

## Investment Themes 2021

The corona pandemic forces people to change their behaviour and is beneficial to companies that cover this new demand. We expect that most trends that have been accelerated by the pandemic will remain even after the corona virus has been defeated.

Further developments will make it increasingly easy to get everything tailor-made offered and delivered by just pushing a few buttons. However, we also believe that the market is ahead of itself, similar to the late 90s, by expecting too much too soon based on recent data. It has always paid off to take some profits if markets or sectors have done extremely well.

Rebalancing is a widely known approach where the winners are cut back to the strategic weight and money is added to the losers or laggards. While the mega-trends in technology, healthcare, renewable energy, artificial intelligence, etc. will continue, it is a good time in our view to shift some assets from a

long-only investment approach to a long and short strategy.

Long/short funds will do better when markets are less directional and more volatile as managers can earn money on their long and short picks. The short portfolio serves additionally as a hedge in a general market set-back or correction. Lastly, an investor in long/short funds can often access very talented and local investment professionals who know their regions or sectors extremely well.

If you are interested in a customized investment in Long/Short Greater China, Long/Short Renewable Energy or Long/Short Technology, please contact us for more information. Through our actively managed certificates, we can also efficiently invest smaller amounts in the best hedge funds worldwide in order to get exposure to one or more of the interesting themes in 2021.

Please contact Stefan Steiner at [ss@cb-partners.com](mailto:ss@cb-partners.com) for more information.



Stefan Steiner

Bonds (USD)	2020	2019	2018	3Y CAGR	5Y CAGR	5Y Std Dev
Switzerland Gov Bonds 1-10Y TR	1.27%	3.06%	3.52%	2.61%	2.13%	2.08%
FTSE WGBI (ex-Citi WGBI All Maturities)	10.11%	5.90%	-0.84%	4.96%	4.78%	5.36%
Barclays Global HY TR	7.03%	12.56%	-4.06%	4.95%	7.84%	9.00%
HFRI Event-Driven Index	8.84%	7.49%	-2.13%	4.62%	6.38%	8.17%
HFRI Relative Value Index	3.66%	7.42%	-0.43%	3.50%	4.65%	5.64%
Crossbow Credit Distressed Portfolio	9.58%	8.13%	2.73%	6.77%	7.14%	5.51%
Crossbow Alpha Portfolio	9.67%	7.35%	1.77%	6.21%	4.76%	2.68%
Equities (USD)	2020	2019	2018	3Y CAGR	5Y CAGR	5Y Std Dev
SMI TR Index	5.72%	34.05%	-4.17%	10.74%	9.89%	11.54%
MSCI AC World TR	16.25%	26.60%	-9.41%	10.06%	12.26%	15.08%
MSCI EM TR	18.31%	18.42%	-14.57%	6.17%	12.81%	17.58%
HFRI Equity Hedge Index	17.41%	13.71%	-7.14%	7.43%	8.17%	9.78%
HFRI Macro Systematic Diversified Index	2.65%	7.08%	-6.62%	0.87%	0.67%	7.35%
Crossbow Equity Hedged Portfolio	11.28%	9.68%	-3.83%	5.48%	3.49%	4.47%
Crossbow Trading Portfolio	4.22%	4.04%	1.71%	2.32%	3.95%	4.49%
Crossbow Trendfollowing Portfolio	2.10%	12.36%	-0.74%	4.43%	3.60%	5.91%
Others (in USD)	2020	2019	2018	3Y CAGR	5Y CAGR	5Y Std Dev
BVG-25 Plus	4.68%	14.04%	-0.13%	6.04%	6.07%	4.72%
BVG-40 Plus	4.50%	17.23%	-1.49%	6.47%	6.96%	6.48%
BVG-60 Plus	4.42%	21.75%	-3.31%	7.12%	8.21%	8.97%
SXI Real Estate Funds TR Index	12.25%	24.30%	-2.40%	10.84%	9.94%	7.52%

The negative correlation between equities and bonds and falling interest rates of recent decades have resulted in above-average Sharpe ratios, limited drawdowns and attractive performance of a balanced portfolio. There are reasons to believe the environment may be changing. Active investment strategies, and in particular long/short and macro strategies, can contribute to diversification and portfolio protection in an environment of positive correlation and rising interest rates.



Peter Rice

## Danger from bonds?

Bonds have historically been one of the largest allocations in pension fund portfolios and have been an important source of return and diversification in recent years. But in the current environment, where bond yields are historically low and the diversification contribution may decline, investors need to rethink their strategic portfolio composition and consider new sources of return and diversification.

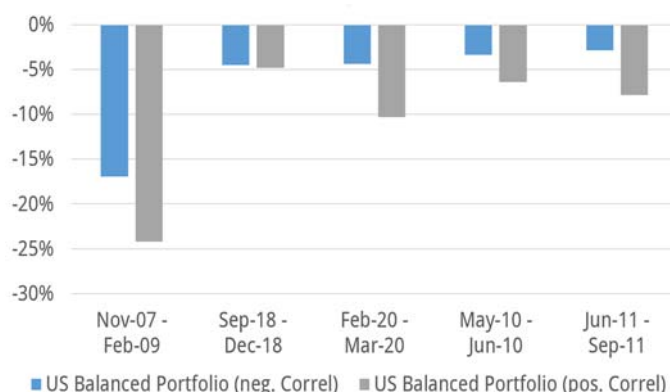
Correlations are very important to portfolio optimization techniques. Both Markowitz-based methods and methods based on multivariate distributions are highly sensitive to changes in correlations between asset classes.

Correlations between assets in a portfolio have a direct impact on the volatility of a portfolio. For example, if the correlation of two asset classes changes from -0.2 to +0.2, the return remains the same but the volatility increases significantly.

	Rendite p.a.	Volatilität p.a.
Korrelation = -0.2	5.9%	5.3%
Korrelation = 0.2	5.9%	6.0%

Key figures of a portfolio of 2 assets with correlations 0.2 and -0.2

If we simulate two balanced portfolios that differ only in the correlation between bonds and stocks, we can clearly see how losses are higher when the correlation between bonds and stocks is positive.



Drawdown of a balanced portfolio with positive and negative correlated assets (simulation)

Historically, correlations have not been stable. For example, the correlation between U.S. stocks and U.S. government bonds was positive until the year 2000, and then turned negative.

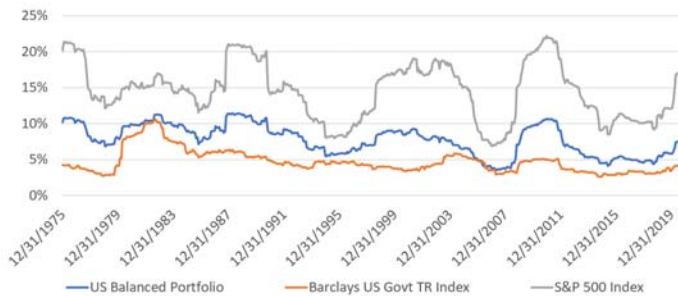


36 months rolling correlation of US bonds and US equities

## Why is the correlation not stable and why could it flip?

One possible explanation for this shift is inflation expectations and the belief in the effectiveness of the U.S. Federal Reserve's money market policy. As a result, bonds took on a "safe haven" function from the late 1990s when inflation fell below the 2% level and the Fed was increasingly trusted to have inflation risks under control. Investors saw that a major threat to bonds was disappearing and bonds were able to take over the "safe haven" function.

Traditional portfolios in particular have benefited from the negative correlation between stocks and bonds in recent years. For example, risk parity approaches have profited from the negative correlation and "safe haven" effect and have been able to maintain a correspondingly high equity allocation. The volatility of a balanced portfolio fell to historically low levels in the years following the financial crisis.



36 months rolling volatility of bonds, equities and balanced portfolio (60% bonds, 40% equities)

This has led to Sharpe ratios of traditional portfolios reaching historically high levels.



36 months rolling Sharpe ratio of balanced portfolio (60% bonds, 40% stocks)

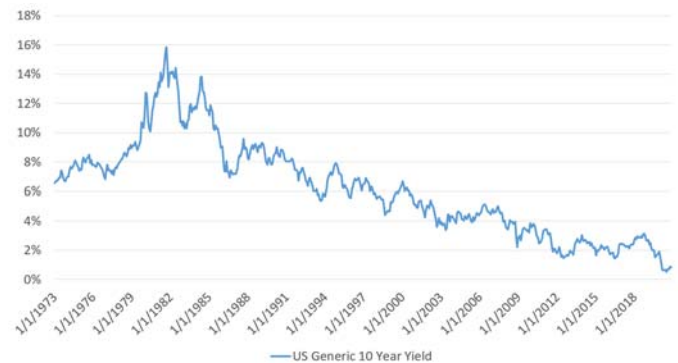
## What does the future hold?

The big question is whether this negative correlation will persist in the future, and if not, what alternatives do pension funds have to diversify their portfolios and make them more resistant to a market correction?

What could cause the correlation to increase? Many countries have borrowed heavily in the aftermath of the global financial crisis and in the current Corona crisis. Interest rates on government bonds have fallen to historically low levels and in some cases, have even turned negative at the short end.

These two facts may cause government bonds to lose their "safe haven" function in a next crisis. An investor who no longer believes in the safety of government bonds - either because of over-indebtedness or the level of interest rates - sells both bonds and stocks in order to hold liquidity (cash) or buy real assets such as gold, for example. If a majority of investors behave this way, stocks and bonds will lose value at the same time and the correlation becomes positive.

But correlation is only part of investors' concerns. In the current interest rate environment, interest rates are below the target return of pension funds and have reached a level where investors have to ask themselves whether they want to (or can afford to) hedge highly valued stocks with low yielding bonds.



Annual interest rate of ten-year US government bonds

Of course, bonds can continue to generate a positive return if interest rates continue to fall, but there is not much breathing room left until interest rates also become negative at the mid and long end. For example, to generate a 6% yield on ten-year U.S. government bonds, the interest rate would have to fall by about 0.75 percentage points from today's 0.88% to 0.15%. If the interest rate level continues to fall, the situation of pension funds will also become more precarious, because the market interest rate on bonds is already significantly below the technical interest rate of a pension fund.

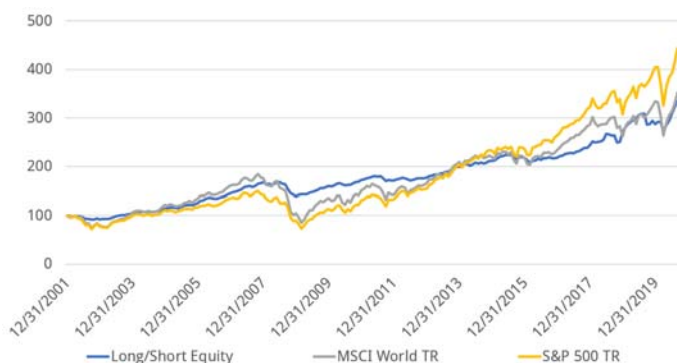
## What options do investors have to protect themselves against changes in the correlation?

Most pension funds manage their bonds passively. However, an investor cannot change the characteristics of bonds by holding the securities passively.

It is different with dynamic trading strategies. Long/short equity or global macro strategies provide diversification, not through inherent characteristics of securities, but through the investment strategy of the particular manager.

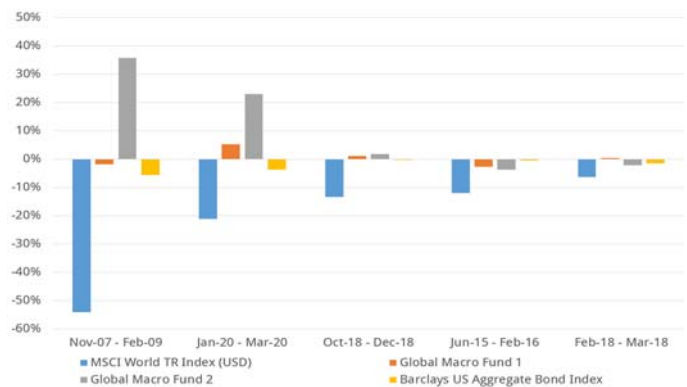
These hedge fund strategies have low market dependence (beta) because they are either a combination of long and short positions, or can dynamically switch between long and short positions. While a long position generates a positive return when prices are rising, short positions generate a positive return when prices are falling. The combination creates an investment strategy that has a low beta and still generates a positive return.

Long/short strategies typically build on the analysis of overvalued and undervalued securities. Managers dynamically manage market exposure, typically staying between 30-60% in a normal market environment. The strategy is therefore suitable to reduce volatility within the equity allocation and generate a stable return.



Performance of Long/Short Equity since 2002

Macro strategies are dynamic trading strategies and change their market exposure between long and short to profit from broad market movements caused by political or economic events. Due to the low correlation to equities, this strategy is appropriately suited as a hedge for a portfolio.



Performance of Global Macro in Drawdowns of Equities

## Conclusion

Long/short equity and global macro strategies may be alternatives for allocation to bonds if bond yields remain low and bonds lose their "safe haven" function:

- the strategies have a positive expected return, which is above the current interest rate and,
- dynamic strategies can counteract the increased drawdown risk when the correlation between bonds and equities becomes positive.

In the simulation, a portfolio of stocks and bonds with 7.5% each in long/short equity and global macro is diversified and more robust than the traditional balanced portfolio when stocks and bonds are positively correlated.

Of course, we do not know if and when the characteristics of bonds will change. However, the low interest rate environment seems set to continue for the time being. Pension funds will therefore remain under pressure even without a market correction. Investors who want to prepare for the scenario of a change in correlation can or improve their changes of achieving their target returns may do so thanks to the attractive characteristics of long/short and macro strategies.