Julius Bär

THE WORLD AFTER THE CORONA CRISIS

Brief answers to big questions

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PART ONE

Brief answers to big questions

BRIEF ANSWERS TO BIG QUESTIONS

- The corona crisis is an unprecedented disaster that has caught the global economy off guard. We take first glimpses at the world after the crisis and provide brief answers to big questions. Generally, we believe that the corona crisis will accelerate existing structural trends rather than create new ones. As a consequence of the economic shock and in order to fight the fallout of the crisis, Modern Monetary Theory will move more and more into focus during the next few years. It vindicates the monetisation of public debt to achieve full employment and provides a permissive attitude towards inflation.
- The corona crisis will likely lead to a more polarised world as authoritarian leaderships tighten the grip on their countries. That said, our observations show that successful crisis fighting is not about an authoritarian or libertarian approach. It seems instead that social cohesion and trust in the institutions are key.
- Globalisation will come under scrutiny, as self-sufficiency and reshoring are likely to make their way back on the political agenda. Companies will need to reassess their supply chains, likely leading to higher costs as well as higher prices.
- Socially, our lives will not change a lot. We will still enjoy ourselves, be back in bars, cafes and restaurants. Work-from-home will be more common, but it will not become the new normal.
- The crisis highlights inequality in an unprecedented manner and offers an opportunity to address it, in order to reshape societies. Reducing inequality is a starting point and not the end goal.
- Woeful shortcomings of our healthcare systems were exposed by the corona crisis. It should serve as a wake-up call to further foster the long-term transformation of healthcare, rendering it more resilient and more efficient for humankind.
- The debate about how to balance the costs of the corona crisis and the aspiration to safeguard public health has only begun. We believe it is, in fact, unethical to dismiss this debate, although we acknowledge that it is a slippery slope.
- While the trend towards digitalisation has been well established before the crisis, it has accelerated the speed by which it is occurring. An even more digitalised world brings opportunities, but comes with a growing threat of cyber insecurity.
- Sustainable investing went through its baptism of fire during the financial turmoil caused by the corona crisis, outperforming the broader market. Demand from investors is set to amplify as a result of the crisis, providing a boost to a booming strategy.

THE VIRUS THAT TURNED THE WORLD UPSIDE DOWN

The corona crisis is an unprecedented disaster for humanity, an external shock to the global economy the likes of which we have never seen before. If somebody had told us around the turn of the year that the global economy would be shut down in order to contain the spreading of a virus that had originated in an animal market in central China and that it would cause the sharpest recession since the 1940s, most likely we would have shook our heads in disbelief. The global economy was caught totally off guard. As an increasing number of countries around the globe are thinking about how to ease existing lockdown measures and restart their economies, without risking a second wave of infections, the return to normal looks like a longer-lasting process. But what will this 'normal' be? Will it be the old normal or a new normal instead?

We try to take a first glimpse at the world after the corona crisis. What will be the impact of the pandemic from an economic, social and political point of view? How will the corona crisis impact the world we live in? Will we experience major changes in many areas – political, social and economic – or will the changes be concentrated in a few areas, while already existing trends accelerate? Will the crisis be another catalyst that, in the long run, will make the world a better place for us all? The following texts elaborate more closely on these questions from different angles:

- Economics: Entering a new normal?
- Politics: Shifting to a more authoritarian world?
- Globalisation: The start of reshoring?
- Society: How will we live tomorrow?
- Inequality: Unmasking the need for change?
- Healthcare: How to make the system more resilient?
- Ethics: What is life worth?
- Digitalisation: A leap forward?
- Investing: A boost to booming sustainable investing?

This report provides brief answers to these big questions on the basis of how things currently stand. Generally, we believe that the corona crisis will accelerate existing structural trends rather than create new ones. Our answers to these questions are based on the assumption that the world experiences 'just' a short and sharp recession and does not slip into a longer-lasting depression. Those not sharing this assumption would likely find different answers to the very same questions. In any case, the consequences of the corona crisis will resonate for longer, affecting individuals, companies and countries for years to come.

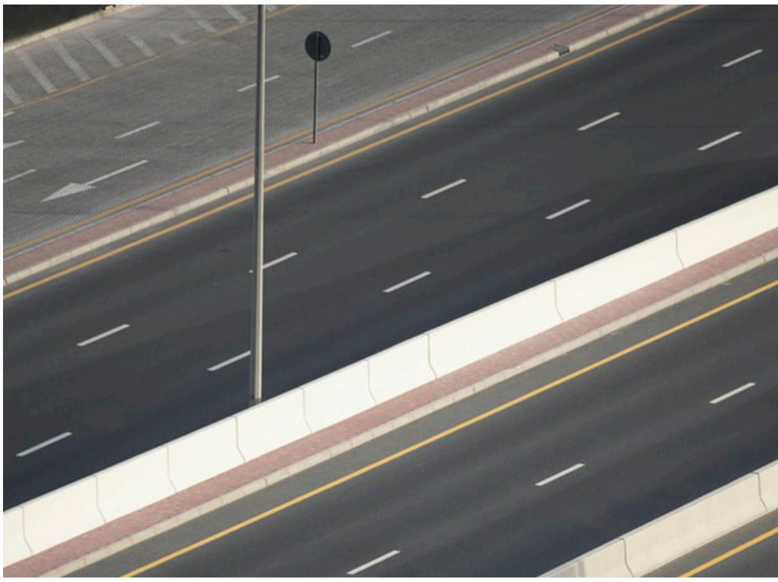
Carsten Menke, CFA

ECONOMICS: ENTERING A NEW NORMAL?

Confronting the spreading of COVID-19 has created substantial financial costs via lost revenues and labour income. Dealing with these costs will shape the economy in the years to come. The public sector is currently absorbing a large proportion of these costs, as much as countries' public budgets allow for. Dealing with the legacy of substantially expanded public debt will shape national economic landscapes significantly, once a recovery of economic activity to pre-crisis levels materialises.

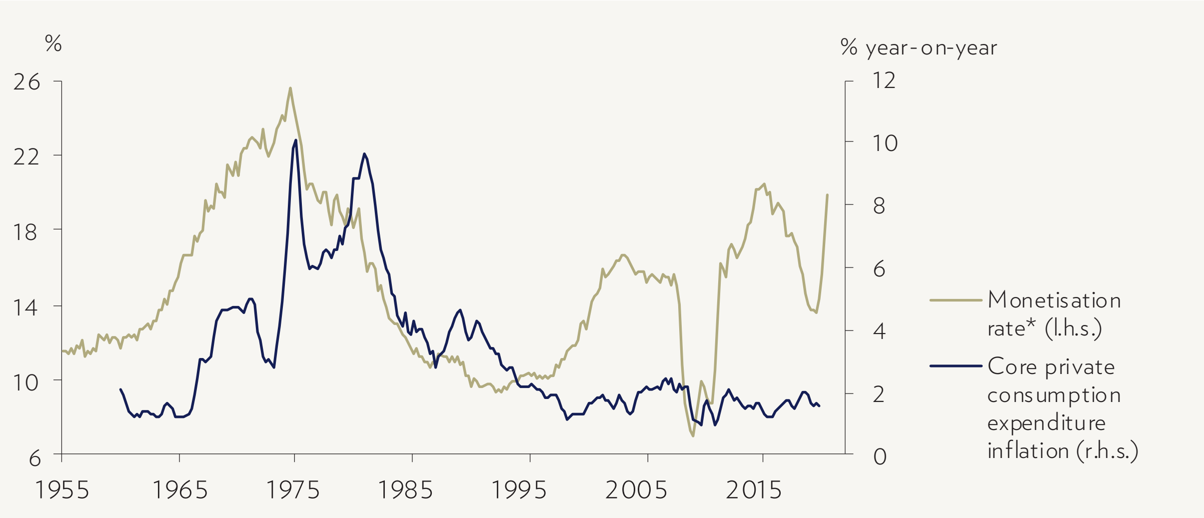
FOOTING THE BILL OF FIGHTING THE CRISIS

In order to foot the bill of the corona crisis bailout, policymakers have three options at their disposal: increasing taxation, renewed borrowing from the private sector and monetisation. Higher taxation corresponds to financial repression in the shorter term for those concerned, but borrowing could also bring financial repression, if governments cap public borrowing costs, in an effort to service high debt burdens. Monetisation of debt, on the other hand, raises the risk of inflation in the medium to longer term, eventually creating financially repressive effects for everybody. However, the last decade has impressively shown that debt monetisation, with a central bank buying public debt, does not have to be necessarily inflationary, as it depends crucially on the incentives to use the newly created central bank money in the economy. The inflation outlook therefore depends on the readiness to reduce well-received state support and balance public budgets, once the emergency that triggered the fiscal stimuli is over. Reluctance to stop the expansion of public debt, with the aim of not endangering swift economic growth and prosperity, would foster inflation with some form of supply bottlenecks, and insufficient private investment and deglobalisation could eventually become catalysts for sharply rising inflation. On the other hand, aggressive austerity, caution in the use of the newly created central bank money, as well as pressure on the private sector to shrink its financial liabilities, all keep the deflationary risks, that emerged during the economic slowdown, alive, even when the economy recovers. This has happened in many advanced economies in the last decade, against a backdrop of secular deflationary pressure from widespread globalisation.



At present, the five-year-in-five-years inflation expectations for the eurozone extrapolate the current deflationary shock and discount a medium-term inflation rate of below 1%, slightly lower than the current core inflation. While the medium-term inflation expectations are, at 1.8%, higher in the US, they are also slightly below current core inflation readings. This is in stark contrast to the inflation expectations a decade ago, when monetising of public debt pushed medium-term inflation expectations to more than 2.5% in the eurozone and 3% in the US, well ahead of measured inflation at the time. Given the currently depressed inflation expectations, the risk that inflation will surprise to the upside over the medium term is considerably higher than that it will fall below current low expectations.

DEBT MONETISATION AND INFLATION IN THE US



Source: Datastream, Julius Baer (* Share of federal debt held by the US Federal Reserve)

CENTRAL BANKS TO LOSE THEIR INDEPENDENCE

Central banks responded decisively to the financial market and economic fallout of the containment measures against COVID-19 and pulled their weight to prevent a total systemic collapse. In order to avoid such a collapse, following the sudden cessation of activity in large parts of the economy, central banks provided financial markets with liquidity at an unprecedented speed and scale, slashed interest rates and also reactivated extended quantitative policy tools. The failure of central banks to prevent a persistent undershooting of inflation below their targets in the past decade, had already weakened their claim to independence. The dominating fear in financial markets, that the corona crisis fallout will be long-term deflationary, undermines central banks' independence further and promotes the idea of coordinated monetary and fiscal policies under the name of 'Modern Monetary Theory' (MMT). MMT vindicates the monetising of public debt in order to achieve full employment, and claims that the risk that monetisation would result in hyperinflation or a sharp currency devaluation is low. In addition, MMT justifies capping the level of sovereign bond yields, in order to disentangle fiscal spending from the whims of financial markets. This permissive attitude towards inflation, which policymakers had already started to adopt prior to the corona crisis, is currently receiving an extra boost, as the sharp economic slowdown and the collapse of the crude oil price have further sensitised policymakers to deflation risks.

THE STATE REBORN 'AS PROTECTOR OF LAST RESORT'

The corona crisis has forced the state into the role of 'protector of last resort'. The risk that governments bail out 'zombie' companies, i.e. companies without an economic future, is on the rise. In addition, the pandemic could change people's perception of globalisation. There is growing acceptance of the notion that governments and public bodies deserve a more active and protective role in shaping a country's economic and social future, instead of focusing conservatively on the ideals of a more restrained role characterised by financial austerity. Many sectors of the population also welcome a reduction of globalisation and an increase in self-sufficiency (reshoring, nationalisation of key supply chains), due to the disruptive effects of the pandemic and in light of the ongoing trade disputes. However, a state-dominated economy, combined with less globalisation, will tend to reduce overall economic productivity and wealth creation potential for its citizens.

Janwillem Acket, David Kohl

POLITICS: SHIFTING TO A MORE AUTHORITARIAN WORLD?

Aside from the spread of the virus around the world, the corona crisis is the result of the politics and measures undertaken to safeguard public health. Over the past decade, the multipolar world has been subject to endless debates, primarily originating from the rise of China to superpower status, a political system that differs in many ways from those seen in the Western World. Confronted with the outbreak in its origin, China took drastic measures, dismissing what the West sees as civil rights, and showed strong leadership to fight the pandemic. Geopolitical analysts and commentators soon launched into a debate on whether authoritarian rather than libertarian approaches were potentially more effective in fighting a pandemic, or whether strong leadership is a prerequisite to protecting citizen health. Of course, pondering these questions in all their dimensions could fill many books. Instead, we focus on some early, noteworthy observations.

- Effectiveness of the measures. Strong leadership and an established security apparatus aligns society swiftly with political will. The evidence from Europe and North America, however, reveals that the libertarian approach proves effective too. Compliance with promoted health measures was very high in most countries and soon curbed infection trends. Citizens saw themselves as part of society, less as an individual, which nourished the intrinsic motivation to follow the policies.
- Flexibility of the systems. The Western World's libertarian systems showed great flexibility in enabling an effective response. Politics nudged some existential civil rights in order to make fast decisions and enact burdensome measures. Such emergency mechanisms are part of any libertarian constitution. That said, some raised concerns about constitutional breaches.
- Success of the measures. While infection rates and speculation on deaths from COVID-19 filled the news, it is the overall mortality rate that is the most appropriate data by which to measure the success of fighting the pandemic. This data is not biased by selected testing or differing definitions of causes of death. Relying on this data, mortality seems to vary wildly across countries, independent from political systems.

Not strong leaders but social cohesion brings success.

These observations imply that success in fighting the pandemic has little to do with authoritarian or libertarian rule. It seems that social cohesion and trust in the institutions was a key factor enabling effective politics. This early conclusion sheds light on a bigger economic debate, where social cohesion is a key determinant of wealth, instilling trust and lowering all variants of transaction costs within society. There are, nevertheless, long-term implications for politics. The crisis is a catalyst. It gave strong leaders in authoritarian countries the opportunity to tighten their grip, which many did not waste. We will not see a more authoritarian but likely a more polarised world. Geopolitically, the virus and the quest for guilt is set to become the next battlefield, where the two hegemons, the United States and China, will wage their power struggle. The multipolar world will thrive as we enter the next decade, and will remain a source of surprise and market volatility. Something the trade war episode had already taught investors.

Norbert Rücker

GLOBALISATION: THE START OF RESHORING?

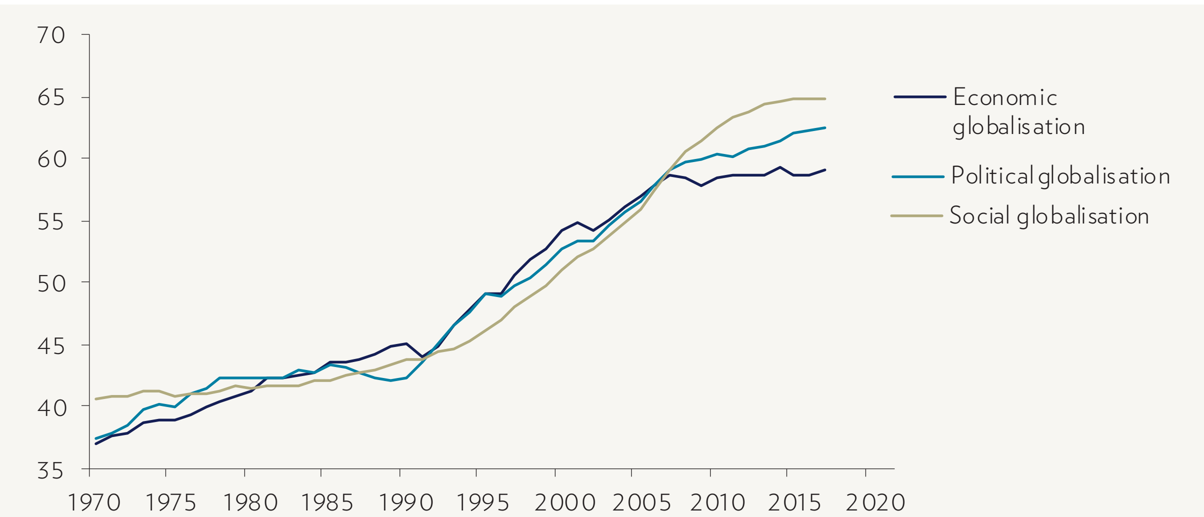
Borders closed, flights cancelled, exports restricted, supply chains disrupted: COVID-19 brought the functioning of our globalised and interconnected world to an abrupt halt. Of course, this extreme situation will not last. Borders will be reopened, people will start travelling again, trade flows will resume. However, the outbreak of COVID-19 has revealed the fragility of international relations, the risks of international interdependence and the vulnerability of global supply chains. This experience adds pressure on governments and businesses to rethink their global dependencies.

Although the benefits of globalisation are widely recognised, the focus has increasingly shifted towards the risks and downsides of an over-globalised world. This debate has been most prominently led by nationalist politics and has been fuelled over the years by the failure of governments to adequately support the economic losers of the global integration process in their home countries. Brexit, debates over border walls, the trade conflicts between the United States and China as well as the European Union, are just a few examples. The corona crisis has put even greater emphasis on reducing dependencies on other countries, especially when it comes to critical supplies. Self-sufficiency and reshoring of manufacturing are thus likely to make their way back to the political agenda.

Independent of the political agenda, the corona crisis forces companies to reassess the risks of their supply chain systems, especially for those that are dependent on single sources of supply and just-in-time production. The recent supply chain disruptions are prompting reconsiderations about efficiency, robustness and costliness. For some companies, the reshoring of production might be the optimal response to a higher risk of supply chain disruptions, but for many international companies this is unlikely to be the case. For the latter, greater robustness means diversifying production across geographies rather than concentrating it on one location only, relying on a broader range of suppliers or holding larger inventories. Either way, greater robustness comes at cost. The shift to more robust supply chains would not only increase costs for companies but eventually also for consumers.

Sophie Altermatt, PhD

GLOBALISATION HAS LOST MOMENTUM SINCE THE GREAT FINANCIAL CRISIS



Source: KOF Swiss Economic Institute, Julius Baer

SOCIETY: HOW WILL WE LIVE TOMORROW?

Beyond the major challenges the corona crisis poses for politicians and policymakers all over the world, it is a major test for society. The way we used to live our lives changed from one day to the next, as lockdowns started to spread from country to country. Most of us were forced to stay at home, unable to meet family and friends, unable to go to work. What does this mean for the future, for our private life as well as our working life? Will we enjoy ourselves less, go less to restaurants and cinemas? Will working from home become the new normal? Most likely not. We are one of the most social species and our connections are important to our well-being and our health. We are dependent on social engagement and we are suffering from social distancing, one way or the other. Nevertheless, some things are likely to stick.

When it comes to our private lives, most of us are eager to be out again, to be back in bars, cafes and restaurants. How fast this will happen very much depends on our own personality. Those who are very risk averse, will likely avoid going out for longer, while those who are less risk averse, will do so more quickly. A recent survey in the United States showed that between 40% and 60% of respondents would feel comfortable going to a restaurant, a shopping mall or the movies within the next six months, if they were allowed to. Between 20% and 30% believe it would take them more than six months. And between 20% and 40% do not have an opinion, reflecting a high degree of uncertainty about how and when they would be willing to return to normal life. That said, some of us will also have realised how cosy and snug a place our homes are and that we do not necessarily need to be out to enjoy ourselves.

Work-wise, we will enjoy greater flexibility in the future and work-from-home will be more common. This will allow employees to avoid packed trains and jammed streets on days when no meetings requiring physical

presence are scheduled. It will also allow employees to be less caught in 'activity-seeking' behaviour, which happens in the office from time to time. Work-from-home will also allow families to manage their tasks in a more efficient way, if physical presence in the office is not required on a day-to-day basis, leading to less stress. However, employees have also seen that work-from-home blurs the boundaries between private life and work life, which, on a permanent basis, makes it less appealing to many. Work-from-home may thus lead to both a better and a worse work-life balance, which is why we do not believe it will become the new normal, leading to empty offices in city centres. From an employer's perspective, however, offering a well-rounded and well-functioning work-from-home solution will likely be more important than ever to attract top talent.

Overall, we believe that due to the experience with COVID-19, some of us will show greater gratitude for the little things in life – a beer with a colleague, a nice dinner with friends, a chat with the neighbour, we have got to know better during the crisis. We even might live and consume a little more consciously, realising how little it takes to completely turn our lives upside down.

Carsten Menke, CFA

INEQUALITY: UNMASKING A NEED FOR CHANGE?

Viruses do not differentiate between rich and poor. But the gap between rich and poor is crucial for the extent of the damage a pandemic leaves behind. The corona crisis highlights inequality in an unprecedented way. The laying bare of inequality-related issues offers an opportunity for policymakers to address them and shape societies that are more robust against future pandemics.

Factors related to poverty facilitate the spreading of a pandemic. Meanwhile, wealth often defines the access to and quality of healthcare. Informal work and living conditions can considerably facilitate the transmission of diseases. People relying on current income from informal work, due to lack of private wealth accumulation or social safety nets, often have no other option than to continue working, risking exposure to infection and contributing to a quicker and broader spread. Informal living conditions have similar effects: lack of space impairs social distancing and undersupply of clean water impedes necessary hygiene. By improving working and living conditions, authorities have a powerful option to increase the population's resilience against future pandemics. However, the economic fallout of the current crisis could exhaust financial measures needed to tackle these issues.

Unequal access to healthcare risks undermining social cohesion. The COVID-19 crisis could increase the willingness to improve national healthcare systems and reduce the entry barriers for poorer people. Healthcare has lately climbed the ladder of political preferences of US voters and could become a decisive factor in this year's presidential election. However, health crises also make voters susceptible to nationalistic populism, which could let governments direct fewer funds to international cooperation and more towards domestic economies. It is, however, highly questionable whether populist policies benefit lower-income segments and reduce inequalities. In fact, such measures tend to aggravate international inequalities and pave the way for worse consequences, such as social unrest, immigration waves, room for corruption and organised criminality, and lower thresholds for armed conflicts.

How will the recent emergency measures of central banks affect inequality? Ultra-expansive, unconventional monetary policy during the 2008/09 recession were often criticised as being for the rich, keeping asset valuations afloat, but depriving the poor of an interest income on savings. Contrary to widespread belief, research shows that inequality was not aggravated by the unconventional monetary policies over the past decade. Although traditional inequality measures indicate for some countries a widening of income inequality since the financial crisis, monetary policy contributed more to the average income growth of the lowest-income classes than for the highest ones. Maintaining economic stability enabled a period of unprecedented job creation, ultimately benefiting the poorer. Therefore, a renewed period of ultra-expansive monetary policy need not exacerbate inequality.

It has become clear that in order to be better prepared for future pandemics, it is essential to reduce inequalities by improving working and living conditions and to lower the access barriers to adequate medical treatment. In this regard, reducing inequalities is the starting point and not the end goal.

David Alexander Meier

HEALTHCARE: HOW TO MAKE THE SYSTEM MORE RESILIENT?

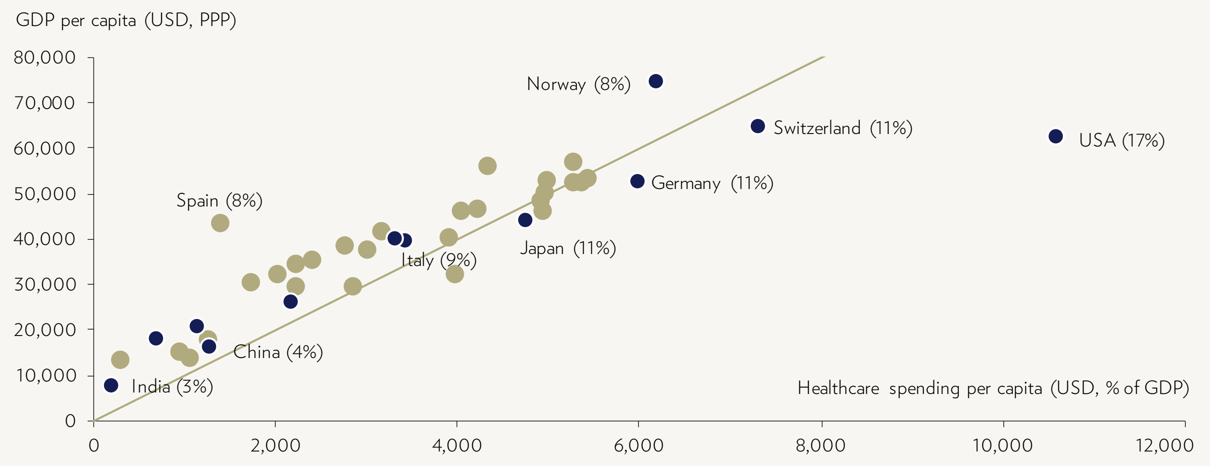
The outbreak of the coronavirus has undoubtedly exposed the woeful shortcomings of some healthcare systems in developed and developing countries alike. Nevertheless, the pandemic should serve as a wake-up call for all to better prepare for the adverse impact of future infectious threats, as vulnerabilities in our healthcare systems and inequalities in access to health services due to ever-spiralling medical costs have been revealed. For instance, Americans incur a disproportionate amount of expenditure on their health relative to their wealth. But despite the higher spending, roughly 28 million Americans do not have healthcare insurance at all and nearly 90% of those who do, are underinsured. Some of them might even be forced to go to work despite being sick.

It is therefore in this context that corona crisis will inevitably prompt authorities and healthcare organisations to re-examine the robustness of their national healthcare systems. Put simply, the extent of the outbreak will hasten the further digital transformation of healthcare to improve patient care due to the rising demand for greater adoption of digital health technologies, which should free up capacities at clinics and hospitals. An example lies in the field of telemedicine. Specifically, online medical consultation became a popular source of healthcare advice among Chinese consumers during the outbreak.

Furthermore, the knowledge gained from the COVID-19 research could pave the way for more study into gene-based therapies and other health technologies to combat present and future health threats. Not only will this research help the world deal with the present pandemic, but it could also herald an era of tailored treatments for other diseases like cancer, Alzheimer's and diabetes depending on the patient's DNA composition. All in all, the pandemic should further foster a long-term transformation of the healthcare industry, rendering it more resilient and more efficient for humankind.

Damien Ng, PhD

INEFFICIENCIES IN HEALTHCARE SYSTEMS ARE SHOWING UP



Source: OECD, World Bank, Julius Baer (data as of 2015 or nearest year)

ETHICS: WHAT IS LIFE WORTH?

The beauty of economics is that it makes things comparable. Beyond the corona crisis and the political decision to lockdown the economy to safeguard public health lies an equation. The debate of this equation has only begun and some are quick to denounce it as unethical. Indeed, debating this equation is a slippery slope, the elephant in the room you would like to ignore. The equation puts the costs of the economic fallout in perspective of the value of the lives saved. In a perfect world, the equation would not exist, but the reality is that resources are limited. Curating a healthcare system that enables maximum life expectancy for everyone would come at a cost that no sustainable economy could bear.

The value of the lockdown measures simplistically has two components: saving lives by avoiding the collapse of overburdened emergency care, and saving lives by minimising infections. Some countries, respectively regions, unfortunately looked into the abyss of the former. Most countries managed to keep it at the latter. The data shows that a majority of the victims of the pandemic were those where the virus added to existing health complications to an extent the body could no longer cope with. Put differently, most of those cured from the infection with the help of emergency care have little life expectancy left. Early attempts at calculating the equation reveal that the economic costs of the recession outweighs several estimates of the value of the lives saved. The limited life expectancy left significantly tilts the equation, another morally loaded aspect of the debate.

Luckily, we do not need to provide a clear answer to the question 'what is life worth?' in order to assess the ethics of the corona crisis. Unfortunately, the public tends to have a biased view on economic costs. The economic cost of the recession is not only profits that turn into losses for corporates. The costs are very much social and include the results of job losses, unemployment, insecurity and the many variants of social demise including drugs, deteriorating health and families breaking apart that have occurred. These social tragedies can ultimately be put into economic figures too. Even if you disagree with the equation given above and the outcomes calculated on average so far, by implying that life is priceless and not reliant on life expectancy, there remains an ethical angle to the corona crisis.

> It is unethical to dismiss the crisis' cost-benefit debate.

The drastic actions undertaken to fight the pandemic, eclipse any other actions undertaken to safeguard public health against other threats. Think alcohol and drunk driving, weapons and crime, sugary foods and obesity, air pollution and respiratory illness. Think climate change and summer heat waves. All of these elements show up as spikes in mortality rates. At least this perspective unveils that it would be unethical not to take a closer look at the equation of economic costs and value of life bluntly revealed by the corona crisis. Were the lockdown measures taken out of proportion to what used to be standard in terms of safeguarding public health? Will we assess health or the environment differently going forward, and will this change climate politics? Unlikely, such topics are too ethically loaded for politics. However, there may be more scrutiny into exorbitant treatment costs that add months, not years, to life.

Norbert Rücker

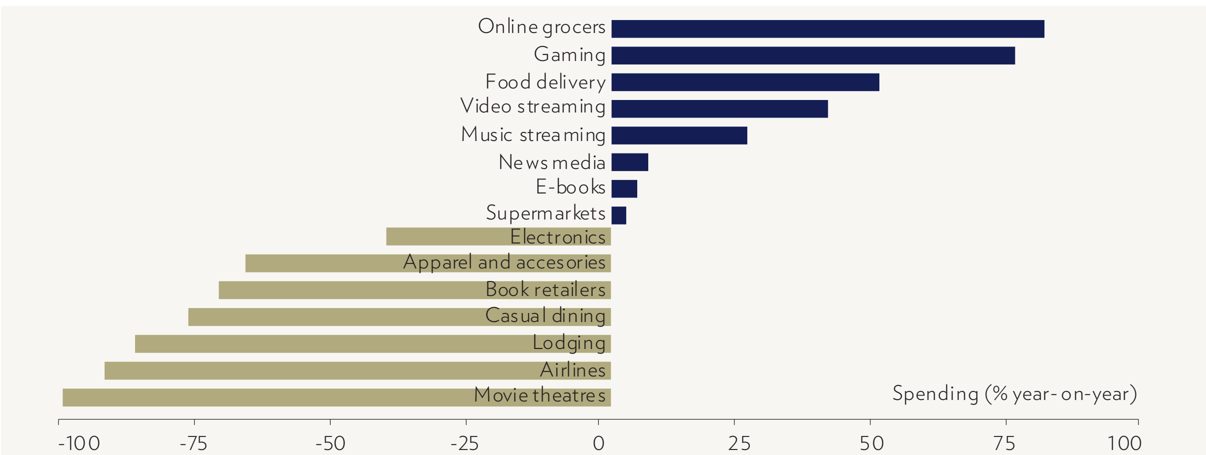
DIGITALISATION: A LEAP FORWARD?

While the structural trend towards digitalisation was established well before the corona crisis, it has since shifted the speed at which it is occurring at least two gears higher. Digitalisation is happening on multiple fronts. E-commerce has been gaining grounds on retail stores for years, but it is likely the loss of revenues during the corona crisis that will deal the final blow to some of the struggling brick-and-mortar stores. Cash has already been slowly losing its dominant payment status against digital solutions such as debit and credit cards. The corona crisis has made the shift more rapid by adding a health risk argument to the existing convenience argument. In the current environment, the vast majority of music concerts have been cancelled and most cinemas have shut their doors; in exchange, video and music streaming is having a field day, with strong double-digit growth rates on a year-on-year basis, as the chart below illustrates.

For many companies, the corona crisis means that the longer-term threat of not being digital is becoming much more short-term. That said, the crisis is hitting hard not just companies, but also individuals. It is bringing the digital divide back to the forefront. Low-income families often do not have as many computers as there are household members, which is an issue when most school teaching has shifted online. Furthermore, low-income individuals tend to more frequently occupy jobs that are impossible to do in a work-from-home setup (fast food cook, cashier, etc.), which means that their income is more at risk. Within the work environment, and beyond the greater acceptance of work-from-home, we believe that business travel will be an area that might never reach pre-corona crisis heights. Companies will be trying to cut costs, portray themselves as environmentally friendly, and just acknowledge that quite a lot of deals can actually be done via video conferencing and do not require physical presence. Working from home naturally means more virtual connections, which in turn means more potential attack vectors for cyber criminals. Nonetheless, cyber security is most likely to receive only small funding increases in the short term, since companies are seeing their revenues disappear in the current crisis environment. The longer-term growth story, however, remains very much intact, as digitalisation increases.

Alexander Ruchti, CFA, FRM

WINNERS AND LOSERS OF THE CORONA CRISIS IN THE UNITED STATES



Source: Earnest Research, Julius Baer (Data as of 1 April 2020)

INVESTING: A BOOST TO BOOMING SUSTAINABLE INVESTING?

Growing from a niche play to a more serious and sought-after investment strategy in the last couple of years, sustainable investing went through its baptism of fire during the financial turmoil caused by the corona crisis. Investors embedding environmental, social and governmental (ESG) aspects into their asset selection had long believed that sustainable investments would be more resilient in times of crises, which indeed proved true during this first test in early 2020. Index strategies clearly outperformed their benchmarks and the majority of sustainable funds held up better than peers. Some of them even maintained strong positive performance in the face of crumbling financial markets, not least due to a traditional sector bias towards information technology and healthcare, away from oil-related investments. But they also managed to outperform on a sector-neutral basis, as leading ESG corporates are likely less exposed to risk and more innovative, providing them with more cushion in difficult times.

Sustainable investments passed successfully through the corona crisis thanks to their higher resilience.

The lockdowns during the corona crisis have had very tangible implications for a large part of societies worldwide, reminding us of the fragility of our economic systems in the face of unfamiliar shocks. The pandemic has produced a staggering disruption with deep implications for our economies as well as our private lives. It has laid bare the weaknesses of just-in-time manufacturing, complex international supply chains and fast, cheap consumer goods, and has stressed the importance of care and stable, resilient and sustainable structures. Moreover, to those fearing the coming implications of climate change, it may have felt like a dress rehearsal, increasing the urgency to act now. Thus, the corona crisis is surely a trigger for those investors interested in ESG but who are yet to invest in the theme.

For those already invested, on the other hand, the crisis might have served as an opportunity to get more deeply involved while the investment segment is maturing and more options have become available. Till recently, an important trend within ESG investing focused on the environment, as climate change is widely seen as the biggest challenge of our time. Lately, however, the focus has shifted to include the social aspect, a development amplified by the current health crisis. Customers and investors are increasingly shunning companies with precarious employment conditions (i.e. contract workers), and corporations have recognised that including the social factor can add value. More and more companies have stated the importance of creating value for all stakeholders, not merely the shareholders. This, together with increased regulation, will lead to better data for the social pillar too, next to already more established data on the environmental side.

Having finally passed this crucial stage of a test in a downturn, sustainable investing now looks ready to take off. Demand is set to amplify as a result of the crisis, in a time when supply and professionalism are increasing as the investment strategy matures.

Susan Joho

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PART TWO

Secular outlook

KEY ECONOMIC AND INVESTMENT TRENDS

The identification of secular forces is a key step in Julius Baer's asset allocation process. Each year, senior experts from our Asset Management and Research departments headed by our Group CIO gather together to reassess secular economic, financial and social trends around the world. Last year's edition was particularly interesting, as the decade 2010-2019 was drawing to a close.

Macroeconomic and capital market trends of the decade 2020-2029 identified in the Secular Outlook*:

MACROECONOMY

- Bipolar Sino-US world
- Energy abundance
- Reshoring
- Stakeholder economy
- Unorthodox macro policies (MMT, etc.)
- Life science disruptions

CAPITAL MARKETS

- Late stage USD bull market
- China rising to core asset allocation
- Rise of political triggers and decline of market signals
- Public equities challenge median Private Equity returns

The current crisis has prompted us to reassess where we stand. Transitions do not happen overnight, but we expect this crisis to act as an accelerator for some identified trends.

*Secular Outlook 2020-2029, economic and investment trends. CIO Office, Bank Julius Baer & Co. Ltd. December 2019

MACROECONOMIC TRENDS

EMERGENCE OF A BIPOLAR WORLD
Sino-American confrontation resulting in separate economic and financial cycles and distinct technology ecosystems.

RESHORING
Decrease in globalisation and value chains shift from global to local.

UNORTHODOX MACRO POLICIES
From monetary to fiscal policy - rise of Modern Monetary Theory (MMT) and Keynesian policies, as well as direct monetary stimulus.

COVID-19 IMPACT

EMERGENCE OF A BIPOLAR WORLD

- The ongoing debate on whether China misled the world about the scale and risk of the coronavirus reinforces existing Sino-American geopolitical tensions
- The blame game is rather unlikely to fade anytime soon as it is driven by the US domestic political agenda

RESHORING

- The spread of the virus unsparingly revealed the vulnerability of global supply chains, particularly in the medical field
- Further set-backs to globalisation are to be expected, as trade openness was already plateauing before this recession

UNORTHODOX MACRO POLICIES

- The neoliberal orthodoxy born 40 years ago is definitely over. We are entering an era of state-sponsored capitalism
- MMT including some degree of monetisation is needed as a tactical solution to swiftly reflate the economy and support nominal GDP

CAPITAL MARKET TRENDS

CHINA RISING TO CORE ASSET ALLOCATION
Rise of China to a standalone, core asset class status.

RISE OF POLITICAL TRIGGERS AND DECLINE IN MARKET SIGNALS
Political triggers overtake market signals while systematic trading alters the market structure

COVID-19 IMPACT

CHINA RISING TO CORE ASSET ALLOCATION

- Reinforced reshoring efforts accelerate China's shift from manufacturing to services, and from exports to a domestic, consumer-led economy
- Expected decoupling of China from the US-led economic and financial cycle increases diversification merits of Chinese assets

RISE OF POLITICAL TRIGGERS AND DECLINE IN MARKET SIGNALS

- The fastest correction in the S&P 500 by 10% from an all-time clearly revealed that algorithms have taken on an important role in stock market activity.
- In such crisis situations, markets are driven more than ever by flows and liquidity rather than fundamentals in the short term

WHAT A DIFFERENCE A CRISIS MAKES

The COVID-19 crash in financial markets has significantly altered the likely future performance of different asset classes. While risky assets such as equities look set to perform better from today's levels over 10 years, risk-free asset classes such as government bonds appear set to yield less. Once a year, before December draws to a close, our Chief Investment Officer (CIO) publishes 10-year expected returns for asset classes and sub-asset classes, ranging from mainstream equities and bonds to niches such as private equity. In normal times, they remain valid for a year. But the COVID-19 crisis is far from normal, prompting us to revise our capital market assumptions and expected returns.

A FRESH PERSPECTIVE ON ASSET CLASSES

After the crash in asset prices in March this year, and taking into account the effects of global economic recession, we expect that world equities will return 1% a year more from current levels over 10 years than we had anticipated at the end of 2019. By contrast, US government bonds will yield 1% less. That makes a big difference over time.

At first glance, this difference appears small, but compounded over 10 years it makes a substantial difference – particularly in the low-yield world that we live in. Indeed, it lifts the total return from equities by almost a quarter and shrinks those from bonds by half. Such a large shift in expected returns can wrongfoot investors, if they let markets decide on their asset allocation..

CORPORATE EARNINGS AND RISKY ASSETS

Looking back to the end of 2019, we had fairly low expectations for future returns across all asset classes. But the crash in the price of risky assets has improved their risk premia. We estimate that the crisis will reduce corporate earnings by 20%–30% and that, at the time of writing, equity markets are down about 20% from their highs. Yet over 10 years we foresee a catch-up, so we have added 2% to our expected annual risk premium, as we expect a return to average corporate earnings and valuations. We have similarly raised our expectations for other risky assets, including hedge funds and private equity.

A LOOK AT THE BOND MARKET

But for government bonds the opposite is the case. After the US Federal Reserve adopted its zero-interest-rate policy to fight the economic effects of COVID-19, the yield on US government debt is now significantly lower than in 2019. Turning to European government bonds, reductions in yields have been less extreme, as euro, Swiss franc and UK pound bonds were mostly already close to, or lower than, zero beforehand.

Other corporate, high-yield and emerging market bonds yield far more as their spreads over government bonds have ballooned in the crisis, so adding to expected returns. But in light of the looming recession, we assume that defaults on bonds will rise, so offsetting any theoretical rise in yields.

WRAPPING IT UP

In conclusion, the efficient frontier is now steeper, particularly in US dollars, making the relative attractiveness of risky assets over risk-free assets higher. In other words, the expected pay out per unit of risk should be higher looking forward. The COVID-19 crisis has been one of the biggest events in all of our lifetimes but it will not dominate headlines forever. As times slowly return to normal, so our assumptions suggest that equities and other risk assets will outperform bonds by a wider margin than we assumed at the end of last year. What a difference a crisis makes.

Yves Bonzon and Jacques Ph. Roulet, CEFA

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PART THREE

A Wealth Planning perspective

A WEALTH PLANNING PERSPECTIVE

The corona crisis has been an unprecedented challenge for humanity and a shock to the global economy, the likes of which we have never seen before. If someone were to have asked us if we could imagine being where we are today, we would have shaken our head in disbelief.

For some, the crisis may have been a time to reflect about what really matters to us and to our families. It may have moved us to rethink our priorities or to reaffirm them. What plans do we have with our families, and what do we want to achieve with our wealth? Are our plans secure? How will the aftermath of the crisis affect them? What if it were to happen again?

We now see that an increasing number of countries around the globe are thinking about how to ease existing lockdown measures and restart their economies without risking a second wave of infections. Does this mean that we are slowly returning to normal? And what will this new “normal” actually be?

Our Wealth Planning experts have thought about these questions carefully. Furthermore, they asked themselves what we have learned from the crisis. Therefore, we expect to see certain patterns or trends developing in the following five areas:

- Family and asset protection
- Succession planning
- Relocation
- Digitalisation
- Financial and liquidity planning

FAMILY AND ASSET PROTECTION

Considering the speed of change in the world today and the challenges which the crisis has posed to globalisation, we have been consulted from different quarters about how to best protect families and their wealth in these times of uncertainty. Some families have taken the time to think on how to plan ahead in order to mitigate the risks that this crisis has posed to them and their assets.

As some countries lack borrowing capacity, they need to find other sources of revenue generation in order to respond to COVID-19. A handful of countries have already reacted by issuing draft legislation about increasing solidarity taxes to be borne by the wealthiest parts of the population. Others are looking into taxing digital platforms, to VAT increases, or imposing stricter measures in the enforcement of tax collection. Aside from the negative effects that an increase in taxation could have for the economy as a whole, what does this especially mean for High Net Worth Individuals (HNWIs) and their families?

If executed properly, wealth structures may prove to be a useful vehicle, providing protection and consolidation. More importantly, they may mitigate risks and guarantee accessibility to assets in an efficient manner by providing liquidity in times of need. (Examples of such structures could be trusts, foundations, life insurance, private label funds, companies, wills, or other legal arrangements.)

In times of crisis, priorities shift and our crisis-defined experiences flag the way toward finding new values. Whether a certain wealth structure is suitable for a particular family or not, will depend on those values, on family objectives, country of residence, family members affected, applicable legislation and the type of assets involved. Unfortunately, doing nothing is no longer an option.

Maria Eugenia Mosquera

RELOCATION

Many people have been able to attest to the value of their citizenship. Citizenship has shown itself to be more than merely another passport; it has proven to be a lifeline, a window of opportunity for returning to a safer haven. In a world in which borders were perceived to no longer exist (EEA), COVID-19 demonstrated that those country borders still significantly impact on the free movement of people and capital. In the future we expect to see a rise in the number of people placing increased value on their citizenships and people exploring ways in which to activate those citizenships to which they are entitled (by birth), as they have now come to realise the real value of having such.

Having emergency assets, such as access to bank accounts, real estate property, forms of mobility etc., which are spread out over a number of jurisdictions, has proven to be very useful for maintaining living standards for our HNWI clients and their loved ones - who quite often live in other countries.

Under normal conditions, the preferred place of residency is often determined by factors such as quality of living, access to education, clean environment, safety, etc. However, going forward we expect people to be more concerned with other primary factors which have gained in importance, such as access to health care, the availability of supporting infrastructure, the possibilities of (speedy) repatriation and the general handling of crisis scenarios. Countries which handled the crisis well will become more popular. This will not only feature the short-term considerations of mortality or infection rates, but will take in the length of time it took for the country to recover economically. Did short-term success incur a disproportionately high bill in the long-term?

Silke Mies

DIGITALISATION

What role will digitalisation play going forward? Have certain traditional industries been too relaxed in the past and too slow and too reluctant to move with the times? One of the most common questions we have heard asked was ‘How can we get our important documents, such as Power of Attorney, to a public notary for certification if we cannot physically meet with them?’ It is certainly time for the question of digital signatures to be addressed by lawyers and institutions that need to recognise such signatures. We may have successfully put man on the moon, but many jurisdictions have still not found a way around a physical signature. It is not a question of whether it is technologically possible - because of course it is; rather, it is a question of institutional willingness to embrace digitalisation.

We expect to see a rise in digital archiving of documents in places where documents can be signed electronically and then shared with lawyers, banks, insurance companies and the authorities.

Anna Ivanova

SUCCESSION PLANNING

FAMILY
Since the beginning of the 21st century, we have suffered multiple financial crises, from the Dot-Com bubble bursting, 9/11, the 2009 crash and now the COVID-19 crisis. We have seen wealth both increase and disappear in the flash of a moment. The last 20 years have made it very difficult to build wealth and to maintain it, especially through financial markets. Protection and conservation of wealth will become more and more relevant as the older generations realise that it will become increasingly challenging for the next generation to build their own wealth, through no fault of their own.

The pattern that is starting to appear is unique to our time. Until recently, the notion was held that the next generation would be better off than the previous one. Asset and family protection will now become more relevant than ever. This means that much more will be required than simply reviewing a last will and testament or an advance care directive once in a blue moon. A regular review will be vital - preferably annually - and should become standard practice for everyone."

BUSINESS
With or without COVID-19, the topic of succession planning is at the top of many agendas today, whether it concerns a family business or not. The questions are usually the same: 'Is the business model still relevant? Will it be relevant in the future? And who is best suited to lead the business to ensure long term success?' The question of securing liquidity in emergency situations also needs to be actively addressed and solved.

Eleanor Yuen

FINANCIAL AND LIQUIDITY PLANNING

Many businesses will have woken up to the shock of not being able to operate fully, if at all, for several months, despite the spending power of the purchasers still being there. Being able to remain liquid and pay wages for a few months - even if the business itself does not make money, will likely be a governmental requirement going forward. After having spent much of the public budget on keeping companies afloat, it is likely that going forward, governments will ensure businesses have capital reserve minimum requirements in place for such emergencies.

A further trend we might see in the future is liquidity insurance. Businesses might consider insuring against future pandemics in order to generate cash flow should another crisis occur. Time will tell whether the demand arises and if so, as to whether insurers will feel up to it or not.

Naturally, the effect which the crisis has had on business has also had a knock-on effect on individuals. Such an unpredictable event will without a shadow of a doubt have thwarted many personal plans. How can we get these plans back on track? The important thing is to plan-ahead carefully for it.

As we have just seen, another key aspect of forward planning is the need to have good contingency plans. A fixed feature in any financial and liquidity plan for the future will most likely include the simulating of crisis scenarios and a consideration as to how assets and liquidity are best preserved in such cases, thus ensuring that they do not negatively impact any long term plans.

Susanna Keller

IMPRINT

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