

MARKET REVIEW

Myopic markets

Are the financial markets myopic? that is the question that being asked, so obvious is the decorrelation between economic figures on the one hand and the stock market performance of certain securities on the other. Furthermore, there are significant disparities between markets. The United States benefits from the "technology" effect with securities such as Apple or Microsoft, while Europe is penalized by the reduction in trade and the strength of the EUR. The crisis is multifaceted coupled with a resurgence of Covid-19 cases and leaves deep of uncertainty.

While the second quarter had been positive for bonds, the month of August registered a pause due to the slight rise in interest rates.

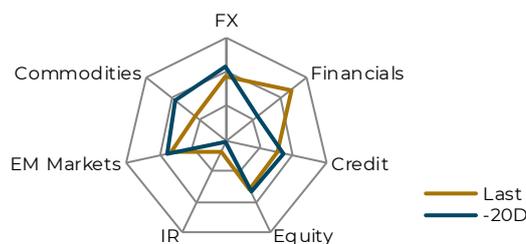
On the currency side, large movements eased. The USD remains under pressure. Finally, for raw materials, oil continues to recover, while gold paused.

Our risk indicators are easing on commodities as they rise on the financial sector.

	Value	August	2020
Equity markets			
Switzerland (SMI)	10 136	1.30%	-4.53%
United States (S&P500)	3 500	7.01%	8.34%
Europe (Euro Stoxx 50)	7 072	3.18%	-11.04%
Japan (Nikkei)	23 140	6.59%	-2.18%
China (Shanghai SE)	3 396	2.59%	11.33%
Brasil (Bovespa)	99 369	-3.44%	-14.07%
Currencies			
USD/CHF	0.903	-1.14%	-6.58%
EUR/CHF	1.079	0.28%	-0.58%
GBP/CHF	1.208	1.10%	-5.82%
EUR/USD	1.194	1.30%	6.37%
Other asset classes			
Swiss Real Estate		-1.28%	-1.17%
Swiss Bonds		-0.79%	-0.42%
Foreign Bonds		-0.80%	3.02%
Commodities		4.59%	-30.86%
Oil	42.61	5.81%	-30.22%
Gold	1 971.90	-0.07%	29.49%
Rates / Indicators			
10 years Swiss rate		-0.41%	-0.47%
10 years US rate		0.70%	1.92%
US Unemployment		10.20%	3.50%
US GDP		-9.10%	2.30%
US CPI		1.60%	2.30%



XO Risk Aversion Index - Components

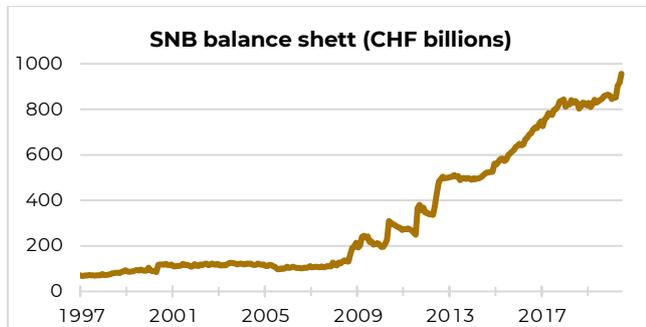


THE 1'000 BILLION DOLLAR QUESTION

In 20 years, the balance sheet of the Swiss National Bank (SNB) has increased tenfold and the 1'000 billion mark is about to be reached. How is this amount used by the SNB and the other major central banks? Has the SNB become a huge investment fund?

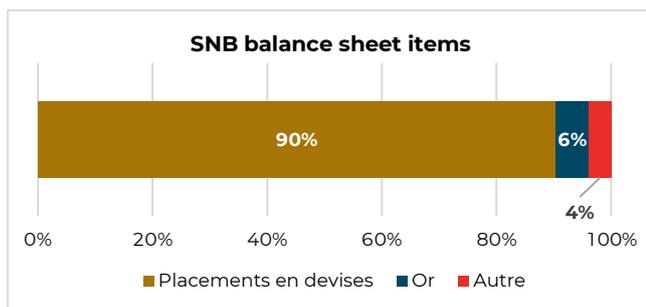
A balance sheet revolutionized in 20 years

As of June 30, 2020, the balance sheet of the SNB reached the astronomical sum of CHF 956 billion, ten times its size at the beginning of the 2000s. The growth started with the crisis of 2007-2008, but the injections really exploded with the European crisis of 2011-2012. Since then, growth has been steady before the recent crisis further accelerated the trend. In terms of the Swiss economy, the SNB balance sheet now represents 135% of the GDP. This ratio is well above that of the ECB and the FED.



Source : BNS

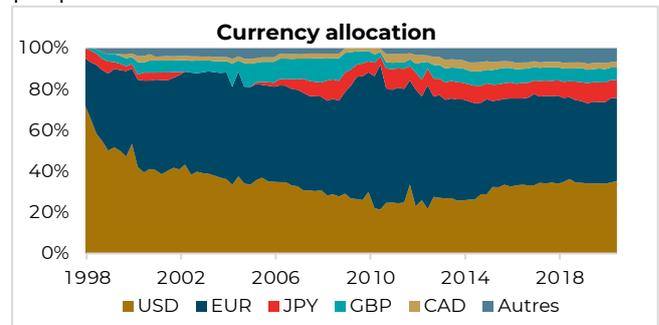
The SNB sees the size of its balance sheet increase as it seeks to limit the appreciation of the CHF, as a strong CHF penalizes the Swiss export industry. It does this through negative rates, which are supposed to discourage foreigners from buying CHF, but also by intervening in the foreign exchange market. In practice, the SNB creates CHF in order to sell it immediately against foreign currencies. As a result, foreign currency investments account for 90% of the balance sheet (863 billion as of June 30). Gold, despite the sharp reduction over the last 20 years, still accounts for 6% of the balance sheet.



Source : BNS

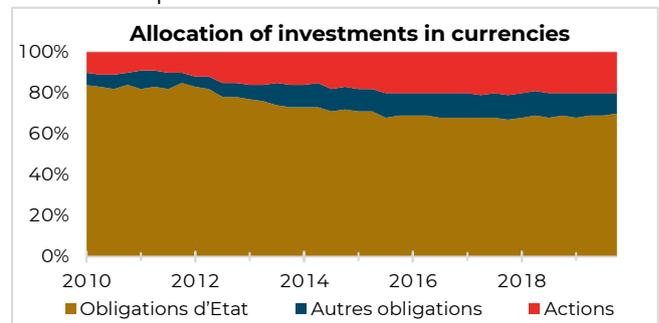
The SNB's foreign currency investments

The currency allocation of foreign currency investments has changed over time. Whereas before the introduction of the EUR, the USD accounted for almost 80% of these amounts, the European currency has gradually become more important for the Swiss central bank. During the European debt crisis, the EUR accounted for 70% of the total in this category. Today the balance sheet has more equilibrium. Given the increase in the size of the balance sheet, this means that the SNB buys the major foreign currencies USD, EUR, JPY, GBP and CAD in stable proportions.



Source : BNS

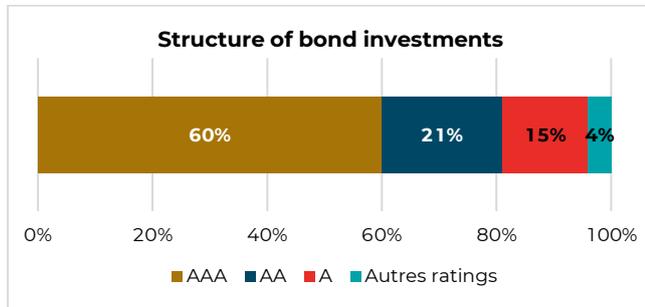
To avoid having only liquid assets on its balance sheet, the national bank then invests these currencies (USD, EUR, ...) in financial instruments. With a portfolio of CHF 863 billion, the SNB is undoubtedly the country's largest investor. As a reminder, the Swiss occupational pension plan as a whole reaches 1'000 billion assets spread over 1'500 institutions.



Source : BNS

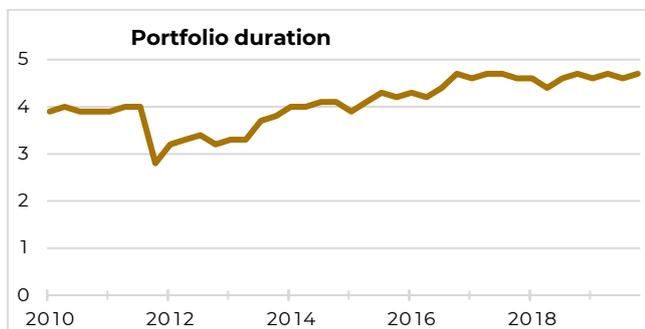
70% (\$605 billion) of foreign currency investments are invested in government bonds, 10% (\$85 billion) in corporate bonds and 20% (\$170 billion) in equities.

60% of the bonds are invested in high quality AAA debtors. The SNB does not give details but AAA countries are few. It is highly likely that the main positions are therefore bonds from Germany, Austria, Finland, Luxembourg, the Netherlands, Canada or the United States. Only 4% of bond assets are rated below A.



Source : BNS

Like every bond investor, the SNB is attentive to the average duration of its portfolio, i.e. the average duration of the debts it has purchased. This duration reaches 4.7 years, an increase of one year over the last decade. This duration is shorter than the world bond indices which show durations of around 7 to 8 years.



Source : BNS

An equity portfolio of 170 billion

The weight of equities has doubled in 10 years in the balance sheet of our national bank, making the SNB a major investor as well.

The problem is that for this asset class, it is not possible to replicate bond purchases by buying mostly government guaranteed securities. To justify its choices, the SNB communicates its strategy on its website¹ :

"In its equity portfolio, the National Bank replicates the composition of broad indices. In

other words, it does not carry out positive or negative stock selection, but its portfolio is a reproduction of the entire international stock market. The National Bank sees itself as a purely financial investor, i.e. it deliberately does not take any strategic stakes in companies. Its investment policy is thus protected from political considerations, and its influence on individual markets is minimized.

In some cases, the National Bank departs from the principle of full market coverage. For example, in order to avoid conflicts of interest, it refrains from acquiring shares in banks [...]. It also refrains from purchasing shares in companies that massively violate fundamental human rights, that systematically cause serious environmental damage or that are involved in the manufacture of internationally condemned weapons. [...]. »

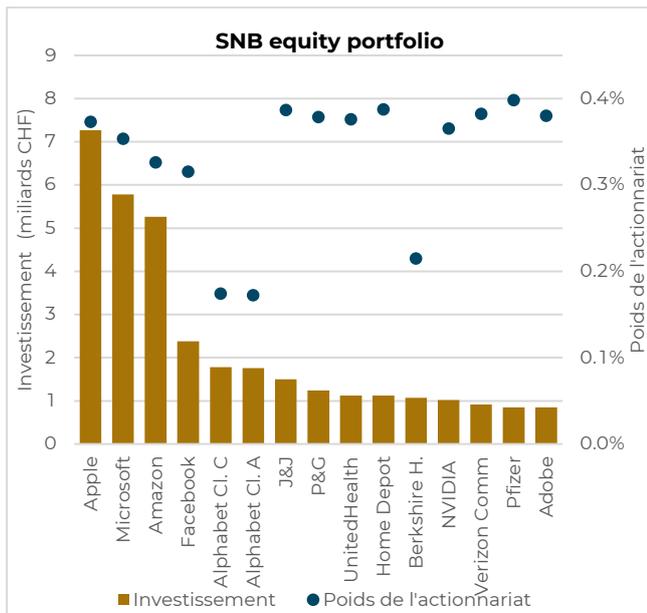
It is interesting to note that the SNB considers itself as a purely financial investor while refusing to create a sovereign fund..

Thus, the SNB uses a so-called passive strategy for its equity investments. It will buy the largest securities on the market. It is therefore easy to make a projection of its equity portfolio by using the composition of the MSCI World index.²

The first global position is currently Apple. To meet its strategy, the SNB has had to invest more than CHF 7 billion in the stock. This makes the SNB the 27th shareholder of the US company, but the largest individual shareholder. The largest shareholders are banks on behalf of their clients. The SNB represents 0.40% of Apple's total shareholders. Our national bank has therefore invested billions in the largest companies in the world: Microsoft, Amazon, Facebook, etc. The larger the SNB's balance sheet, the more it will buy these shares. For all these securities, the SNB presently represents about 0.4% of their shareholding. The Swiss central bank is therefore not an insignificant buyer on the equity world markets.

¹ https://www.snb.ch/fr/i/about/assets/id/qas_assets_1#t24

² A finer analysis can be made through the analysis of Form 13Fs where the SNB must report its holdings of securities to the SEC on a quarterly basis.



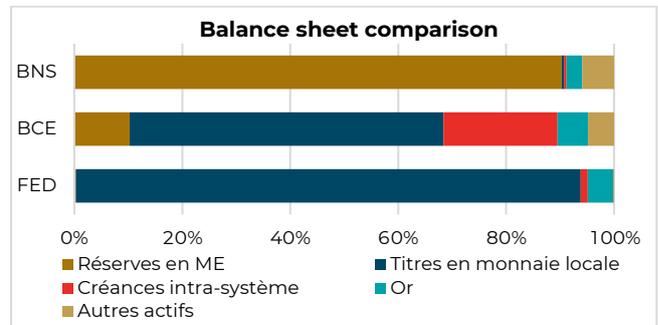
Source : XO Investments SA

A reverse FED strategy

For 10 years now, all central banks have been creating money in order to deal with the various crises (banking, European and then COVID-19). All central banks' balance sheets exploded in March 2020. Nevertheless, the use of this money is very different from one central bank to another. Thus, the ECB and the FED have a use of the funds created diametrically opposed to that of the SNB. The FED has used 93.5% of its balance sheet to buy securities in its own currency and implicitly support the economy and lower rates. This is also what the ECB is doing with 79.2% of its balance sheet. One can therefore better understand the behavior of the financial markets when such players intervene, both in the bond and equity markets. While the FED and the ECB support local assets with their purchases, the SNB supports foreign assets to devalue its currency. The FED and the ECB by creating the USD and EUR lower the value of their respective currencies against the outside world, especially against the CHF. To limit the rise of the CHF, the SNB is then trapped by its own policy and has to create proportionally (relative to GDP) much more than its counterparts to achieve the desired effect by

selling CHF and then buying the same (foreign) assets as the ECB and the FED.

It should be noted that if the SNB applied the same policy as the FED by buying Swiss securities, its leverage ratio on the SMI would be around 55%. Given the size of the SNB, it seems difficult to implement such a policy.



Source : BNS, FED, BCE, XO Investments SA

The SNB also stands out for its gold position, representing 5.9% of its assets, compared to 4.8% for the ECB and only 0.2% for the FED.

The SNB is an investment fund

The SNB will soon reach a balance sheet of CHF 1'000 billion. Given its strategy, this amount makes the SNB a real investment fund, "prisoner" of the strategies implemented by the FED and the ECB.

What are the limits? It is hard to imagine that the SNB can create money indefinitely, however reversing its policy would be counterproductive since it would increase the value of the CHF.

If the SNB were to implement a policy equivalent to its American and European counterparts by creating CHFs and leaving them in its national currency, it could limit the rise of the CHF while investing in the national economy. The major disadvantage of this strategy would be the potential creation of inflation. The SNB does not currently act in this way in order to respect the mandate given by the Confederation, which provides a single objective: to maintain a low level of inflation.