PERFORMANCES 2021	
EQUITIES	
MSCI World	+4.8%
S&P 500	+4.8%
Nasdaq	+9.4%
Stoxx 600	+4.5%
SPI	+2.1%
Nikkei	+9.6%
China	+11.4%
Emerging	+10.7%
BONDS	
CHF Corp	-0.1%
US Govt	-1.7%
US Corp	-1.8%
US HY	+1.3%
EUR Gvt	-1.2%
EUR Corp	-0.1%
EUR HY	+1.2%
CURRENCIES	
USD index	+0.4%
EURUSD	-0.6%
EURCHF	0.0%
USDCHF	+0.6%
USDJPY	+1.9%
EM FX	+0.5%
COMMODITIES	
Gold	-4.2%
Silver	+4.4%
Brent	+22.0%
Copper	+8.5%
CRB index	+10.4%

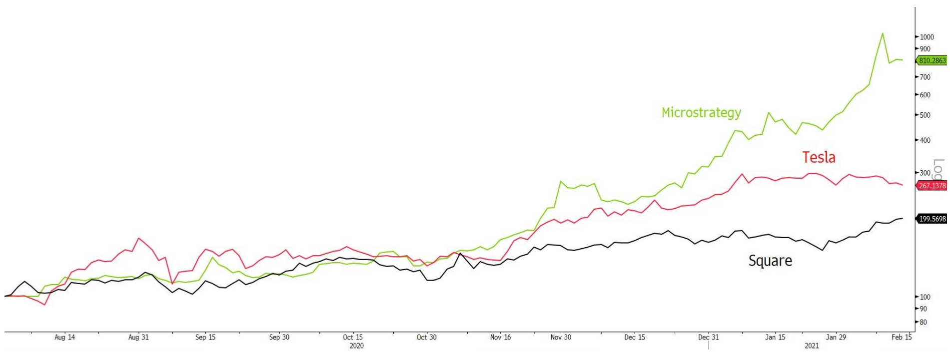
Elon big gamble

Elon Musk (EM), the flamboyant entrepreneur and sulfurous pot smoker leaves no one indifferent. Formidable innovator, he regularly transgresses limits and cultivates difficult relations with the establishment and the banking world. Regularly lectured by the SEC for his improbable tweets and sometimes on the verge of break-up, he is now back in the spotlight, boldly and… differently with his massive support to Bitcoin, the star of cryptocurrencies.

Iconoclastic visionary or megalomaniacal adventurer?

In Q3 2020, Microstrategy, a company listed on Nasdaq since 1998 and active in ¨business software intelligence¨, bought $450m worth of Bitcoin, which represented about 100% of its cash. Then, Square Inc, a fintech (transaction processing services), had also invested $50m in the crypto-asset last October. Both transactions went relatively unnoticed. However, they clearly represented a new paradigm in two respects: they were validated by their auditors and approved by the stock exchange authorities, the SEC.

So far, so good for crypto-purchasing corporate



Source: Bloomberg

EM's controversial - even divisive - personality and the size of the recent transaction - $1.5bn of Bitcoin - belong to a different category. From now on Tesla, a company recently included in the very select club of the S&P500, not only embraces cryptocurrency as a store of value, but also as a future means of payment for its customers.

EM ambitions to give respectability and impose BTC

His undeniable audacity is a gamble in several respects

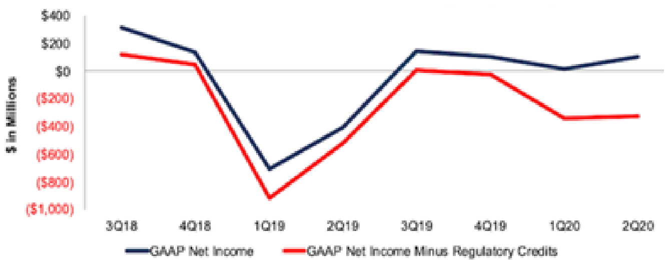
Non-benign stakes for Tesla

First, the volatility of BTC is a potential source of instability for the company as, a) it represents an exceptionally large amount, even more so for a company which traditionally burns cash and b) the - low - liquidity of the BTC market would make it difficult to reverse it (sell) in case of need.

Tesla intends to treat its crypto holdings as an intangible asset with long-term value, like goodwill. Therefore, according to US accounting standards, it will be obliged to regularly mark it to market. As a logical consequence, BTC evolution would impact profits. But a positive effect would only be accounted for when the company actually sells this holding (realized profit). Things remain fluid from an accounting perspective so far. According to tax experts, US authorities are contemplating new rules on how companies should recognize crypto-like investments.

Second, a large exposure to crypto-assets by Tesla may ultimately challenge a company's major source of revenues: carbon credit. Indeed, Tesla's depends significantly on selling regulatory credits to other - car manufacturing - companies. Ultimately, some argue that Tesla's status of a clean car manufacturer could face scrutiny because of BTC. Incidentally, over the medium-term, mainstream automotive companies will scale up their zero-emission vehicle sales, and thereby reduce the need to buy credits from Tesla…

Tesla profits are highly dependent on carbon credits



Third, Tesla is modifying its image. The company may indeed be delicate with a fringe of his shareholders and clients, i.e. those having an environmental sensitivity. Indeed, Bitcoin mining is a nightmare when it comes to its energy consumption! It therefore puts at risk Musk's declared intention to build a ¨new style of corporate conglomerate dedicated to tackling climate change¨. More, he runs the risk of alienating the institutional flows that require ESG criteria.

Musk may succeed to impose BTC as a new - standard - method of payment…

… but he could as well trigger negative regulators / clients / shareholders reactions

- *Musk engages a crusade in favor of cryptocurrency*
- *In doing so, he definitely raises the risk profile of Tesla*

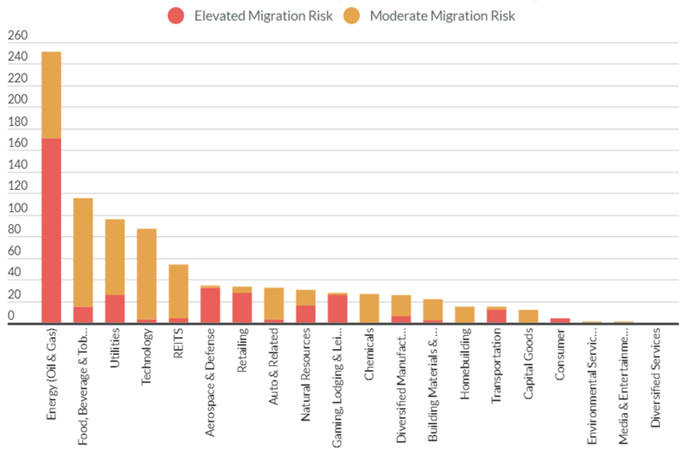
Fixed income. Time for upgrades

The average yield on US HY bonds dropped for the first time ever below 4.0%. Yield-hungry investors have rushed into junk bonds as an alternative high quality low yield bond. The total amount of negative yielding bonds remains very stable at high level since October 2020.

The lower yield environment should encourage more HY companies to tap the market. January was a record month for sales with $52bn priced, and year-to-date volume stands at $68bn. The demand continues to outweigh supply. Most new issues, even those rated in the riskiest CCC part have been hugely oversubscribed. Issuance conditions have been so conducive that some of the riskiest types of transactions (PIK) come back to market, bonds that are used to fund dividends. This robust new issue pipeline of lower-quality bonds will conduct to a market re-rating lower shortly. It is time to become more selective.

Based on ratings, outlook and sector exposure to the Covid-19 crisis, the oil and gas sector still accounts for the largest share of potential fallen angels, just as it did in March and April 2020. However, the risk of sharp downward pressure on oil prices has reduced due to OPEC+ production cuts, reduced oil inventories and increased investor optimism. This is dramatically different to spring 2020 situation.

Total debt of potential fallen angels ($bn)



Source: Fitch

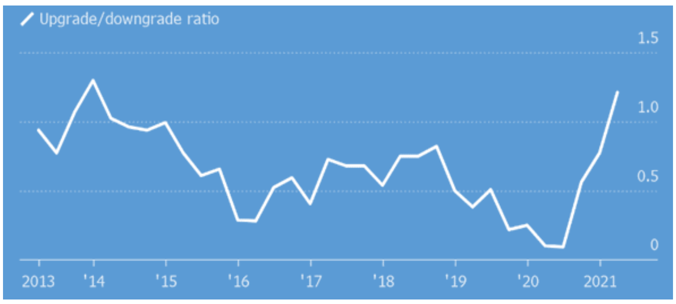
The other sectors the most exposed to the new restrictions are transportation, aerospace and defense/civil aviation, gaming, lodging and leisure, and non-food retailers. However, these four sectors account for about 12% of the investment-grade market. Furthermore, most issuers took advantage of buoyant capital markets to improve their liquidity positions, which will help them to weather the most acute period of restrictions. Finally, many governments have extended their support measures which alleviate lockdown-related stress. Pressure in other sectors has reduced from the peak downgrade period in 2020.

New pandemic-related restrictions will not lead to a repeat of the 2020 spike in fallen angels in Europe and the US. The main reason is that the outstanding debt issued by the most sensitive sectors to restrictions - including transportation and lodging - represents a small share of the market.

So, where to find value?

While 2020's fallen-angels count hit a 5-year record, the bleeding has stopped. March 2020 was the nadir for descents into junk, with Ford leading credits worth €16bn in downgrades to high yield. Last year's second-worst month was May, when 6 companies and €10bn were downgraded to junk. Since August, there was just one fallen angel. The increasing stream of rising stars is starting. The risk of forced selling has receded pulling down BBB- premiums to record lows. As an example, only €2.75bn of BBB- credit is on negative watch. Conversely, €8bn of BB+ debt is on positive outlook or watch. This downtrend has been reversed by a string of rising stars from junk to investment-grade in last three months. The credit rating momentum has turned. We expect more rising stars than fallen angels this year.

High Yield rated companies are being upgraded this quarter at the highest level relative to downgrades since 2013



Source: Bloomberg

Despite overall lower credit risks, there is still IG debt that could suffer from forced selling by key investors (insurance, banks, pension funds) that are not allowed to hold below-IG credit. BBB- is the last IG-rated notch, and 12% of the market is on this pocket. Some 422 bonds (78% senior, 22% sub) with €287bn are rated BBB-, €40bn more than 3 months ago, due to supply and rising stars. Within this group, 113 bonds and €82bn are on BBB- with a negative outlook from at least one rating agency, implying 27% of BBB- bonds are on the brink of junk.

On the opposite as earnings outlook has improved, HY names could benefit from forced buying by key investors (insurance, bank HQLA, pension funds) once they come back into the IG bucket. BB+ is the first HY-rated notch, and 32% of the HY index is on this pocket. Some 180 bonds (67% senior, 33% sub) with €120bn are BB+ rated within the HY index. Within this segment, 7 bonds and €6bn are on BB+ with a positive outlook from at least one rating agency, implying a good chance to become IG shortly.

Since the March 2020 selloff, markets have rallied on the back of stimulus and recovery momentum, but downgrade risks, especially around the lowest IG rated bonds, had been high. The differential between BBB- spreads and the IG index hit a high of 130bps last March. Since then, BBB- names have rallied back, outperforming the index, and this differential now stands at pre-Covid levels, near record lows. As the riskier credits have fallen into the HY index, the quality of the BBB- names has improved. Given that the differential has recovered to nearly 4-year tight, we do not see much upside now in the BBB vs. the market.

- *Credit market will face challenges in 2021. The BBB space has limited room of tightening given the remaining risks of fallen angels*
- *BB-rated bonds are still offering a decent yield pick-up and will benefit from both rising stars price gain and fallen angels additional yield pick-up*
- *Continue to favor HY but selectively*

Equities. After liquidity, back to fundamentals

2021 will be a more complex year, marked on the positive side by expectations of an economic recovery, by the strong recovery in profits and by supportive fiscal policies, and on the negative side by central banks still supportive, but less ultra-accommodating, by rising interest rates and inflation fears.

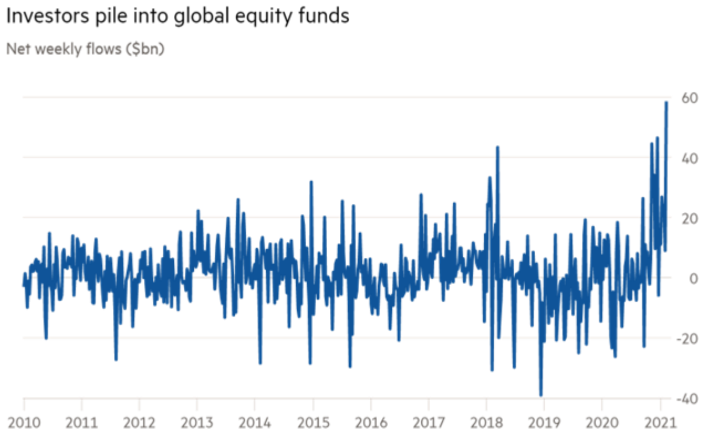
Central bankers Jerome Powell and Christine Lagarde are giving their places to ex-central bankers Janet Yellen and Mario Draghi. It's good news. At her first meeting of G7 finance ministers, the US Treasury Secretary reiterated the important support needed for the economy and repeating: "The time to go big is now". Janet Yellen confirmed the return of the US to multilateralism. The US is ready to find an agreement on the GAFA tax. The arrival of Mario Draghi in Italy could promote apolitical stimulus packages in Europe.

After a conference call with China, Joe Biden warned a bipartisan group of senators that the US was behind China in infrastructure, particularly transportation, Joe Biden referring to Chinese high-speed trains. The US must invest billions in traditional infrastructure, the winners being cement, steel, copper, aluminum and Caterpillar.

Stock indices are rising, as profits will rise sharply in 2021. But not only: operating margins will improve. The pandemic has forced companies to drastically cut operating costs, such as rent, travel and wages. The pandemic was also a precursor to changes in business models. Firms have substituted variable costs (wages) for fixed costs (technology). In 4Q20, profits of the S&P 500 should increase by 2.9%, while we expected -10% in early January (!), and revenues by +2.8%; in Europe, profits are expected to drop by 18% (-27% expected at the start of January) and revenues by -10%. For 2020, profits and revenues will decline by -11% and -1% in the US, and -33% and -11% in Europe. For 2021, profits and revenues will increase by +24% and +9% in the US, and by +43% and +13% in Europe. Source: Factset and Refinitiv.

Last week, investors bought a record of $ 58 billion for a week in equity funds at the expense of cash. See graph below. The big beneficiaries were technology stocks and US stocks with 62% of the total, which corresponds to the weight of the US in the MSCI World. Risky assets remain the preferred target with low interest rates and the prospect of a strong economic recovery. The enthusiasm for equities, for bitcoin, as well as the sharp rise in account openings for e-trading (retail investors) in January and the speculative movement of short squeezing by Robinhood e-traders could signal excesses, euphoria and a temporary pause, or even an imminent correction, but with Janet Yellen, expectations of additional US fiscal stimulus are high.

The negative side for equities is rising interest rates and fears of a surge in inflation. Even though the Fed said once again that monetary policy will not change, we felt Jerome Powell not so relax; despite inflationary fears, the Fed instead referred to employment to justify its accommodative policy. The prices of all commodities are rising, a rather rare phenomenon. Another inflationary phenomenon is the shortage in semiconductors with the



Source: FT, EPFR

sharp increase in sales of electric and connected cars, other connected objects, 5G, the cloud, data centers and all technological products (PC, gaming, ..) linked to stay-at-home / work-at-home. The pandemic has accelerated the digitalization of the economy and of the social / private life. Semiconductor manufacturers are experiencing more than 15% price increases in some segments.

Increase in all commodity prices

Source: Bloomberg

- *More complex and volatile stock markets in 2021, because they are based on fundamentals and less on liquidity*
- *Overweight cyclical stocks (materials, industrials) and banks*

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