors, as they provide an indication of the discount rate and determine the valuation level and relative attractiveness of investments.

Review of assumptions for 2021

We do not wait until the end of the year to see whether our assumptions have been confirmed, but whenever necessary we stop and assess the situation. It is noticeable that the euphoria that has boosted the markets since the beginning of November has continued at the beginning of 2021. To illustrate the euphoria, we have come up with something special for this time: a financial market quiz! Below are four graphs and the idea is that you can puzzle with your team (or at home with your family) which of the developments belongs to which asset. To make it not too complicated, we give you a selection below: Index of Unprofitable Technology Stocks, Money Supply M1 USA, Bitcoin, Number of IPOs. You will find the resolution on page 2 at the end of the investment commentary.

Prio Partners financial market quiz

The last 12 months have been intense



For us, the developments shown are a clear indication of euphoria and excesses attributable to surplus liquidity. In

Source: Financial database, Prio Partners other words, we are in a pronounced phase of asset inflation.

A familiar uncertainty widens

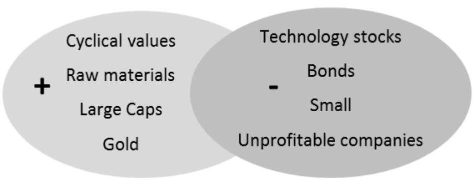
The more unsettled capital markets have their origins in the chart below, which shows the breakeven inflation rates of 10-year inflation-linked U.S. bonds. A clear increase in inflation expectations over the past 12 months can be seen.

Rising inflation expectations

Development of 10-year break-even inflation rate USA (in %)

Source: Financial database, Prio Partners

If this is true, then already high valuation levels seem not only high, but far too high. This would be bad news for investors in a wide range of assets. We have prepared a small overview for you, which - admittedly simplified - shows which investments are more in demand (+) or more avoided (-) in an inflationary environment.
increasingly avoided (-) in an inflationary environment.

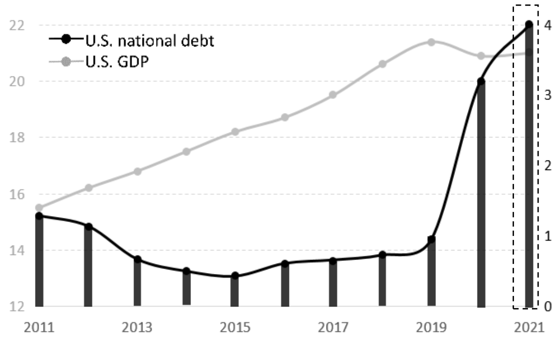


Stimulus coming from America

The current rotations in the market (from e.g. technology stocks to cyclical stocks) may even be justified due to valuation levels and with regard to an expected upswing. However, cash and bonds still seem unattractive as an alternative to equities. Moreover, the will of politicians and central banks to solve potential problems with even more money seems to be unbroken. Thus, the U.S. will soon send every American another check (total volume USD 600 billion) as well as pump around USD 1,900 billion into the economy with additional measures. At the same time, an infrastructure program is currently being negotiated in Congress, which will raise another sum of around USD 2,000 billion. All in all, we can expect a stimulus of around USD 3,900 billion in the USA alone. A first decision will be taken at the beginning of March, which should give the markets a boost.

Biden boosts the economy

Development of US deficit compared to US GDP (in USD trillion)



Source: Financial database, Prio Partners
- - - Estimated value, Stimulus 2021

The dimensions of the stimulus in 2021 are enormous, amounting to a good 20% of US gross domestic product.

Where do we go from here?

The question we ask ourselves is how much of this money will ultimately flow into the stock market. At the same time, the U.S. Federal Reserve seems willing to keep interest rates low and would control the yield curve to do so. It could be another year of surprises in the form of a continuation of the stock market rally this year. Accordingly, it seems premature to get out of the markets completely. However, a somewhat more defensive positioning or repositioning in the market does not hurt in our view.

Hyperinflation on the horizon?

Liquidity offers financial security and the option to seize opportunities. However, it should be clear by now that our financial system does not reward holding liquidity. Liquidity is an unproductive asset, offers no protection against inflation and does not participate in the magic formula of the financial market: the compound interest effect. Whether the devaluation of money for everyday goods will get out of control, as it did in the times of the Weimar Republic, seems unlikely at the moment. However, the devaluation of assets in the face of rising prices has long been a reality.

P.C.

Resolution of the Prio Partners financial market quiz:
1: Index of unprofitable technology stocks
2: Bitcoin
3: Money supply M1 of the USA
4: Number of IPOs