MONTHLY COMMENT

March 2021

MARKET REVIEW

Tout va très bien Madame la Marquise

The financial markets seem to be immune to bad news. The successive reconfinements of European countries do not undermine the confidence displayed by the financial markets. Stocks that had lagged in February were the most dynamic in March. This is particularly true of the big Swiss stocks such as Nestlé and Roche. Only China is lagging in this last month of the quarter. Against all expectations, Europe was the best equity market of the quarter.

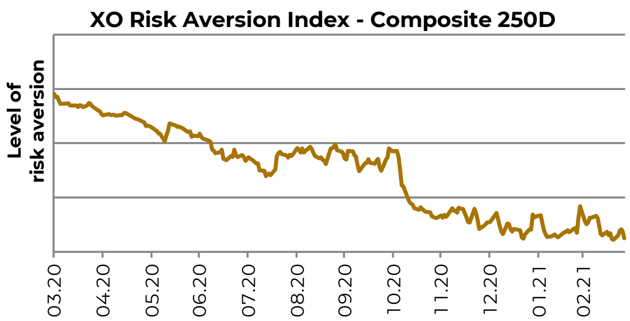
The major rise in interest rates in February continued into March. The US 10-year yield rose by a further 0.2%. Swiss rates, on the other hand, are easing somewhat. Bonds, like real estate, were negative for the quarter. The USD remains strong at the beginning of the year. The CHF is no longer in demand, as economic fears have vanished.

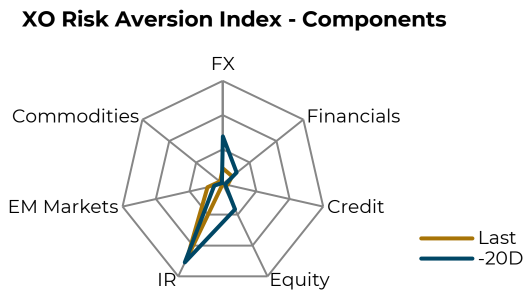
Finally, commodities are marking time, including oil. The blockage of the Suez Canal did not lead to a further increase in the price of a barrel of oil, even though 12% of world trade had come to a halt. The Egyptians can now compete with the Marseillaise and their sardine blockade of the port.

Despite the bad news, the financial markets are in good health. All is well, Madam Marquise, all is well, all is well.

Our risk indicators remain low, with the notable exception of interest rates.

	Value	March	2021
Equity markets			
Switzerland (SMI)	11 047	4.99%	3.21%
United States (S&P500)	3 973	4.24%	5.77%
Europe (Euro Stoxx 50)	8 515	7.88%	10.66%
Japan (Nikkei)	29 179	0.73%	6.32%
China (Shanghai SE)	3 442	-1.91%	-0.90%
Brasil (Bovespa)	116 634	6.00%	-2.00%
Currencies			
USD/CHF	0.942	3.70%	6.43%
EUR/CHF	1.107	0.93%	2.42%
GBP/CHF	1.301	2.76%	7.58%
EUR/USD	1.175	-2.69%	-3.89%
Other asset classes			
Swiss Real Estate		2.43%	0.43%
Swiss Bonds		0.49%	-1.20%
Foreign Bonds		-0.51%	-2.79%
Commodities		-2.15%	13.55%
Oil	59.16	-3.80%	21.93%
Gold	1 712.02	-1.27%	-9.63%
Rates / Indicators			**Δ**
10 years Swiss rate		-0.28%	0.28%
10 years US rate		1.74%	0.83%
US Unemployment		6.20%	-0.50%
US GDP		-2.40%	0.00%
US CPI		1.30%	-0.30%





THERE WILL BE ONLY ONE LEFT !

As the $1900 billion stimulus package has just been signed, the FED is preparing to be a major, if not essential, player in these new injections. Confirmation that the money printing press is working at full speed across the Atlantic.

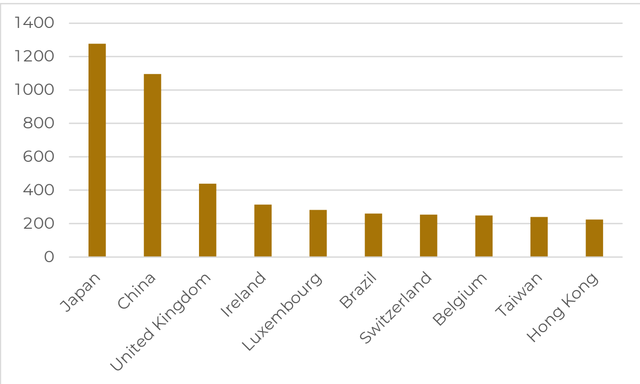
The geopolitics of debt

The Covid-19 crisis is an accelerator at all levels. The technology sector is increasing its hold on the economy. This is not new, but it is as important and much more strategic today, than it was a year ago. The crisis is accelerating social and geopolitical tensions. The debt, which had been rising steadily for several decades, is now increasing dramatically with the multiple aids for the sectors affected. Nothing changes but everything accelerates.

US government debt is following the same trend and is expected to exceed the dizzying sum of USD 25 trillion by the end of the first quarter of 2021. In 20 years, its value has increased fivefold.

Many countries are among the main creditors of the United States. Japan, with more than USD 1.2 trillion outstanding, is in first place, ahead of China and the United Kingdom. Switzerland is the seventh largest holder with more than USD 250 billion in US bonds.

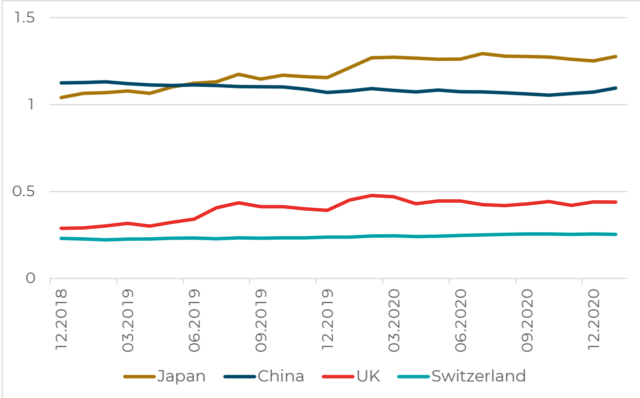
Top countries holding US government debt (USD billion)



Source : Bloomberg, XO Investments SA

The dynamics of buying or selling government bonds is a true indicator of global geopolitics. Japan, for example, contributed almost USD 100 billion in 2020. 100 billion from the Bank of Japan to finance US state aid. China, on the other hand, has only maintained its debt stock over the period, without lending more to the US. The Sino-American trade conflict is certainly not unrelated to this.

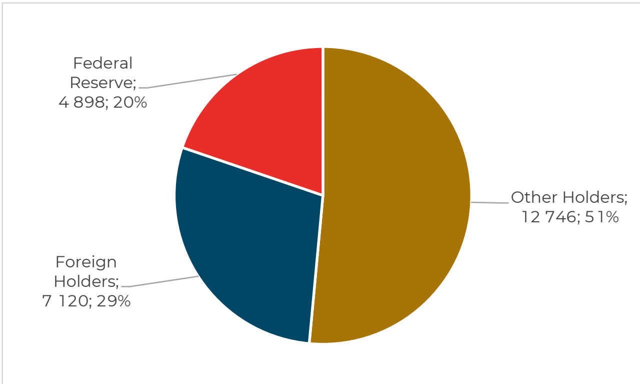
Evolution of US government debt holdings (USD trillion)



Source : Bloomberg, XO Investments SA

Although foreign countries lend massively to the US, totaling 29% of the 25 trillion US debt, none of them is the government's main lender. Indeed, it is the Federal Reserve (FED) itself that is the largest holder of US treasury bills. The other holders are private institutions, such as investment funds, pension funds, banks, insurance companies, etc.

Breakdown of US government debt (USD billion)



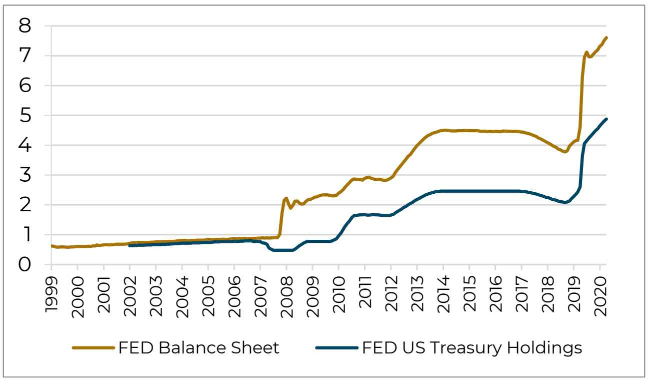
Source : Bloomberg, XO Investments SA

The FED: holder of first resort

It is often said that the Fed is the lender of last resort for the financial markets, but it is clear that in the context of US government debt issuance, it is in first place.

Prior to 2007, the Fed's balance sheet consisted exclusively of US Treasury bills. The 2008 crisis forced the Federal Reserve to intervene by buying private paper, notably from banks. The aftermath of the health crisis now shows a parallel increase between the Fed's balance sheet and the amount of US treasury bills held.

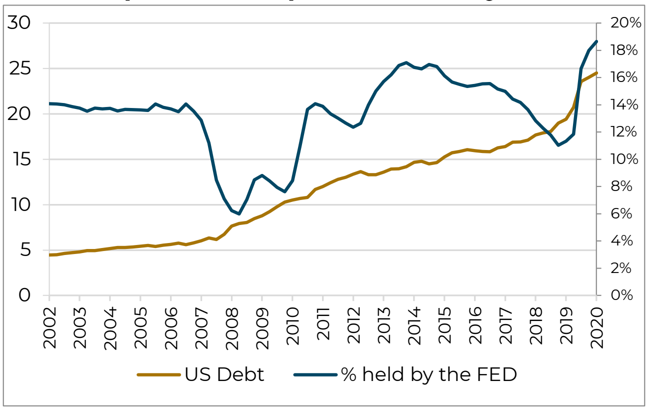
FED balance sheet (USD trillion)



Source : Bloomberg, XO Investments SA

The FED now holds almost 20% of government debt. This figure grew robustly in 2020 and is the highest in the last 20 years.

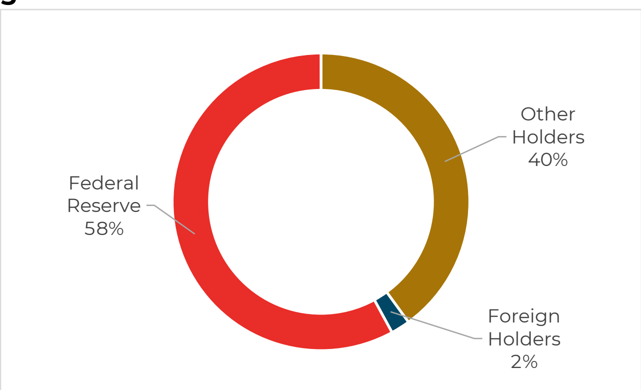
US debt (trillion USD) and % held by the FED



Source : Bloomberg, XO Investments SA

More importantly, the FED contributes 60% of the increase in US debt. Thus, for every dollar borrowed by the US government, 60 cents is printed at the issuing institution which becomes the de facto US Treasury.

Contribution to the growth of the US government debt in 2020



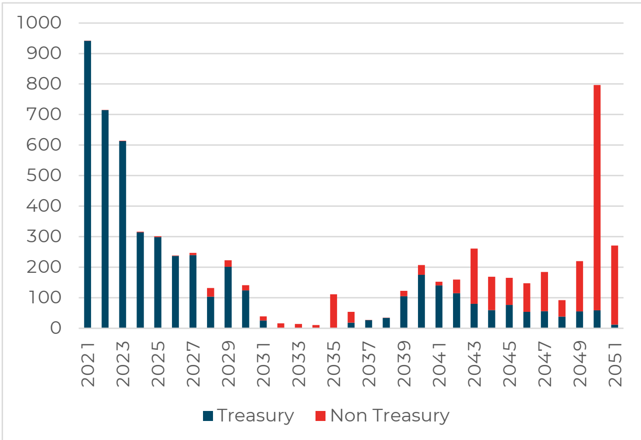
Source : Bloomberg, XO Investments SA

The implementation of the new USD 1.9 trillion aid package should further accentuate this spectacle. If we look at these figures with caution, we can imagine that one trillion of the 1.9 will be created by the FED. We assume that this will faction reality be much more since, such a loan, if not in sufficient demand, could lead to a significant rise in interest rates, hence the central bank's desire to "control" the yield curve as best it can.

Debt schedule forces FED to be omnipresent

The FED holds substantial amounts of short-term bonds from the US government. Despite a duration of 12.3 years overall, the years 2021 to 2023 offer many repayments: 940 billion in 2021, 715 in 2022 and 614 in 2023.

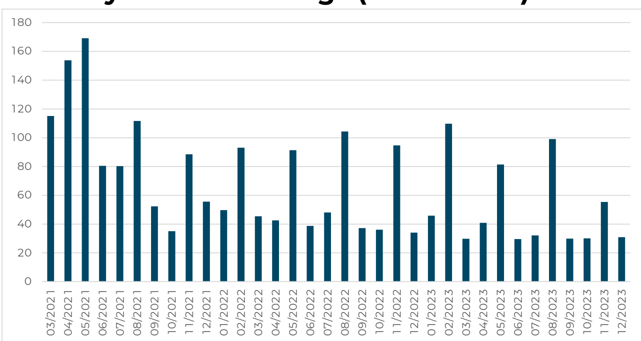
Maturity of FED holdings (USD billion)



Source : Bloomberg, XO Investments SA

The spring of 2021 will be particularly busy as the FED will have to renew between 110 and 160 billion per month.

Maturity of FED holdings (USD billion)



Source : Bloomberg, XO Investments SA

This compressed time frame will force the FED to be omnipresent in the market in the years to come. The amounts repaid will be immediately reissued by the government. Given that the FED has a contribution of around 60%, which it did not have in the past, and taking into account the new aid plan, it seems safe to assume a FED balance sheet of USD 9 or 10 trillion at the end of 2021.

There can only be one left!

The crisis only accelerates underlying trends. The FED is gradually taking over as the largest lender to the US government.

Like the Bank of Japan, which holds more than 50% of the debt issued by the Japanese government, the US debt is gradually beginning to function as a closed circuit. The independence of the Federal Reserve is evaporating as this system progresses, creating a de facto merger between the Treasury Department (headed by former FED chairwoman Janet Yellen) and the FED. The extrapolation being, there will eventually be only one lender left to the US government: the FED, or itself! The only question is when this dynamic will start to cause problems for the USD and interest rates, making this headlong rush to the bottom deadly.