

CEO Corner

Coming out of the global lockdown



Daniel Zurbrugg
CEO BFI Infinity

The title of our February 2020 update was: [“The year ahead: Expect the best, prepare for the worst”](#) and we explained in our publication why we were cautious and advised investors to hedge their bets. While our main concern was a slowing global economy, the start of the corona pandemic added extra uncertain-

ty and we clearly highlighted the risk of a stock market correction. Also in our February edition we looked at the potential impact of the developing corona crisis and while we certainly realized the potential risk, we did not foresee the enormous impact it would have on all of us. Just in a matter of a couple of weeks, we saw the whole western world go into some kind of lockdown and borders were closed pretty much everywhere. The fact that we had hedged our bets could only give us a bit of comfort, as the pandemic had far-reaching consequences, the kind of which most of us have never seen before in our lifetime. Nevertheless, despite the widespread disruptions and business shutdowns, our company continued to operate normally. Throughout this challenging time, our investment positions were safe and so were our employees.

Most major stock markets reached a high around February 19. After that, the unfolding corona crisis was really starting to bite and within just 4 weeks, global equity markets tanked by 30-40%, falling into bear market territory. While in the beginning of the crisis the health risks were the main concern, very quickly people started to realize the enormous economic damage that would be caused by the world-wide shutdowns. Unemployment rates have since then risen sharply, especially in the United States, where many workers are on short-term contracts and live on weekly paychecks. There was never a time in the country's history during

which so many people lost their jobs. The picture in Europe looks better so far because typically workers are not getting fired as quickly as is the case in the U.S., but it is clear that the situation will worsen in the coming months as the structural damage across the economy is becoming more visible.

In the beginning of the crisis, all eyes were on Italy and Spain that were hit the hardest by the disease, with areas in Northern Italy, as well as Madrid, developing into pandemic hotspots. Initially, the outlook for the rest of Europe was also very bleak. It was projected that the pandemic would rapidly spread around the continent, potentially causing millions of deaths until the summer and there were warnings that most healthcare systems would collapse. I think most of us felt like we were in some kind of science fiction movie and everybody was surprised by how quickly the western world moved from “business as usual” to complete lockdown mode.

In the early phases of the lockdown, the harsh measures were well understood and largely accepted, but it wasn't long before questions began to emerge regarding the restrictions that were enforced and a debate started about how long this global economic freeze could be realistically maintained. While the virus continued to spread in Europe and North America, the worst-case scenarios and fears have not materialized. Of course, it is very sad to see people dying, but during the last couple of weeks it was a relief to see that social distancing and other safety measures did indeed cause the spread of the virus to slow down. Now, most of Europe and soon the United States are re-opening their economies, businesses are getting back to work and very soon borders will re-open too. While some risks and fears remain with regard to a potential new spike in infections, it is good to see people getting back to their lives and their work, kids being able to go to school again and all of us starting to enjoy the freedoms we are getting back.

Financial markets also reacted quickly. In fact, stock markets started to bounce back in mid-March and at

the time of writing, almost two-thirds of the losses caused during the corona sell-off have been recovered. However, the real economy will take longer to heal. The structural damage has yet to be seen and at the moment we can only estimate how deep the wounds will be. So far, the stock market recovery has been fueled by the enormous injection of liquidity coming from central banks and governments around the world, as well as the re-opening of all major economies. At BFI Infinity, we took profits on our hedges in mid-March and have since then participated in the recovery. However, in early May, we decided to add again equity hedges until mid-July, as we feel that the current recovery was too fast and has gone too far without taking into consideration the full extent of the economic damage that the corona crisis caused.

The enormous liquidity injections by central banks around the world and the historic fiscal stimulus packages from governments will certainly help initially to get us through the worst part of the crisis. But the question that we all need to ask ourselves is: How much can we afford and for how long can we afford it? The discussion in recent weeks has been a polarized one, with a deep divide between those who believe that it is too early to reopen the economy and those that think we need to get back to work as quickly as possible. Who is right and who is wrong? Is there even a right or wrong answer to this? In our view, there must be a way to achieve both goals, to protect our health as well as keep the economy going, because after all, a well-functioning economy is probably the biggest welfare-supporting system that we have today. While we do our best to protect our own health and to shield the most vulnerable people in our society, we also have a responsibility to move forward, keep businesses going, preserve jobs and maybe most importantly think of the generations to come that will eventually have to foot the bill and repay the enormous amounts of debt that are being created. Not considering these viewpoints is a huge mistake and would be unfair on those that got hit the hardest in this catastrophe.

It is our opinion that the coming weeks will present another test for markets, because the structural damage is only now becoming visible. The short-term momentum has improved as we are moving out of the lockdown mode, but we need to be realistic and un-

derstand that it might take a long time until the global economy is back to where it was before the coronavirus. Until then, many companies will face headwinds and subsequently corporate earnings are going to be very weak initially. Therefore, the risk of a renewed drop in equity prices remains high, especially in the next few weeks. While we are now generally hedged and hold a lot of cash, we approach the coming weeks in a comfortable but flexible position. We are ready to put more cash to work and increase our equity exposure, yet at the same time we want to have protection in place, just in case.

While the short-term outlook for stocks is more positive than what we expected it to be, we need to bear in mind the wider impact of the crisis on other asset categories. Looking at bonds, we might have reached a 40-year bottom in interest rates, as the whole world now has rates at zero or even in negative territory. So unless an investor is willing to accept significantly higher levels of risk, there won't be a meaningful return. This begs the question: Why would somebody still hold bonds or reinvest in new bonds? Thus, at this stage, we plan to hold the existing bonds we have bought at higher yield levels, but will most likely not reinvest funds in the fixed-income market for the time being.

In addition, low interest rates, record levels of liquidity and heightened global uncertainty make a perfect recipe for precious metals prices. The very positive developments in recent weeks might only be the start of a longer-term appreciation. We therefore remain positive on precious metals in the short term and we are bullish over the long term.

Even as the world now returns to a new kind of normal and as we enter the post-corona era, it needs to be understood that this crisis has revealed many weaknesses in our western society, our political system and our economy. In an ideal world, we would learn our lessons and we would be better prepared for the next pandemic, whenever it may come. However, there's a risk that the crisis has had effects that will not be reversible. The European Union is a prime example of this. Although the situation in Italy is stabilizing, the economic damage is so extensive that it is already clear that the country will need much more support from

the European Union. But as all countries in Europe are themselves dealing with the effects and aftermath of the crisis, will there be the political will and the practical economic capacity to support the weaker members of the Union? From this perspective, it seems more likely that tensions in the European Union will continue to rise, even after Brexit is eventually completed.

The situation in the United States is equally challenging. The country has produced deficit after deficit for more than 20 years now, and even when the economy was strong, the country was producing higher and higher debts. And what happens now? We are simply seeing a huge spike in terms of new debt being generated and at some point there is not going to be enough demand from investors. Ultimately, the solution could come from the Federal Reserve. After bailing out the corporate bond market, why not start buying government debt? Investors around the world need to realize that we are in uncharted territory here and that the most likely scenario will be an effort to re-inflate the global system by creating asset inflation. Of course, this has already been happening for many years, but we are now about to see it on a whole new level.

So what are the implications for investors going forward? In our view, bonds are not attractive anymore and over the long term, investors need to hold assets that will benefit from the attempt to re-inflate the global economy and financial system. High quality stocks and precious metals are prime examples of investments that stand to benefit.

With regard to stocks, we firmly believe that it is crucial to be very selective and pick sectors and individual stocks prudently. Diversification is always good, but investors need to be careful not to diversify at the expense of conviction. We like quality companies in sectors such as healthcare, technology, consumers staples and commodities just to name a few. We are also screening for so-called "supertrends" in the global economy, to detect strategic long-term value drivers and themes to identify attractive investments. This is not an easy process, but it should be clear to investors that at least for now, passive investing and simply following the market are not going to be effective strategies. While this will make it easier for the financial

industry to sell products to their clients, it is certainly a great time for active investors and investment management firms with an active investment style. That is the camp we are in and we therefore appreciate the opportunity that the current environment presents, so that, together with our clients, we can continue to do what we have always done best: protecting and growing what is rightfully yours.

While our main concern in the past few months was to be careful, we should not forget to embrace life and the opportunities it is giving us. We hope you are well and stay well, and we wish you a wonderful summer.

Equities strategy for the post-Covid era



Dirk Steinhoff
Chief Investment Officer

The past few months have abruptly introduced levels of uncertainty and volatility in the financial markets unseen since the Great Financial Crisis, while the state of the global economy is in disarray. The corona crisis and the global lockdown and shutdown measures

that were meant to combat the spread of the virus have brutally impacted millions of businesses, international trade and supply chains and even pushed entire industries, like the airlines, to the brink.

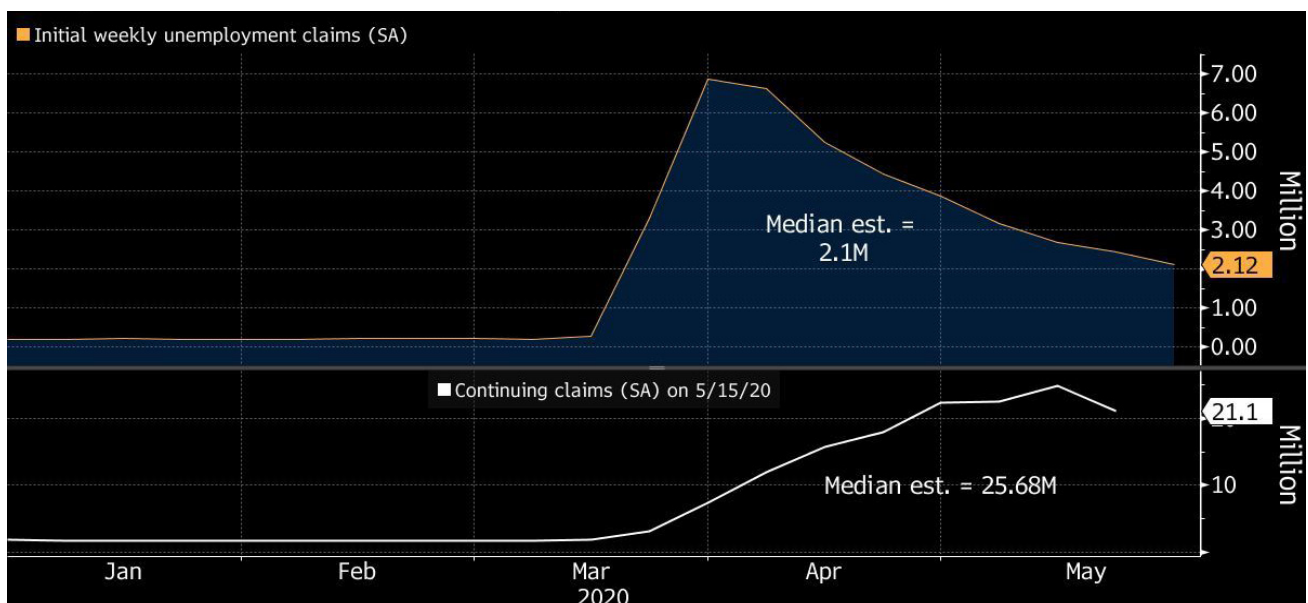
It is therefore not surprising that the last quarter was a very challenging time for investors around the world, as many were caught off guard by the Covid-19 shock and suffered steep losses. It certainly was an unusual time for us too at BFI, however, as we were well prepared for an adverse scenario, we achieved generally very satisfactory results amid the market downturn. Thanks to the allocations and

our solid downside protection in our main strategies, which we outlined in our [previous InSights](#), we managed to deliver an up to 9% positive performance for the first four months of 2020, despite the multitude of new challenges and market turbulence. While we are very pleased with these results, this is for sure no time for complacency. It is clear to us that the uncertainty and volatility will stay with us for a while, but this environment will also create great investment opportunities. Pro-active measures, focus, adaptability, caution and vigilance will be essential going forward.

Extreme conditions

While it is still early to accurately predict the precise consequences and aftermath of the corona crisis, all economic indicators and recent data out of most major economies paint a sinister picture of what lies ahead. In the US, jobless claims have climbed to unprecedented levels, with over 40 million newly unemployed people in just ten weeks. According to the Labor Department, productivity fell a sharp 2.5% in the first quarter, the steepest decline since 2015, while consumer spending dropped by a record 16.4% in April, far worse than the expected 12.3%.

US weekly unemployment claims above 2 million for 10 weeks in a row



Source: US Labor Department, Bloomberg

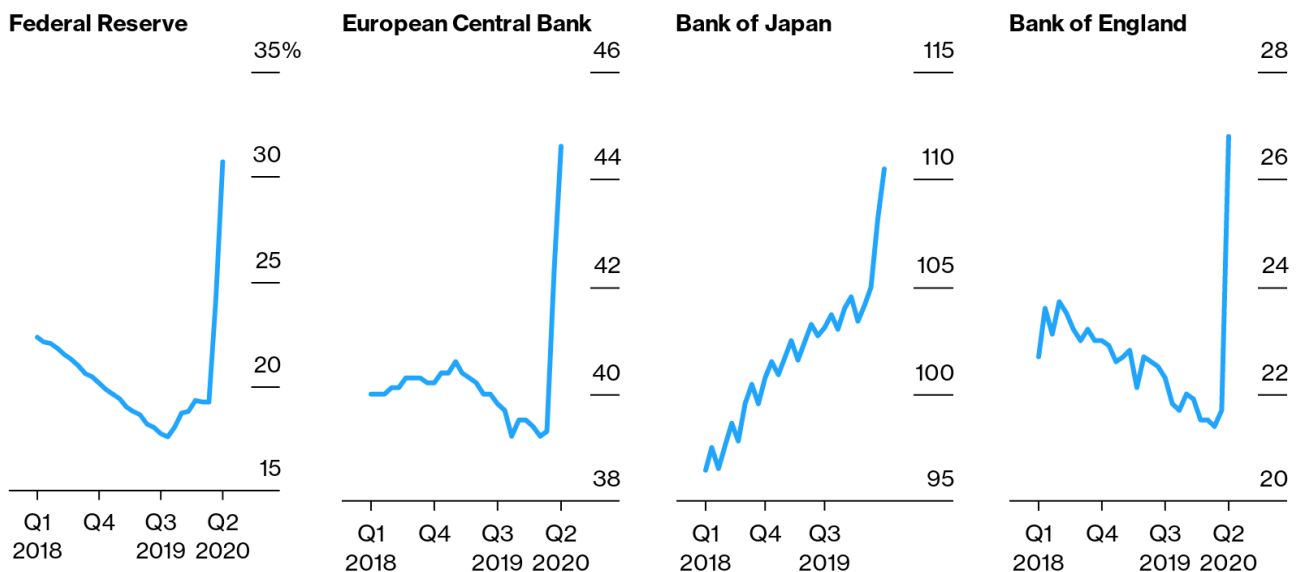
Similarly alarming metrics are coming out of Europe. Germany, the Eurozone's growth engine, experienced a historic drop in employment levels, with sharp declines in all four sectors, i.e. manufacturing, construction, services and trade, according to data from the Ifo Institute for Economic Research. This is despite the "Kurzarbeit", or "reduced work hours", scheme that is meant to stave off mass layoffs through state-subsidized salaries. France suffered the greatest economic contraction since records began in 1949, Spain also saw a record-breaking decline of 5.2%, while in the UK, jobless claims skyrocketed by a staggering 70% in April. Italy, the worse-hit nation in the continent, once again entered into a recession, with a GDP decline of 4.7%, the worst reading since 1995.

The effects of the global economic freeze and the lockdown measures have certainly been extreme, but so were the monetary and fiscal measures that were swiftly introduced to combat them. The Federal Reserve has opened the QE floodgates, adding more than \$2.4 trillion to its balance sheet, while it also launched a barrage of lending programs surpassing \$600 billion. Most likely, this is just the start, as the central bank's chair recently reassured investors that they can count on monetary support for the foreseeable future, highlighting that "there's no limit

to what we can do". On the fiscal side, on top of the nearly \$3 trillion in federal relief packages already approved by late April, there was another \$3 trillion package passed by the House of Representatives in May. Over in Europe, the ECB has also followed suit with "unlimited QE", while it is "fully prepared" to expand its existing €750 billion Pandemic Emergency Purchase Programme, according to President Lagarde. Another €750 billion in fiscal support is now on the table, proposed by the European Commission in a new stimulus program. All the other major central banks, e.g. the Bank of Japan, Bank of England, People's Bank of China, have also deployed massive monetary support policies in response to the corona crisis.

We are only at the beginning of what we think might become one of the biggest monetary and fiscal stimulus operations in recent history. However, it is impossible to accurately predict the mid- to long-term economic effects of these measures, especially as we still don't know when the global lockdown measures will be entirely lifted. Once this happens, the full impact of the economic freeze might become clearer and we will see over time the full scope of monetary and fiscal stimulus added after the initial programs.

Central bank balance sheets as a share of GDP



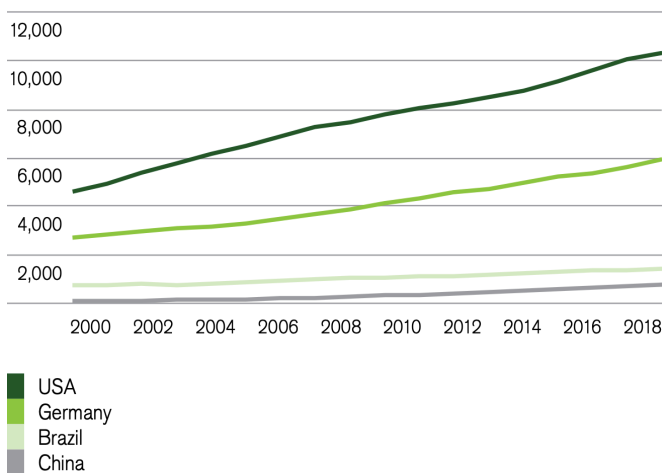
Source: Bloomberg

Risks and Opportunities ahead

It is abundantly clear that the investing landscape has drastically changed and the kinds of risks and challenges we face today haven't been this acute or even relevant in almost a decade. Over the last few years, we were operating in a growth environment where the "rising tide would lift all boats". There was widespread complacency and to many, the record-breaking rally in US equities seemed unending. Broad-market strategies were effective and risk tolerance was high among investors. Now, however, the tables have arguably turned. Looking ahead, we expect markedly weakened GDP growth, we see debt levels as a primary concern and we anticipate the overall high levels of volatility to persist. That being said, we also see some very promising investment opportunities in commodities (especially precious metals), equities and alternative investments.

Concerning equities, some sectors are clearly better positioned than others going forward. For instance, healthcare, technology, communications and defense can come out on the winning side of this crisis. On the other hand, the current pressures and the Covid-19 shock have severely affected others, such as the automotive industry, financials and insurance.

Healthcare costs since 2000, per capita in purchasing power parity (PPP) terms



Source: The Global Health Observatory, World Health Organization, Credit Suisse

However, it is important to highlight that merely identifying a promising sector is not enough. As mentioned above, the broad approaches that worked in the past years will be unlikely to be successful now, as they are no longer fit to meet the present challenges and risks. This is why we at BFI prefer in this situation to focus on single stocks, carefully selected after diligent screening and extensive analysis. Focusing on the aforementioned sectors is just the start, as we then narrow our search for specific companies, looking for healthy and solid balance sheets, for profitable and robust business models and for convincing and promising business perspectives. Finally, we then also take into account whether there's an alignment with a "supertrend".

Supertrends

In the 2020 edition of its "Supertrend" report, Credit Suisse identified a number of global shifts and important economic and societal changes that constitute compelling and viable investment themes in the post-Covid era. Some of those, like "Anxious Societies", "Infrastructure", "Technology", and "Silver Economy", are very relevant to our own outlook and strongly support the investment case for our equities strategy.

The supertrend "Anxious Societies" involves the impact of the Covid shock on consumers and employees. The extremely heightened fears of unemployment and of future income streams is expected to drive consumer spending down, while the affordability of even essential products and services is bound to become a core concern. As can be seen in the graph on the left, one of the heavier costs dragging down household budgets is healthcare, and thus, companies that offer solutions to lower these costs, either through innovation, new technologies or individualized services, would have a competitive advantage.

The supertrend "Technology", which consists of technology, digitalization, artificial intelligence, virtual reality, industry 4.0 and healthcare, is another theme that we see as relevant, even more so in the aftermath of the corona crisis. The global lockdown and shutdown measures already triggered an immense

acceleration in the ongoing shift towards an online economy, as we saw an explosion in work-from-home schemes and a great push towards digitalization. In addition to this, there are further supporting factors, such as the spread of 5G, the increasing prevalence of AI and robotics, as well as the institutional adoption and normalization of decentralized and blockchain-based systems and solutions. This digital shift is something we take into account when assessing specific companies from all the sectors we're looking at, as aligning with this supertrend has the potential to make a significant difference in the following years.

Another supertrend that is also on our radar is related to changes in specific age segments. "The Silver economy", or investing in population aging, is especially interesting, given the fact that the world's senior population is projected to double to more than two billion by 2050. Also, taking into account the current pressures introduced by the corona crisis and their impact on saving and wealth accumulation for the younger segments of the population, today's seniors are likely the last "big spenders". This theme, involving, among other factors, innovations in elder care, ties into our screening of the healthcare sector, but it is also relevant to technology companies that we're assessing.

Investment Implications

Nobody can predict the precise outcomes and impact of the corona crisis and the global shutdown, but it is safe to say that we're very far away from getting back to normal, whatever that may look like in the post-Covid era. The economic damage runs very deep and it's too early to tell whether the record-breaking spending and liquidity injections will have their intended effects.

Nevertheless, we are confident that equities will and should continue to play a key role in an investment portfolio, even though caution will be essential going forward. This is why we will continue to apply risk management tools when it seems appropriate. Furthermore, given the corporate borrowing spree of the past decade and the severe disruptions

and challenges caused by the corona crisis, we are likely to see existential pressures for many companies over the next few months. The rising bankruptcy filings that began in the last couple of months could continue and intensify, especially in the hardest-hit sectors and among heavily leveraged companies. This is why it is essential to look for red flags in debt levels, to handpick healthy companies, and to focus on single high-quality stocks or targeted, sub-sector ETFs.

Our outlook also remains positive for precious metals. The investment case for gold, which we already outlined in our last issue of the InSights, is further strengthened by the recent global wave of monetary and fiscal interventions. This massive stimulus, that is bound to increase inflation expectations, should also benefit real assets. Many of the commodities that suffered an almost decade-long bear market with significant underinvestment now look even more promising for a recovery. Finally, we continue to have a positive view on certain specialty REITs on income producing real estate, for example related to data centers, tech-centers, healthcare and logistics.



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