AXIOMA
Wealth Management AG

2021 Investment Strategy

(09.12.2019)

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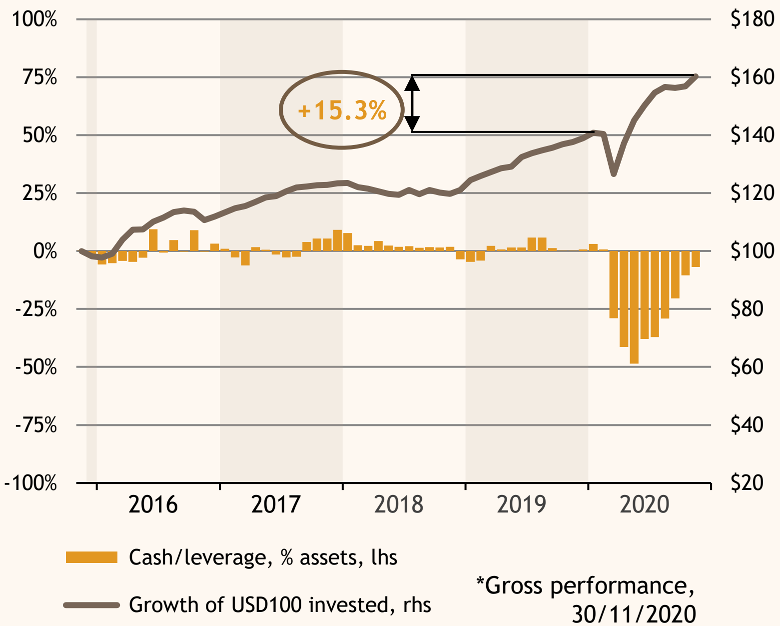
2020 in Retrospect

No doubt, 2020 has been the most challenging year for markets since the 2008-2009 financial crisis. After the prosperous 2019 for financial markets, this year started on a positive mode, with valuations at pretty high levels. Then the Covid-19 pandemic ensued and brought panic to the financial markets and March saw a severe sell-off. The unprecedent nature of the crisis pushed central banks and governments worldwide to react swiftly and aggressively and that helped bring liquidity and normal functioning to the markets, which subsequently saw a sharp recovery in April and May. The mood stayed optimistic for the most part of the year. Except for some brief periods of heightened volatility in June and September, bond markets have continued their rally up to the date of writing this.

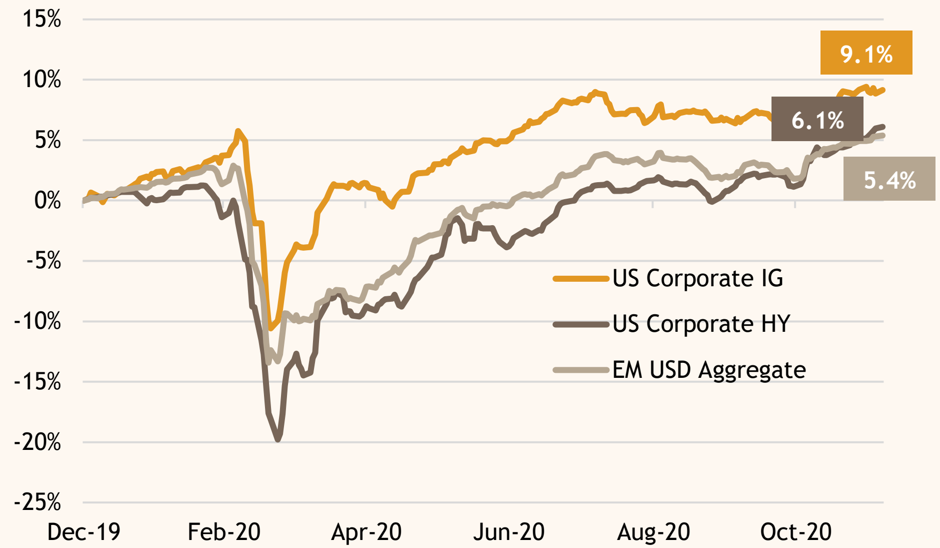
We have entered the crisis on the defensive, with no leverage and high credit quality of our portfolios. While this did not save us from a sharp drawdown in March, it sheltered us from defaults and allowed us to employ leverage extensively. We were able to borrow at low interest rates and acquire high quality names at distressed prices. These names were the first ones to see a sharp recovery once the US Federal Reserve stepped in with its assets purchase program, and our portfolios were able to recover fast from the March correction. We have fixed profits on segments which saw significant spread tightening, thus gradually decreasing the leverage. Given the uncertainty regarding the economic recovery, we maintained high proportion of IG in the portfolios. Our strategy has proved effective. Axioma Leveraged Bond Fund is up 15.3% in gross terms YTD (as of 30/11/2020), thus exceeding the 2019 own record of 15.1%.

AXIOMA Leveraged Bond Fund: Historical performance* and use of leverage



*Gross performance, 30/11/2020

Bond Indices Total Return YTD



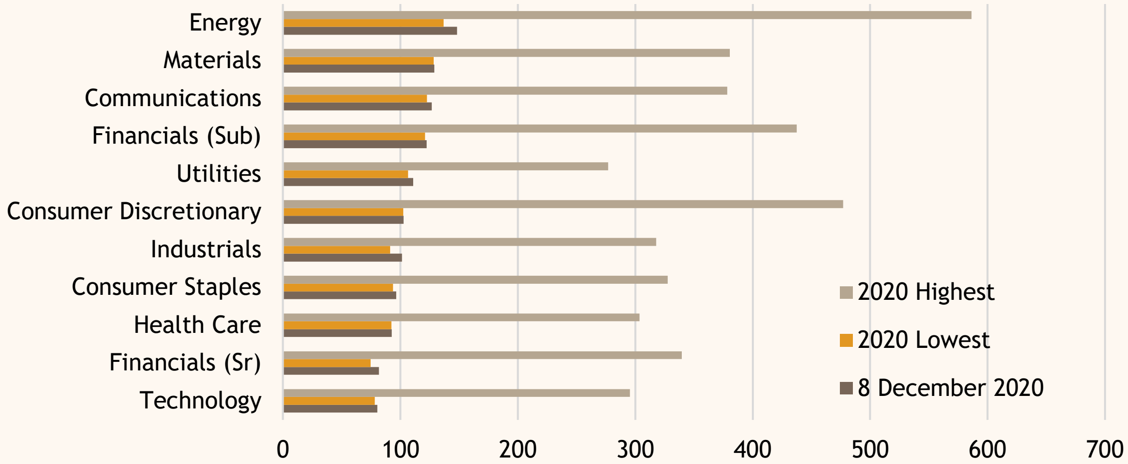
Source: Bloomberg Barclays Bond Indices, Bloomberg (08/12/2020)

Market Outlook: Dominant Themes

Vaccine announcements improved the mid-term outlook, but near-term risks persist

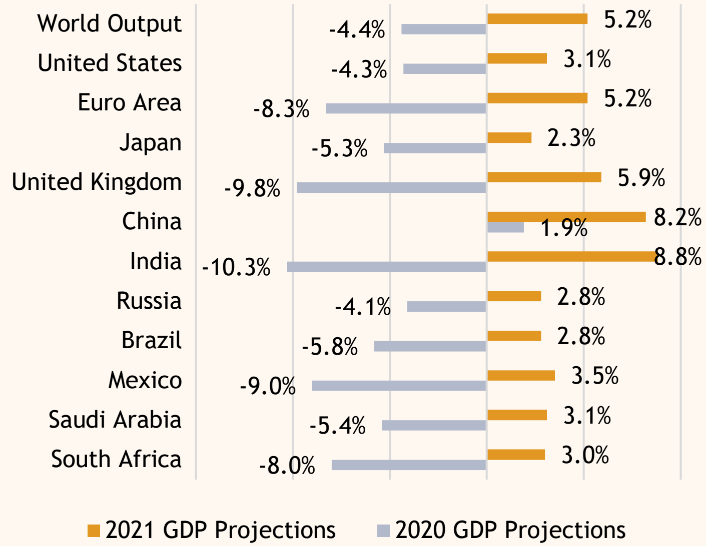
Global economy is on the recovery path, propped up by central banks and governments worldwide. Recent achievements in terms of Covid-19 vaccine development have also brightened the outlook. However, there is still much near-term risk to the economy due to a recent rise in Covid-19 infections and the imposition of new lockdown measures. With interest rates close to zero, the case for more fiscal support is high and it will be critical for supporting the economic recovery going forward. In the US, a split government may hinder the process of approving additional fiscal stimulus; the lack of it is already weighing on consumer spending. Should the economic recovery be slower than expected, there may be a growing number of defaults in the following months, in particular in cyclical industries, like air travel, tourism, retail, energy and transportation. China maintains its growing momentum in the economic recovery. That will have a positive effect on emerging markets in Asia and Latin America. US and Europe lag behind China: PMI has showed a recent slowdown in the economic activity.

Credit spreads tightened significantly from March highs; energy is still lagging behind



Source: iShares iBoxx $ Investment Grade Corporate Bond ETF bonds OAS spreads (bps), Bloomberg (08.12.2020)

2021 should catch up the major part of 2020 economic drop, but not completely



Source: World Economic Outlook, IMF (October 2020)

Uncertainty reduced following the US presidential elections

Overall, the outcome of the presidential elections has been positively accepted by the markets. But the implications of the election's outcome are mixed. On one hand, a less generous fiscal stimulus package is expected now. On the other hand, a split Congress implies much moderate regulatory changes and lower, albeit still existent, chances for a roll-back of Trumps' tax cuts. Also, on the positive side, an expected softening of the rhetoric and more predictability from Joe Biden towards China, which could ease geopolitical tensions.

Market Outlook: Dominant Themes

US monetary policy remains accommodating

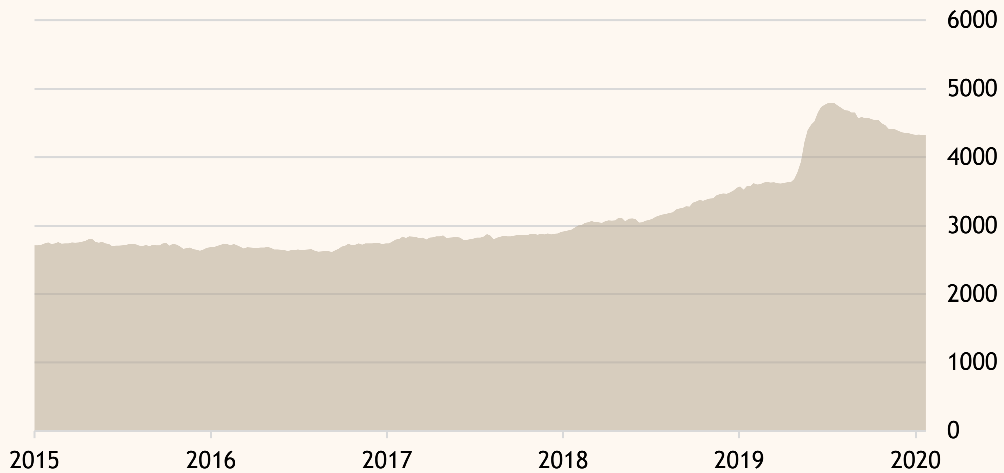
We expect monetary policy in the US to remain accommodating through to the end of 2021 and beyond, with short-term rates anchored at close-to-zero levels. No rate hikes are expected by the FOMC members up until 2023, as shown by the dot plot published following their September policy meeting. Following the vaccine announcements markets have started pricing in rate hikes in 2023. We expect the US Fed to maintain its current level of asset purchases or even expand it further, if near-term risks to the economic recovery materialize. We believe balance sheet unwinding is off the cards until the economy recovers completely.

For the long-end of the US Treasuries curve, we expect yields to rise as the economy gradually recovers. However, Fed will likely intervene to keep rates from rising too high. The outcome of the US elections has taken off some of the upward pressure on UST yields, as fiscal programmes will likely be paired back, quite the opposite of what would have been were the Democrats to win a majority of seats in the Senate.

Global stock of negative-yielding debt hits record USD 17.5 trillion

Source: Bloomberg Barclays Global Agg Negative-yielding Debt Index (USD trillion), Bloomberg (08.12.2020)

Large pile of money chasing assets



Source: ICI Money Market Funds Assets (USD billion), Bloomberg (02.12.2020)

Risk-on environment pushes credit spreads significantly tighter

Ample amounts of liquidity provided by central banks and the pile of cash which still waits to be invested have encouraged a robust search-for-yield on the markets. As the result, credit spreads have seen significant tightening over the past months. While cyclical issuers have been lagging, the announcement of vaccine developments has brought demand even for issuers in industries that were most severely-hit by the Covid-19 crisis. Considering the close-to-record high amount of the negative-yielding debt, the search for yield and abundant liquidity will continue to support the bond markets in 2021.

2021 Strategy on One Page

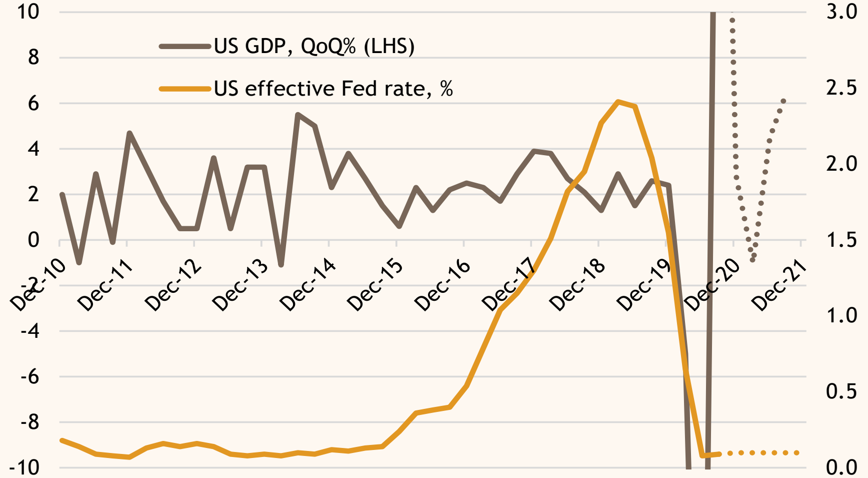
Main fundamentals:

- Ultra accommodating monetary policy is favorable for fixed-income
- Economy is recovering, yet inflation is not looming
- Political risks in the USA have reduced
- Technically, the search for yield will favour continuing inflows into EMs
- Credit spreads for IG are close to their 10y minimum, while spreads for EM HY just broke through 10y average and there is still room for further compression

Among **the main risks** we consider:

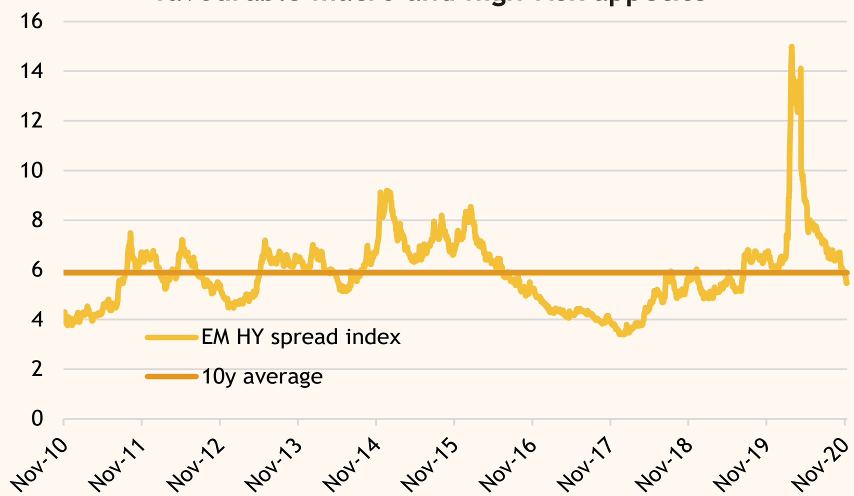
- Problems with vaccines
- Slowing economy recovery rate
- Falling oil prices due to global economic growth slowdown
- Continuing de-globalization
- Health problems of the US president-elect
- Surge of defaults if the recovery phase is too prolonged
- Geopolitical instability always remains on the radar

Economy is recovering, but interest rate will stay at 0 in 2021 to avoid double whammy



Source: Bloomberg, JP Morgan (08.12.2020)

EM HY spread could tighten more given favourable macro and high-risk appetite



Source: Bloomberg, AXIOMA (08.12.2020)

Stay invested, bottom-up approach for ideas and leverage on market opportunities

Strategy 2021- Main Points

Zero interest rate environment offers good prospects for fixed-income as the benchmark risk is minimized. Credit spreads have mostly recovered from the Covid-induced crisis, however some spread tightening potential is still possible to uncover. **Bottom-up approach will be crucial for investment ideas search as well as to avoid worsening credits.**

The main performance component in 2021 will be the coupon return, while further spread compression due to better economic prospects and the search for positive yield could result in some price growth. US issuers are in a privileged position as they could receive both direct support from the Fed in case of the worsening economic situation and could enjoy higher demand due to fiscal support programs. At the same time, US issuers had been already burdened with higher debt compared with their EM peers. The situation was further aggravated by the Covid-19 crisis. They were helped to refinance but it’s still their task to redeem part of the debt to lower the debt burden.

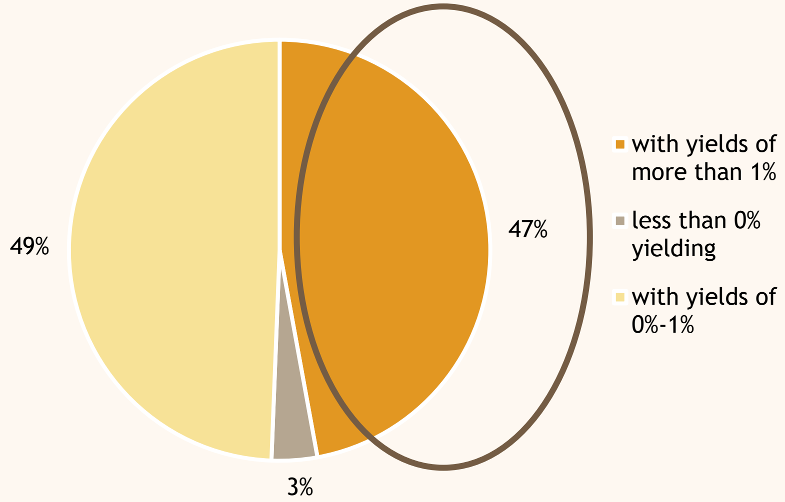
EM countries can offer less support to their companies due to scarce resources, however on the individual basis **EM issuers are stronger**. EM corporates have higher political risks, which can be also used as an opportunity to build a position.

After a prolonged recovery rally since Apr’20 **there could be some correction** due to overwhelming optimism which already looks unhealthy. We don’t believe the correction will be comparable to Mar’20 sell-off as there are hardly such severe risks as global lockdowns due to the pandemic. Moreover, global monetary authorities are keen to support economic recovery and will react quickly.

Until such correction we plan to maintain a conservative duration of 5 years, while broad diversification is a must for us in any market circumstances. We plan to keep portfolios fully invested as search for yield together with ultra soft monetary policy may prevent or postpone any correction. For strategies with leverage, we will resort to it to enhance the return from market opportunities.

There still are hot-spots where inflows will push prices higher

(USD denominated FI market according to yields)



Source: Bloomberg, AXIOMA (07.12.2020)

The main source of income - the coupon, bottom-up approach for credit opportunities could add 1-2%. Focus - on EM for its economic comeback and current yield premium. As the risk of correction remains, duration is not higher than 5 years coupled with broad diversification.

Performance Forecast under the 2021 Strategy

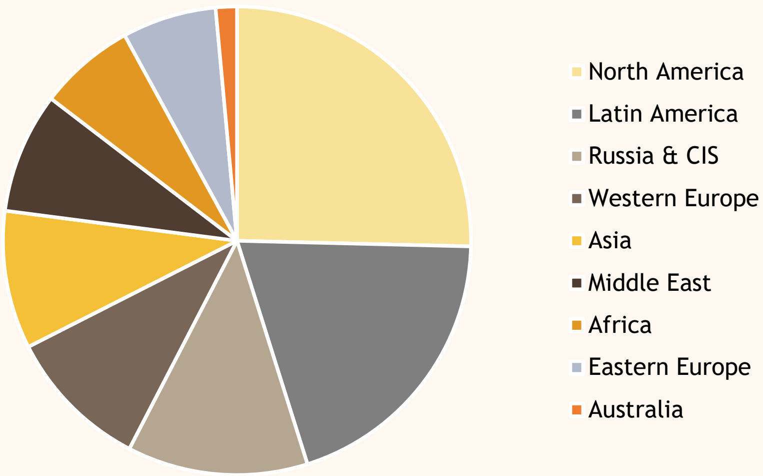
In our forecast we have made following assumptions:

- 5-year US Treasuries yield stays around 0.5%
- Potential for tightening is less than for widening
- We have attributed countries to 2 groups: Stable (spread tightening by 10 bps, spread widening by 40 bp) and Volatile (spread tightening by 20 bps, spread widening by 60 bp)
- Positive P&L from spread tightening in Optimistic Scenario can be offset by rising 5y UST yields, as this scenario will reflect quick economic recovery with growing risks of US rate increase
- Negative P&L from spreads widening in Negative Scenario can be offset by falling 5y UST yields, as this scenario will reflect problems with economic recovery thus postponing any US rate increase

Expected total return under the strategy for 2021 by scenario

Spread (bp)	5 years UST yield to maturity						
	-1.0%	-0.5%	0.0%	**0.5%**	1.0%	1.5%	2.0%
-45	14.0%	11.7%	9.4%	**7.1%**	4.9%	2.6%	0.3%
-30	13.3%	11.1%	8.8%	6.5%	4.2%	1.9%	-0.4%
-15	12.7%	10.4%	8.1%	**5.8%**	3.6%	1.3%	-1.0%
base	12.0%	9.8%	7.5%	**5.2%**	2.9%	0.6%	-1.7%
49	9.9%	7.6%	5.3%	**3.0%**	0.7%	-1.6%	-3.9%
99	7.7%	5.4%	3.1%	**0.8%**	-1.5%	-3.7%	-6.0%
148	5.5%	3.2%	0.9%	-1.4%	-3.6%	-5.9%	-8.2%
198	3.3%	1.0%	-1.2%	**-3.5%**	-5.8%	-8.1%	-10.4%

Target geographical allocation for 2021



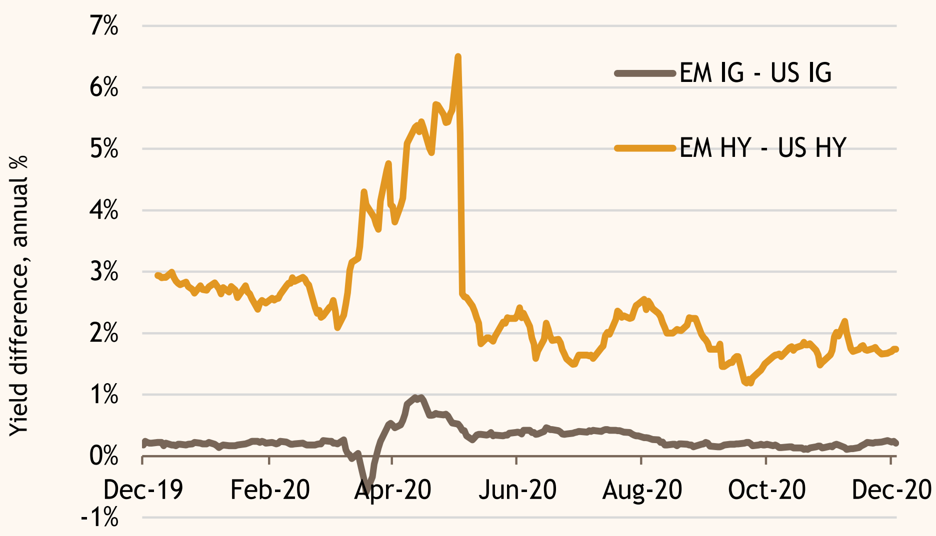
Strategy return	**Optimistic scenario**	**Base case scenario**	**Negative scenario**
Coupon component	4.1%	4.1%	4.1%
Price drop due to higher UST yields	-0.6%	-0.6%	-0.6%
Price change due to spread narrowing or widening	3.7%	1.7%	-7.0%
Default	0.0%	0.0%	-0.5%
Total	7.1%	5.2%	-4.0%
Return subject to 25% leverage	8.8%	6.3%	-5.2%
Return subject to 50% leverage	10.4%	7.4%	-6.4%

2021 Investment Ideas

Emerging Markets (EM)

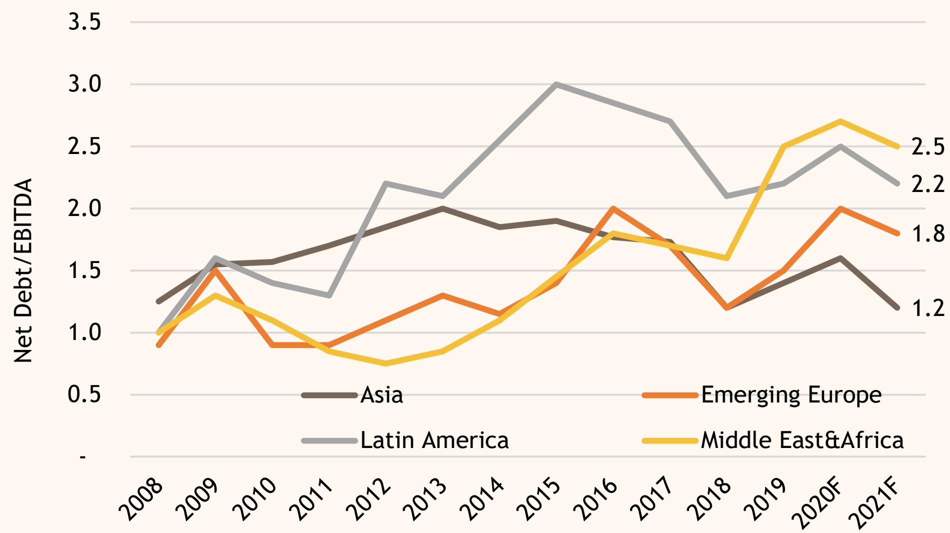
- EM countries still offer yield pick-up over US issuers for the same credit rating
- Post-pandemic economic recovery will help EM issuers especially commodity related, resulting in the leverage metrics improvement
- However, debt increase in absolute terms and fiscal stimulus unwinding may turn out to be a problem for some countries when multiplied by the lack of political support and/or other unpopular reforms if implemented

EM issuers offer yield pick-up over US issuers



Source: Bloomberg, AXIOMA (05.12.2020)

Net leverage metrics show improvement with Asia being the best



Source: JP Morgan (24.11.2020)

EM issuers will represent the major part of the portfolio with focus on corporate issuers. Sovereign refinancing and fiscal deficit normalization may become a hurdle for 2021 performance. Thorough credit analysis stays a must.

2021 Investment Ideas

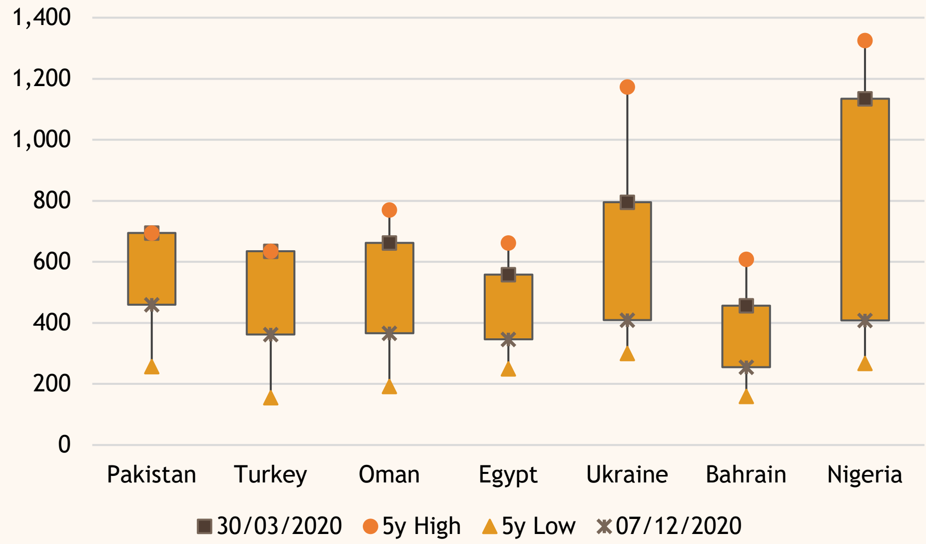
Top picks

Turkey (B/BB-) was amongst the worst-hit countries due to travel restrictions because of Covid-19. As a result, the country suffered from currency devaluation which was around 30% in 11 months of 2020. The government tried to sooth currency deprecation by buying currency through foreign reserves, but that resulted only in a rapid foreign reserves depletion. In November President Erdogan has acknowledged flaws of such monetary policy by replacing the CB head and the finance minister. The move was welcomed by the market which eased pressure on Turkish Lira. The country is yet to prove that it now sticks to economic rather than autocratic methods. Among Turkish issuers we favour producers with large hard currency denominated revenues from export and the locally oriented ones with low debt burden and less vulnerable to changes in monetary policy or politics. For example, **Ulker-25 (BB-/B+),** which traded at yield-to-maturity of 5.2%, and **Istanbul metropolitan municipality-25 (BB-/B+)** which traded at yield-to-maturity of 5.9% as of Dec. 7, 2020.

We believe **Oman (BB-/B+)** has a spread tightening potential of about 100-200 bp with the target of equal or even lower credit spread than Bahrain (B+). Oman is one of the weakest credits in the Middle East region. However, the country is trying hard to improve its finances. Thus, VAT was introduced and will be effective from April 2021. More financial support from GCC countries will help the country to refinance its debt and investors to regain trust in Oman creditworthiness. We like sovereign Oman bonds which will be the first to react should positive news come, for example, **Oman-28** which traded at yield-to-maturity of 5.2%, and quasi-sovereign **Omgrid-27 (BB-)** which traded at yield-to-maturity of 5.1% as of Dec. 7, 2020.

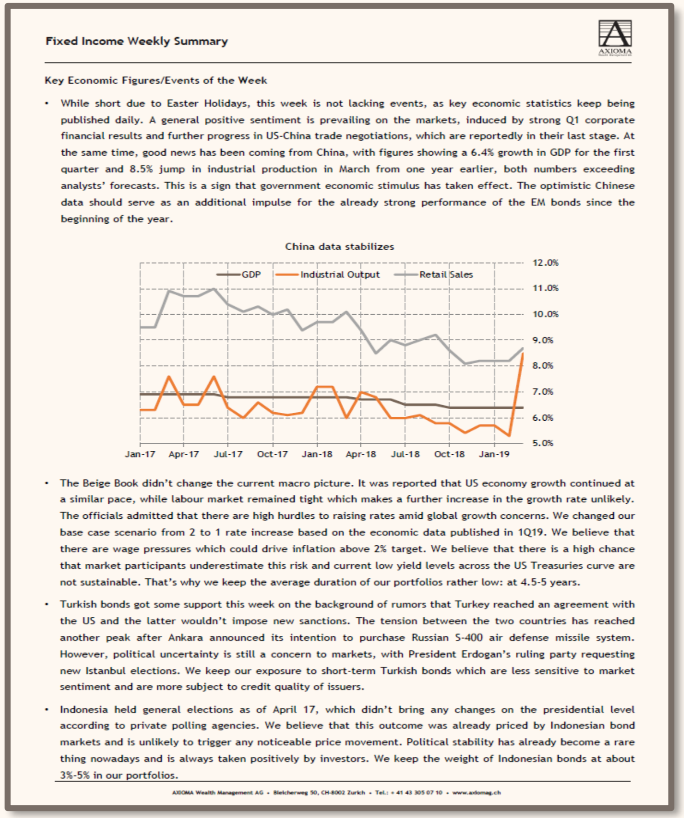
We continue to favour Indian bonds. On the positive side, **India (BBB-)** has high population and GDP growth rates and a quite developed Eurobond market. However, it is in high need of reforms which are difficult to implement and this threatens its IG sovereign credit rating. We believe that Indian bonds have a fair value and are a good bet for an Asian economy. Among our Indian top-picks are **Muthoot-23 (BB/BB),** which traded at yield-to-maturity of 3.5%, **Adani Ports-27 (BBB-/Baa3/BBB-),** which traded at yield-to-maturity of 2.8% as of Dec. 7, 2020.

Turkey and Oman has underperformed other B-rated names
(5y CDS moves)



Source: Bloomberg, AXIOMA (07.12.2020)

Stay Informed about AXIOMA's Investment Strategy



Fixed Income Weekly Summary

Key Economic Figures/Events of the Week

- While short due to Easter Holidays, this week is not lacking events, as key economic statistics keep being published daily. A general positive sentiment is prevailing on the markets, induced by strong Q1 corporate financial results and further progress in US-China trade negotiations, which are reportedly in their last stage. At the same time, good news has been coming from China, with figures showing a 6.4% growth in GDP for the first quarter and 8.5% jump in industrial production in March from one year earlier, both numbers exceeding analysts' forecasts. This is a sign that government economic stimulus has taken effect. The optimistic Chinese data should serve as an additional impulse for the already strong performance of the EM bonds since the beginning of the year.

China data stabilizes

GDP
Industrial Output
Retail Sales
12.0%
11.0%
10.0%
9.0%
8.0%
7.0%
6.0%
5.0%
Jan-17 Apr-17 Jul-17 Oct-17 Jan-18 Apr-18 Jul-18 Oct-18 Jan-19

- The Beige Book didn't change the current macro picture. It was reported that US economy growth continued at a similar pace, while labour market remained tight which makes a further increase in the growth rate unlikely. The officials admitted that there are high hurdles to raising rates amid global growth concerns. We changed our base case scenario from 2 to 1 rate increase based on the economic data published in 1Q19. We believe that there are wage pressures which could drive inflation above 2% target. We believe that there is a high chance that market participants underestimate this risk and current low yield levels across the US Treasuries curve are not sustainable. That's why we keep the average duration of our portfolios rather low: at 4.5-5 years.
- Turkish bonds got some support this week on the background of rumors that Turkey reached an agreement with the US and the latter wouldn't impose new sanctions. The tension between the two countries has reached another peak after Ankara announced its intention to purchase Russian S-400 air defense missile system. However, political uncertainty is still a concern to markets, with President Erdogan's ruling party requesting new Istanbul elections. We keep our exposure to short-term Turkish bonds which are less sensitive to market sentiment and are more subject to credit quality of issuers.
- Indonesia held general elections as of April 17, which didn't bring any changes on the presidential level according to private polling agencies. We believe that this outcome was already priced by Indonesian bond markets and is unlikely to trigger any noticeable price movement. Political stability has already become a rare thing nowadays and is always taken positively by investors. We keep the weight of Indonesian bonds at about 3%-5% in our portfolios.

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- Every week, our in-house team of financial experts and analysts take an in-depth look at how global events are affecting the financial markets and present their forecasts

  Please visit axiomag.ch/insights

- Every month, AXIOMA's fund managers provide an update on AXIOMA Leveraged Bond Fund

  Please visit axiomag.ch/fund

Your Team

AXIOMA's staff are always available to answer your questions and create a tailor-made solution for your specific requirements. Email or call us with any questions, or to make an appointment for a face-to-face meeting at our office in Zurich.

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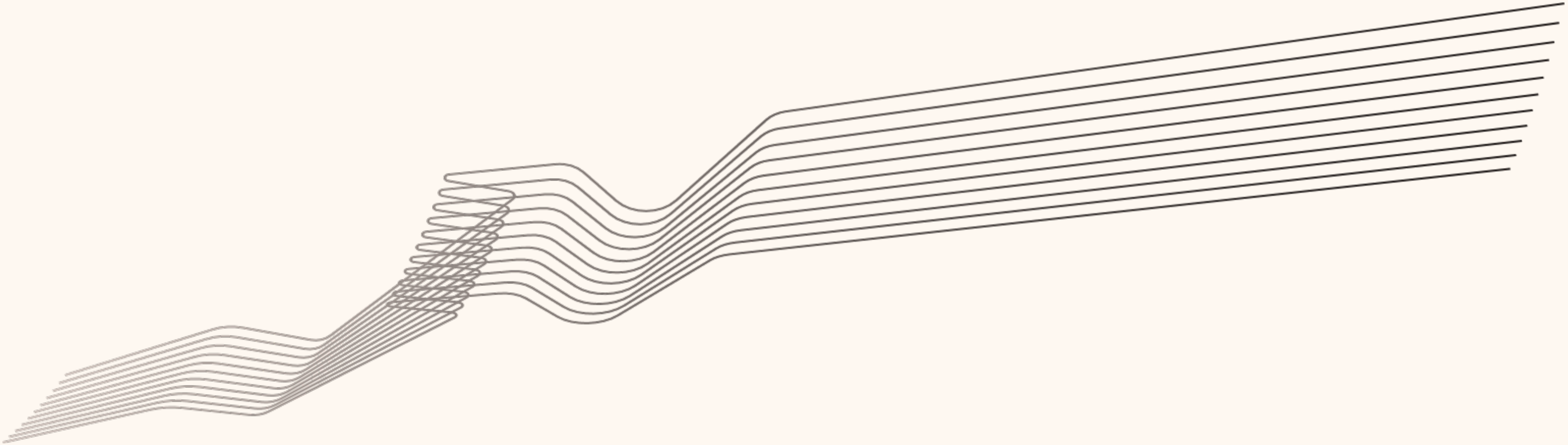

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