N° 591
18 January 2021

BONHÔTE
BANQUIERS DEPUIS 1815

FLASH BOURSIER

EQUITY BENCHMARKS TAKE A BREATHER

Highlights:

9 Chinese companies added to America's black list

US banks are reporting very strong 4th-quarter results

Overview

The main stock market indices pulled back last week in the wake of new restrictions aimed at checking the spread of the Covid pandemic and the announcement by Pfizer-Biontech that it will slow the distribution of its vaccine. Benchmarks remain in good shape, however, with the DAX near its all-time high and the Nikkei at a record peak. The technology sector was weighed down by the US government's decision to blacklist nine more Chinese companies and impose restrictions on firms that supply components to the smartphone manufacturer Huawei. The news flow in the coming week will be heavy, with the official inauguration of Joe Biden as president of the United States on Wednesday, the ECB governors' meeting on Thursday which could end with the announcement of increased monetary stimulus and numerous 4th-quarter earnings reports by US companies.

The USD 1.9 trillion fiscal stimulus package proposed by the new Biden administration is welcome in view of America's weakening jobs outlook. Given the prospect of a strong economic comeback, investors may have feared a reduction in the Fed's asset purchases and a rise in short-term interest rates sooner than expected. Large cash payments to American households could spur spending and give a lift to prices. The result has been an increase in yields in the major bond markets, with US 10-year issues edging up to 1.08%. However, the Fed has set stringent objectives for an uptick in short-term rates. US inflation must rise to 2% for at least a year, a level that has been reached for only 57 months over the past 25 years. Jerome Powell, the Fed chairman, says that for the time being a rate hike is not on the cards.

The leading US banks have kicked off the 4th-quarter reporting season with very strong results. In the last three months of 2020 they managed to reduce their provisions for non-performing loans and boost their revenue and profits in trading and underwriting. According to their forecasts, however, it is possible that defaults on credit cards and consumer loans will turn back upwards when the government's economic stimulus runs out.

China's GDP grew 6.5% in the 4th quarter, bringing expansion in 2020 as a whole to 2.3% and confirming the country's strong recovery. Although this marks China's weakest economic performance in 44 years, it was a brilliant showing compared with other large countries. Industrial production was up 7.3% year on year in December and retail sales up 4.6%, a bit less than expected.

The SMI could break through its 10,950-point objective in the coming days before heading on up to its peak at 11,260. The support at 10,700 nevertheless needs to be watched: if it is breached the drop could challenge the uptrend.

Key data

	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI EMERGING MARKETS
Latest	0.89	1.08	10'877.06	3'599.55	13'787.73	5'611.69	6'735.71	3'768.25	12'998.50	28'519.18	1'358.03
Trend	→	→	↑	→	→	→	↑	→	→	↑	↑
%YTD	0.73%	-0.48%	1.62%	1.32%	0.50%	1.09%	4.26%	0.32%	0.86%	3.92%	5.17%

(Daten vom Freitag vor der Publikation)

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CONVERTIBLE BONDS OFFER A TIMELY DIVERSIFICATION

In an uncertain environment where the deployment of vaccines holds out legitimate hope for an upturn in economic activity worldwide and where interest rates are extremely low, but also where the timing of the recovery remains a huge question mark, investing in convertible bonds makes considerable sense.

Convertible bonds are debt issues supplemented by an option (i.e. a right) to convert the bond into a certain number of shares in the issuer at a predetermined price. The price of the convertible bond will therefore depend on a rise in the value of the share but, in the event of a fall, will converge towards the value of the issuer's bond alone. An investor will therefore partially participate in the equity market's increase while still benefiting from what is called the "bond floor", providing the security of a debt instrument.

This hybrid structure generates very good long-term performances in both absolute as well as relative terms, with a volatility roughly 50% lower than that of the stock market and a return that is sometimes not far from that of the benchmark, depending on the market concerned.

At present we are in a configuration where the value of convertibles is less than the sum of their parts (i.e. value of the bond + value of the conversion option), making this asset class even more attractive. Thus, convertible bonds fit snugly into a diversified portfolio.

It is also interesting to note that historically, in the past 12 cycles of rising interest rates since the beginning of the 1990s, convertible bonds have gained value in 11 of these environments. Enticing!

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