AXIOMA

Wealth Management AG

2020 Investment Strategy

3Q20 Update

Market Overview

Bond markets' rally continued for the most of the third quarter, on the back of a considerable surge in the economic activity and a favorable interest rate environment. Corporate earnings reports have also provided a reason for hope, with more than 80% of companies reporting better-than-expected results for the first half of the year. At its most recent meeting, the US central bank has reiterated its commitment to keep interest rates low for long, which will continue to support markets going forward.

While June and July has showed an impressive pick-up in the economic activity from the March lows, recent indicators suggest that the recovery is becoming sluggish and we expect the growth to decelerate in the coming months. Recent surge in new Covid-19 infections cases keeps uncertainty elevated. While we think that a massive lockdown as the one in March is out of cards, a second wave of infections will weigh on consumer sentiment and will keep companies reluctant to invest. This makes a speedy recovery to pre-crisis level less likely.

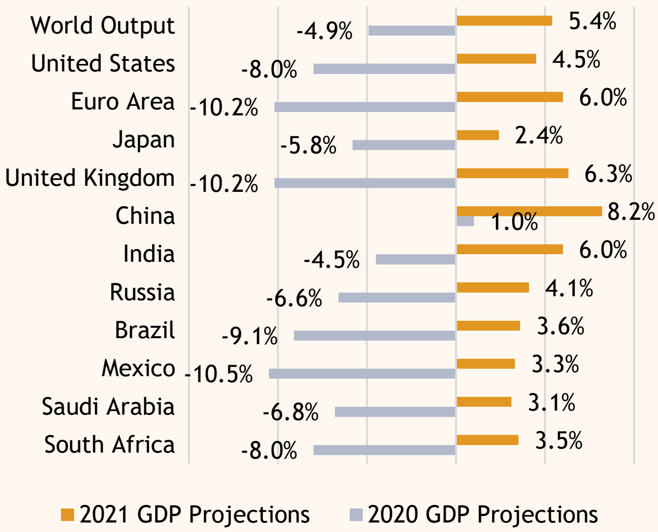
With the monetary stimulus scope fading, the cause for increased fiscal support measures is considerable. US Congress has failed to deliver a new package of fiscal stimulus and this poses significant risks to further economic recovery in the US.

US elections usually bring a spike in volatility and we believe this would be the case as we move closer to the 3 November presidential elections. Either outcome may have positive and negative implications for investors. However, the biggest challenge for the markets will be highly-contested result of the elections. Nonetheless, the impact of this event will be temporary. US-China tensions have resurfaced recently, which was expected, given that this is one of the main cards played by the incumbent president to win supporters.

September has brought an increased stock market volatility, in part due to profit-taking, but also due to worries regarding the economic outlook. This has had a spillover effect to the more risky segment of fixed income markets, as credit spreads widened marginally by the end of the quarter.

China is ahead of the other major economies, as it was the first to exit the crisis, with all activity now back to normal. Eurozone is now ahead of the US in terms of economic stimulus and this is supportive for the recovery, but the existing risks are further amplified by a chaotic Brexit.

Fig. 1 2020 and 2021 GDP Projections



Source: International Monetary Fund (June 2020)

Central banks in emerging markets have also provided significant monetary stimulus, but the scope of further rate cuts is very limited going forward. Recovery in China has been a positive catalyst for these countries. However, the main issue here is that many emerging countries, especially the ones in Latin America, have a limited room for fiscal support and this poses a challenge to further recovery.

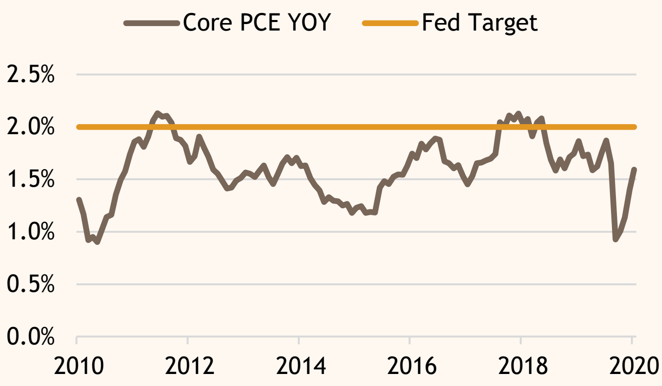
In view of the aforementioned near-term headwinds, we believe that the risk of a correction in the following months has amplified. In terms of economic outlook, our base case scenario implies a slow, prolonged economic recovery (60%). On the optimistic side, we expect the development of a Covid-19 vaccine, along with more ample governmental fiscal support to lead to a quicker rebound in the months ahead (15%). The materialization of risks relating to a significant surge in new infections, coupled with the lack of progress on the vaccine development and an intensification of geopolitical tensions could result in the economies stagnating or resuming contraction (25%).

US Treasury Yield Curve

In August, the US Federal Reserve announced a change to its monetary policy framework by adopting an average inflation target, which would allow potential moderate inflation overshoots. Thus, Fed will refrain from hiking rates too early, even if maximum employment will have been achieved. This is positive for the markets, as embarking on a tightening cycle too early would be destabilizing to the financial markets, as was the case in the late 2016.

Nonetheless, inflation has been running below the 2% target for the last decade and we consider that it will stay so in the near future.

Fig. 2 Inflation persistently below Fed's target

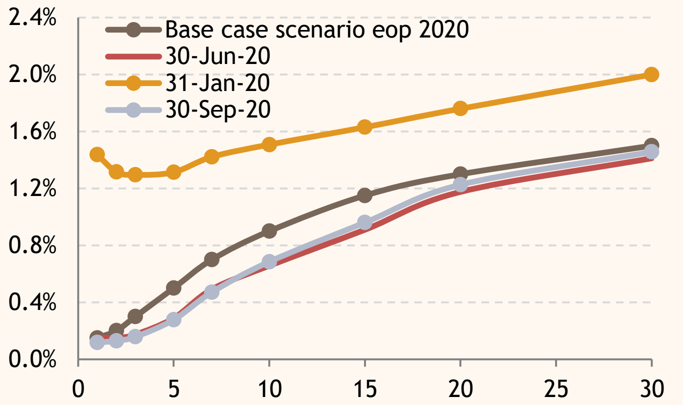


Source: Bloomberg (30 September 2020)

The latest policy meeting of the FOMC didn't bring any changes to the benchmark interest rate, which we believe will stay anchored close to zero for years. At the same time, US Central Bank refrained from announcing any plan for its asset purchasing program. The astounding $2.5 trillion Fed has already added to its balance sheet in just 3 months following the March events have achieved its aim of stabilizing the financial markets. Reversing the balance sheet expansion will most likely have the opposite effect. Therefore, we believe the US Central Bank will refrain from it in the foreseeable future. In addition, should the worst-case-scenario in terms of economic recovery materialise, we believe Fed will stand by to further expand its balance sheet.

We expect yields across the US Treasuries curve to stay at a low level. There are factors that could lead to the steepening of the US yield curve, mainly increased supply for financing fiscal stimulus programs. However, Fed will step in with asset purchases into longer-dated Treasuries to prevent yields from rising too high, in our view.

Fig. 3 US Treasuries curve

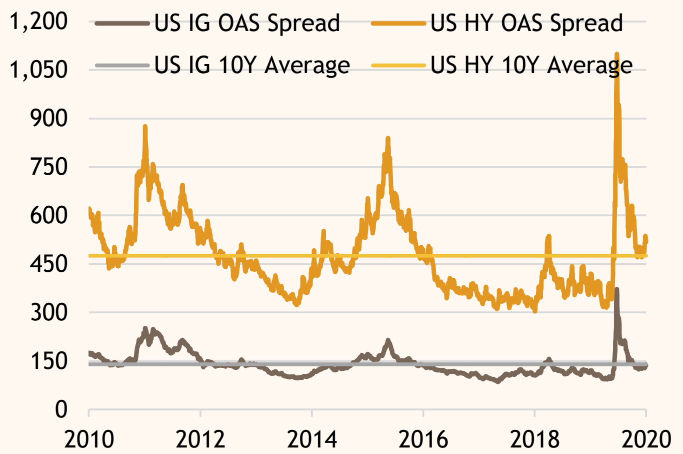


Source: Bloomberg, Axioma (30 September 2020)

Credit Spreads

Corporate bond spreads have continued to tighten during most of the third quarter, much faster than in previous post-recession rebounds, getting close to their long-term average levels, and the potential for further narrowing has become limited. US Corporate bond issuance has set records this year as companies bult up a cash cushions to weather the crisis. Even August, which usually brings a stall in primary market activity has seen heavy corporate bond issuance. There was a slight widening in credit spreads by the end of the quarter, more so on the high yield segment.

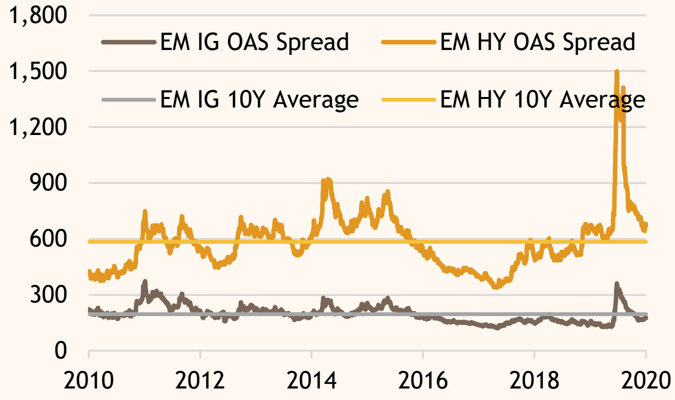
Fig. 4 US IG and HY Credit spreads



Source: Bloomberg (30 September 2020)

Looking forward at the months ahead, we expect the credit spreads to see a volatile performance. However, the ultra-low interest rate environment will encourage the search for yield and will keep the spreads from widening too far.

Fig. 5 EM IG and HY Credit spreads



Source: Bloomberg (30 September 2020)

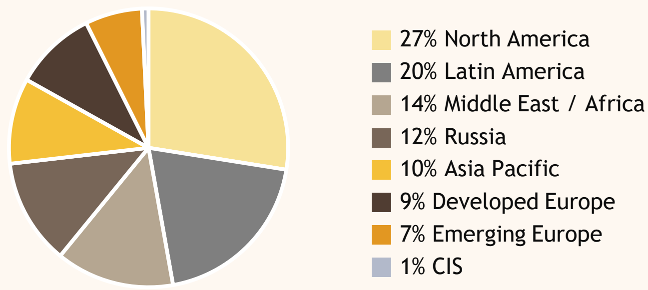
Strategy

In lights of the aforementioned political risks and uncertainties regarding the economic outlook, we have further increased the share of IG bonds in our portfolios. We took advantage of high valuations achieved by the end of August and took profit on some EM issuers for which the outlook is more uncertain, there is a risk of downgrade and/or they are more prone to high price volatility. Going forward, we intend to remain overweight credit quality. We have very low exposure to sectors that are prone to increased level of defaults, like the airline and hospitality industries. We also remain underweight duration, to reduce potential volatility in our portfolios. Average duration in our portfolios was further reduced to an average of 4.6 years, as we have fixed profit on long-duration US IG issues most of which achieved pre-crisis price levels.

Regional allocation has not seen significant changes from the end of the second quarter. Thus, we remain overweight North America. The weight of Turkey has been reduced, as we have sold sovereign bonds as well as reduced holdings in some corporate issuers, as there are significant risks to the economic outlook.

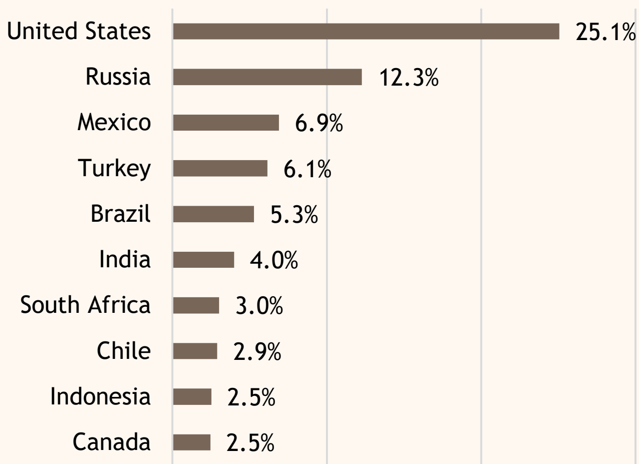
As a result, the leverage in our leveraged portfolios has been reduced down to 20%. We have also accumulated some cash in portfolios with a conservative strategy, which however does not exceed 10%. We believe that the augmented volatility in the run up to the US elections will provide interesting buying opportunities, which will allow us to further increase performance. The key is to be able to act quickly to changes in the market environment.

Fig. 6 AXIOMA Leveraged Bond Fund regional allocation



Source: AXIOMA, (30 September 2020)

Fig. 7 AXIOMA Leveraged Bond Fund allocation by countries



Source: AXIOMA (30 September 2020)

Performance Forecast

We have calculated subsequent 3 months performance according to 3 scenarios: base, optimistic and negative. Calculations are based on Axioma Leveraged Bond Fund portfolio (average coupon of 4.5%, average duration of 4.6 years, average yield-to-worse of 3.2%, leverage 21% as of 30/09/20). Refinancing rate we used in the calculations is 0.7% p.a.

- **Optimistic case** – UST yields stay at current levels and credit spreads recover another 40bps on average getting in line with their long-time average.
- **Base case** – UST yields raise 25bps due to increased offer and credit spreads stay at the current level.
- **Negative case** - UST yields raise 50bps along the curve from the level and credit spreads widen 100 bps on average. We assume a default rate of 1,0% for this scenario.

Table 1. Strategy performance forecast, 3 months (01.10.2020-31.12.2020)

Strategy return	Optimistic scenario	Base case scenario	Negative scenario
Coupon component	1.1%	1.1%	1.1%
Price change due to change in UST yields	0.0%	-1.2%	-2.3%
Price change due to spread narrowing or widening	1.6%	-0.1%	-7.0%
Default	0.0%	0.0%	-1.0%
Total:	**2.7%**	**-0.2%**	**-9.3%**
Return subject to 25% leverage	**3.3%**	**-0.3%**	**-11.6%**
Return subject to 50% leverage	**3.9%**	**-0.4%**	**-14.0%**

Source: AXIOMA (30 September 2020)

Table 2. Strategy performance forecast, 2020

Strategy return	Optimistic scenario	Base case scenario	Negative scenario
01.01.2020-30.09.2020	12.5%	12.5%	12.5%
3 month return (no Lev)	2.7%	-0.2%	-9.3%
3 month return (25% Lev)	3.3%	-0.3%	-11.6%
3 month return (50% Lev)	3.9%	-0.4%	-14.0%
FY2020 (no lev)	**15.5%**	**12.2%**	**2.0%**
FY2020 (25% lev)	**16.2%**	**12.1%**	**-0.6%**
FY2020 (50% lev)	**16.9%**	**12.0%**	**-3.3%**

Source: AXIOMA (30 September 2020)

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We hope you find this information useful and will be glad to answer your questions

Disclaimer