ENTERTAINMENT: A SERIOUS BUSINESS
How the new normal is changing our leisure time
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THE RECOVERY: TO ‘V’ OR NOT TO ‘V’

César Pérez Ruiz
Head of Investments & CIO
Pictet Wealth Management

June and early July saw some upbeat data emerge in large economies, with strong increases in business sentiment, signs that international trade was restarting and solid rises in high-frequency data such as mobility data. However, we continue to expect that the post-pandemic road to economic recovery to be bumpy and believe the rate of travel will largely depend on the behaviour of consumers, particularly in the US. We think the jury is out on that score, but that it is more likely we see a ‘square root’ rebound rather than a ‘v’ shaped one.

It is, of course, possible that positive clinical trials on antiviral drugs prove a catalyst for continued recovery and that the belief of over 60% of unemployed Americans that they will quickly find a new job is justified, helping support household spending. But we believe that a return to a pre-pandemic normal will take time.

First and foremost, covid-19 has not gone away. Along with the appearance of clusters in Europe, the beginning of summer has seen a surge of new cases in some large US states, forcing the authorities to revise their re-opening plans. Second, we believe that unemployment in the US is unlikely to fall back to its pre-pandemic levels any time soon: recent statistics show that alongside improvements in the temporary job market, permanent job losses continue to rise. Third, emergency help for small businesses and wage subsidies are coming to an end, leaving lots of people in limbo.

While we might not see a full economic recovery until 2022, there is a good possibility that corporate earnings will return to and even surpass their 2019 level next year. In other words, we might not see a ‘v’ in the economic recovery, but we could see a ‘v’ in the corporate one. Expectations for a revival in earnings explain the strong performance of stock markets, which has seemed incommensurate with the improvement in economic fundamentals. But the gains in profitability look like remaining heavily skewed toward just a few sectors. Our own analysis indicates that the 2021 improvement in S&P 500 earnings per share (EPS) will be concentrated in just three sectors—technology, health care and retail (which essentially means Amazon)—that account for just over half the index’s market capitalisation (see chart), while EPS for sectors accounting for almost 25% of the S&P 500 will still be below 2019 levels.

All this means that investors will need to be extremely nimble, even within individual sectors like consumer discretionary. An uncertain outlook for jobs and travel restrictions could mean that consumers continue to limit their spending. The trend toward ‘safe socialising’, for example, could mean much lower consumer spending on restaurant meals and other outings. But the events of recent months will also likely to accelerate tendencies already underway for consumers to spend differently—supporting further growth in ecommerce and products and services that meet ecological concerns.

So there will be winners and losers in the post-pandemic recovery. This explains why our focus in the US is on growth stocks with a global reach, while we avoid more domestically exposed small caps. In Europe, where the pandemic has been generally better managed, we are focused on quality cyclical stocks well poised to benefit from Europe’s emergence from lockdown and from renewed support there for the transition to a ‘green economy’.

S&P 500 COMPANIES, PROJECTED INCREASE/DECREASE IN 2021 EARNINGS PER SHARE COMPARED WITH 2019

Source: Pictet WM - Equity Research, Bloomberg, July 2020
LONG-TERM INVESTING IN A WORLD MARKED BY PANDEMIC

Christophe Donay
Chief Strategist, Head of Asset Allocation & Macroeconomic Research, Pictet Wealth Management

Enduring low rates mean improved returns for equities and equity-like assets, while covid-19 is leading us to widen the scope of our research into market and economic drivers.

The latest expectations for long-term returns is marked by this year’s covid-19 pandemic. With central banks abandoning any thought of ‘policy normalisation’ as they scramble to deal with the fallout from the pandemic, persistently low rates are the common thread running through our return expectations for the coming 10 years. First, central banks’ moves to suppress interest rates mean return prospects for government bonds and cash will fall. Because of low rates and the regime shift underway in monetary policy towards versions of Modern Monetary Theory (MMT), we forecast a further decrease in annual returns for cash over the next 10 years. Average annual returns for cash in euro and Swiss francs will be negative, we believe. With 10-year return well below 1% in the US and negative return in Europe and Japan, expected returns for government bonds have decreased.

By contrast, the effects of policy responses to the coronavirus together with adjustments to our analysis of valuations mean there is an improvement in return expectations for equities. Assuming an unchanged end-economic regime, the huge gap between actual returns this year and annualised return forecasts made last year means equities mechanically see their projected returns for the next 10 years increase.

Low rates and improving valuations are also improving return expectations for private assets such as real estate and private-equity deals. Our analysis finds that average annual returns for private equity could reach over 10% (in US dollars) and private real estate equity over 6%.

Gold is one of the few assets that should benefit the most from the shift in the monetary policy regime (and possibly inflation regime), with an expected average annual return of over 4% (in USD dollars). For those willing to assume the risk, emerging-market debt and high-yield bonds offer interesting potential.

Our expectations for the main asset classes over the next 10 years are summarised in the table below.

ACCELERATING TRENDS
Our 10-year return expectations are contained in our annual Horizon publication. The covid-19 pandemic interrupted our work on Horizon just as we were completing the 2020 edition, forcing us to delay publication and revise all our projections. But the crisis has also underlined the validity of our new initiative, called ‘Beyond Horizon’, which widens the scope of our analysis of a series of drivers of long-term economic and asset class performance.

A crisis makes time more dense: it exacerbates and accelerates pre-existing trends and dynamics in economies and markets. A crisis is naturally seen a threat but it is also an opportunity to better understand the world in which we are living and where we are going in terms of economic trends and expected returns.

### PWM'S RETURN EXPECTATIONS FOR THE NEXT 10 YEARS*

<table>
<thead>
<tr>
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<th>Annual average total nominal returns (%)</th>
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<tbody>
<tr>
<td>US Cash</td>
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<tr>
<td>10-yr US Treasuries</td>
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<td>Emerging-market local-currency debt</td>
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<tr>
<td>Global high yield (in USD)</td>
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<tr>
<td>US equities (in USD)</td>
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<td>UK equities (in sterling)</td>
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<td>Hedge funds (in USD)</td>
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<td>Private equity (in USD)</td>
<td>10.1</td>
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<tr>
<td>Gold (in USD)</td>
<td>4.4</td>
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*Past performance and forecasts are not per se a reliable indicator of future performance.
To take two examples: crucially, the co-v-19 crisis exacerbates the innovation trend (tech is everywhere, from people tracking to vaccine development). Second, we can expect inequalities to be higher after the crisis than before.

Since 2013, Horizon has helped us explain and communicate our 10-year return expectations over a range of public and private assets (some 41 in total) as well as our latest thinking on asset allocation strategies. Over time, its long-term focus has naturally pushed us to analyse major underlying forces that we believe could materially impact our long-term economic and asset class forecasts.

This year we are taking our work to another stage. In ‘Beyond Horizon’, we will focus on structural macroeconomic issues with far-reaching and potentially massive consequences on our geopolitical, economic and financial environment. To qualify, they must have the following characteristics:

**COHERENT.** They should be clearly delineated, homogeneous and self-contained, as opposed to being simply a collection of loosely connected topics lacking strong coherence.

**MATERIAL.** They must exhibit a significant potential impact on the macroeconomic environment and asset allocation strategies. Such an impact can be gradual or sudden.

**DURABLE.** They must be long lasting, stretching over many years, if not decades; transcending economic cycles yet also interacting with them.

**GLOBAL.** They must have a quasi-global reach and should not be limited to just a few countries.

**INVESTIBLE.** They must lead to clear, actionable investment conclusions and insights.

We are happy to share with you seven drivers we believe meet our criteria for inclusion. Although our initial selection of key engines of economic regimes is not meant to change often, it is not set in stone, and we expect to add to them in time. Even as we turn our attention to fresh topics, we will strive to further our understanding of those already unearthed, regularly sharing our latest insights with our clients.

“‘Beyond Horizon’ makes a new stage in our analysis of structural issues that stand to have far-reaching geopolitical, economic and financial consequences”
HIDING IN PLAIN SIGHT: 
UNCOVERING REAL ESTATE SUSTAINABILITY

Real estate is among the very last industry sectors to apply technology in pursuit of efficiency and sustainability principles but the effects of PropTech is untapping exceptional potential.

In terms of industry sectors, identification of major environmental villains is usually considered a relatively easy task: auto and aviation, for example, easily come to mind. But there is a sector gets relatively little attention considering the size of its environmental footprint.

Real estate, or the built environment, accounts for almost 40% of global emissions and raw material usage, and more than one-third of the world’s energy usage. Production of materials destined for construction generates a further 11% of energy-related carbon dioxide emissions worldwide as cement and steel are highly energy-intensive to manufacture. Aviation, by comparison, is responsible for 2% of global carbon emissions.

Real estate as an environmental offender might be said to be hiding in plain sight, but not sufficiently to escape the attention of the United Nations. The UN estimates that in order to limit the rise in global temperatures to less than 2 degrees centigrade by 2030, the property industry needs to reduce the average energy intensity of buildings by at least 30 per cent.

On that basis there is, to put it mildly, room for improvement.

“If you take into account that the vast majority of buildings are 20 years old or more, we can imagine the types of inefficiencies that exist in terms of energy consumption, heating, lighting, air quality and so on,” says Zsolt Kohalmi, Global Head of Real Estate at Pictet Alternative Advisors (PAA). “There are lots of quick wins to be captured by focusing on improvement of our built environment.”

Demolition of old buildings and reconstruction is “an environmental disaster” in terms of waste and energy needed to reconstruct. Improving existing buildings is far more efficient and in this regard technology is helping. “Real estate is the last industry to be revolutionised by technology,” says Partha Sarathy, Head of Asset Management – Real Estate, PAA. “Other industries spend an average of 3.3% of revenues on technology, real estate 1.5%.”

Hence, the rise of the PropTech industry – the ecosystem that is applying technology at all stages of the construction cycle with environmental considerations to the fore.

Two technologies in particular are leading the way.

Sensors are being harnessed to monitor, analyse and regulate a range of environmental factors. By monitoring traffic in buildings and collecting and analysing data it is possible to optimise and automate lighting at various parts of the day. As the Internet of Things becomes more pervasive – driven by faster 5G internet connections – so there will be even more opportunities to control building environments for optimal efficiency and wellbeing.

There is also a revolution in modular construction. “The prefabricated quality is now very impressive and very efficient in terms of energy, noise pollution and waste,” says Partha Sarathy. “Everything is constructed in a factory, quality and use of materials is standardised and

TRENDS IMPACTING THE FUTURE OF REAL ESTATE

The changing needs and trends that real estate will have to satisfy from an ESG perspective:

**DEMOGRAPHIC CHANGES**

By 2050, 68% of the world population project to live in urban areas. City density will increase exponentially which will create challenges when it comes to creating spaces for living, recreation and green spaces needed for inhabitants’ well-being, sufficient healthcare facilities and nursing homes etc.

**SOCIO-ECONOMIC CHANGES**

By 2030, Millennials and Generation Z will form 2/3rd of the global work force with 700mm Baby-Boomers reaching retirement age. Generation Z is willing to sacrifice space for proximity to urban centers, “generation rent” prefers to rent rather than buy unlike their parents, they value flexibility and are more tech-savvy.

**TECHNOLOGY CHANGES**

Smart mobility: By 2025, the sector is expected to grow 8–9x. Real estate valuations are tightly linked to proximity to transportation nodes and parking spaces: smart mobility could have an impact on that.

Source: Pictet Alternative Advisors - COIMA sustainability report, UN, Department of economic and Social Affairs; Forbes “E-commerce Set For Global Domination – But At Different Speeds”;
European Commission; Inequality.org, 2018
controlled.” In fact, off-site construction uses up to 69% less energy and reduces waste from construction by up to 90%.

In a process of continuous improvement it is the practice to take thousands of photos during the construction of modules across layers of the building. This makes it possible to trace flaws years after assembly and repair and improve easily.

Unlike many industries, from an investment perspective, making buildings more efficient is one of the most easily measurable and transparent objectives in terms of ESG. Cost savings on a utility bill are innately tangible and immediate, unlike, say, the effects of good governance that might become apparent in an more intangible way some 30 years down the line.

### RE LAGS OTHER SECTORS IN EMBRACING DIGITAL CHANGE

<table>
<thead>
<tr>
<th>Banking and securities</th>
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<tr>
<td>Real Estate &amp; Construction</td>
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**Sources:** (*) Pictet Alternative Advisors - Deloitte interview of N=747 global CIOs, 2016-2017

**Sources:** (**) Pictet Alternative Advisors - Using U.S as a directional source; National Home Builders Association, 2017; Includes construction, and consumption on housing services (e.g. rent, utilities etc.)

### SUSTAINABILITY AND ROI

According to the Urban Land Institute (ULI), the potential value of embedding sustainability measures in real estate transactions can deliver an increase in asset value of 50% and more over the lifetime of an investment. The ULI identifies a number of key strategic opportunities at four stages of the transaction life cycle.

#### 1 ACQUISITION DUE DILIGENCE

At the acquisition due diligence stage the ULI recommends that prospective purchasers examine actual energy and water expenses, not estimates, and benchmark against similar buildings. The potential for improving net operating income (NOI) may be substantial and so due diligence assessment must include key sustainability factors.

#### 2 FINANCING

At the financing stage, buyers should include big-ticket items that generate superior returns through acquisition financing which comes at a low cost of capital and should also utilise sustainability-specific financing tools.

#### 3 HOLD PERIOD

During the **hold period** building systems should be upgraded as soon as possible and *in the right order*. Promotion of sustainability and health features help attract tenants at a premium. Adoption of “green leases” aligns owner and tenant interests to maximise the building’s sustainability performance, likewise guidance during the tenant fit-out.

#### 4 PREPARING FOR DISPOSITION

When preparing for disposition, the building should be marketed to buyers who will pay a premium for sustainability qualities. A qualified “green appraisal” should be made to capture value from sustainable investments during the hold period. Any big investments should be made at least a year before disposal to capture value in the sales price.
Does the pandemic and subsequent lockdowns mark a structural shift in patterns of leisure and entertainment or has it merely exacerbated trends that were already there?

The Covid-19 pandemic has impacted many aspects of our life – from the way we work to the way we spend our free time. Imposed lockdown measures have led to marked changes in consumption behaviour and spending patterns – something particularly visible in the leisure and entertainment space. The vibrant “out of home” world of entertainment, including travel, live and sport events, amusement parks, movie theatres and restaurants, came to a halt. Discretionary spend on “out of home” activities dropped to nearly zero as lockdown measures became widespread to the benefit of entertainment that can be consumed at home. This divergent trend observed in real life has been well reflected in the market and stock performances depending on their exposure to “stay at home” vs “out of home” consumption, with the former outperforming the latter and the broader market by 69% and 46%, respectively.

As consumers and investors, we try to understand whether the pandemic has forever changed the way we spend our leisure time. Will we go back to pre-Covid world or will there be a structural shift in our behaviour?

The answer at this stage is both “yes” and “no”. On the one hand, we have already observed a change in consumers’ preference for content consumption – digital, on demand and interactive, which has driven a shift away from traditional media towards video streaming and gaming. In this case, the Covid-19 crisis is a catalysing change for a trend established well before the virus hit. On the other hand, when it comes to “out of home” entertainment and leisure activities, such as travel, concerts, sports events and dining, the pandemic caused an interruption but not necessarily a structural change in demand. In fact, we believe that the current crisis is creating an emotional pent-up demand that will materialise when consumers feel safe enough to be among crowds and to the extent that affordability remains unaffected.
AN INDEPENDENT VIEW OF THE WORLD
HOW THE NEW NORMAL IS CHANGING OUR LEISURE TIME

WHEN AT HOME: STREAM AND PLAY

Thanks to social media channels, consumers have continued to engage in many of their favorite “out-of-home” activities from the comfort of their living rooms. The internet has exploded with online CrossFit, yoga and cooking classes, “live” music performances, and eSport tournaments. Entertainment activities that stand out as particular beneficiaries from the “stay at home” backdrop are video streaming and gaming.

Viewership on streaming platforms doubled during lockdown weeks, resulting in streaming share growing to 24% from 15% a year ago. Netflix added nearly 16 million net new members in 1Q20, with an additional 6-7 million in March alone, cementing its leadership position despite proliferation of new direct-to-consumer products. Meanwhile, data from various sources, including Steam, Twitch, Nielsen, confirmed c.30% increase in video games player engagement during the lockdown period. PC gaming platform Steam reached a record number of 20.4m concurrent players during 1Q20, +16% yoy, and for the first time ever more than 3bn hours of video games content was watched on Twitch (a video games streaming platform). Spending on video games has similarly been on the rise, up more than 60% during April-May.

“The pandemic is proving a catalyst for entertainment trends established before the virus hit”

The adoption and popularity of video streaming and video games are not new and have been growing over the last few years. The pandemic simply provided a boost to an existing structural trend. Simply put, streaming offers better value versus the TV bundle and is more suited to consumers’ preferred way of media consumption – digital and on demand. Meanwhile video games provide a truly immersive and interactive entertainment experience that is difficult to rival. And while lockdown levels of engagement might not hold as we slowly resume our pre-covid way of living and allocate part of our time and money back to “out of home” entertainment activities, the trend observed in recent months in not fully reversable. Streaming and gaming are here to stay. The structural growth story of these sectors is just too strong to reverse or diminish and we believe they will continue to command a bigger share of consumers’ time and spend, most likely at the expense of traditional media.

WHEN LOCKDOWN IS LIFTED: DINE AND TRAVEL

The global leisure travel spend was expected to grow by c.5% p.a. over the next few years driven by a strong and sustained demand among millennials. However, the covid pandemic has brought the travel industry to a standstill: thousands of cancelled flights, postponed holiday plans, and an ongoing uncertainty for the millions of people employed by the travel and hospitality industry. As individuals and investors we find ourselves in unchartered territories with plenty of unanswered questions: when will the world travel again and when it does how will it travel? Will consumers’ pre-covid habits return or there will be a new normal?

We believe that travel is not structurally impaired; however, it will likely remain depressed until a vaccine is found or consumers feel safe enough to embark on a journey and be in crowded places. It is also important to differentiate between corporate and leisure travel, where we will observe a very different recovery picture. Business travel
is unlikely to resume previous peaks as corporates keep embracing digital tools and video conferencing as a more cost and time efficient way of doing business. On the contrary, we think that the underlying drivers behind leisure travel remain intact. There are some truly powerful motivators that compel people to travel such as exploring new places, culture and food, meeting new people, spending time with family and friends, and taking time to relax. In fact, recent surveys indicate that 50% of the Chinese travellers expect to travel more post-covid, 53% of US consumers expect to resume travel in the autumn and c.23% of UK respondents will take the first safe flight.

Demand exists but a return to pre-covid levels of activity will take time and happen in phases. Hotel operators suggest the industry will take 2–3 years to return to 2019 levels of sales and profits. Most management teams feel confident that leisure travel will recover gradually while corporate travel will likely take a permanent hit. What happened in the UK after the Global Financial Crisis provides some insight into how travel trends may evolve in a post-covid world. After 2008, the number of overseas business trips taken per person in the UK fell by one third and never recovered. Meanwhile, leisure travel recovered back to pre-crisis levels.

Across the hospitality space, the dining sector is seeing the earliest signs of recovery as restaurants reopen at reduced capacity with increased focus on cleanliness and safety. In addition, enhanced collection and delivery options facilitate recovery in demand. Second comes domestic travel, followed by international. In a survey by Tripadvisor, 43% of the consumers indicate that their next international trip will be more than year from today. Consumers would also opt for self-guided and self-drive trips initially and would prefer to avoid small or guided group trips.

These insights suggest a certain pattern of phased recovery for the travel and hospitality companies with restaurants and domestic-leisure exposed names likely to recover first, followed by amusement parks and hotels. Airlines and cruise operators will likely be among the last ones to recover. The industry as a whole will have to adapt to new norms of social distancing, at least in the near term, and offer high hygiene standards. This may increase the cost of doing business but is a must so that consumers feel safe to go out, travel and explore again.
RESTAURANT BOOKINGS: YEAR-ON-YEAR CHANGE (IN %)
Using latest data available at 24 July 2020

Source: Pictet WM-CIO Office, OpenTable, 24 July 2020

RETAIL OUTLETS: YEAR-ON-YEAR CHANGE (IN %)
Using latest data available at 24 July 2020

Source: Pictet WM-CIO Office, Footfall Retail Index, 24 July 2020
Infographics: Valerio Pellegrini
WHERE DO WE GOLD FROM HERE?

Gold bears no credit risk, is an effective store of value and is broadly negatively correlated to the US dollar. As such, demand for its insurance properties in light of the potential unintended consequences of massive monetary and fiscal expansion is unlikely to falter soon.

The great economist J.M. Keynes called it a “barbarous relic”; its inherent value is limited, and it is an asset class whose price behaviour can be driven by less rational factors such as emotion and tradition. Yet, in these uncertain times, gold as an investment inevitably moves into the spotlight.

The extent of the global monetary and fiscal stimulus measures that have been rolled out in response to the covid-19 crisis, especially in the US, indicate how challenging will be any return to ‘normal’ financial conditions – even more so than in the aftermath of the 2008 financial crisis. With elevated uncertainty around the potential unintended consequences of these global easing packages, the attractiveness of gold is likely to rise further, given the yellow metal’s lack of credit risk and proven track record as a store of value.

Gold offers no yield but this drawback has been heavily diminished as a result of monetary policy easing. The piling on of debt in the global economy will likely force major central banks to remain accommodative in years to come, with policy rates expected to remain at very low levels for an extended period. At historically low yields, even modest inflationary pressure could prove painful for bond holders if real rates stay in negative territory. Given its low opportunity costs and resilience to any sharp rise in inflation, the allure of gold is likely to shine even more brightly for investors.

We believe four factors will play a part in the gold price trajectory in coming months and years.

INTEREST RATES: LIMITED DOWNWARD PRESSURE

When rates fall, the price of gold benefits. Gold’s rise since last year is mostly due to the decline in US 10-year real rates which moved from 1.1% in November 2018 (when the gold price was around USD1200 per troy ounce) to -0.4% in early May 2020 (see Chart 1). With the US Federal Reserve’s limited appetite for negative rates, and our scenario of tame inflationary pressure over the next few years, US real rates may struggle to fall much lower than their current levels.

While past episodes of quantitative easing in the US did lead to a decline in US real rates, this was only due to the fall of nominal rates as inflation expectations remained stable. However, as the Federal Reserve is unlikely to welcome an inverted rate curve, the downward potential of nominal rates seems limited. At the same time, the collapse in economic growth, and our scenario of a slow recovery, favours modest inflationary pressure in the next few years as the economy operates at below-trend levels. Coupled with the decline in oil prices, US real rates may not play an active factor in a much higher gold price.

CONCERNS OVER FIAT CURRENCIES

In some respects, gold can be considered as something of a global currency, and its value fluctuates according to the value of fiat currencies. However, what could support the gold price are growing concerns about fiat currencies.
We see investment demand as the main driver of the price of gold, despite its accounting for less than 30% of total gold demand. However, we should not forget that jewellery demand, accounting for roughly half of total gold demand, may remain weak in the coming months in conditions of economic contraction, lower global income and a high gold price. Nevertheless, as shown in the first three months of this year, a collapse in jewellery demand is not an issue if investment demand is strong. While the likely reduced affordability of gold in the next few years suggests subdued jewellery demand, we see investment demand as strong enough to lift the gold price. However, this may lead to higher volatility should investment temporary falter as the usual support provided by jewellery demand has weakened.

**CENTRAL BANK PURCHASING**

In a similar vein, official demand will likely fall this year following the Bank of Russia’s suspension of gold purchases from April. Other strong buyers of gold, such as Turkey and India, may also limit their commitment due to turbulence in their respective financial markets. However, we see this weakness as temporary. Indeed, reserve managers in developing countries are likely to accumulate the yellow metal because of its diversification role relative to the US dollar, its lack of credit risk and its proven efficiency as a store of value. Although we acknowledge that gold has already had a good run over the past quarters and is not immune to potential price corrections, investment demand is likely to remain strong in the next few years.

**CHART 1: GOLD VS. US 10-YEAR REAL RATES**

![Chart 1: Gold vs. US 10-Year Real Rates](image1)

Source: Pictet WM-AA&MR, Bloomberg, 15 May 2020

**CHART 2: GOLD VS US DOLLAR INDEX**

![Chart 2: Gold vs US Dollar Index](image2)

Source: Pictet WM-AA&MR, Refinitiv, 1 May 2020

Because gold is priced in US dollars, the trend of the American currency is always predominant (see Chart 2). We are doubtful that the dollar will be able to sustain its broad appreciating trend since 2011, given the complete erosion of its interest rate advantage and long-term fundamental overvaluation. Overall, we see scope for some depreciation in the US dollar in the next few years, which should prove supportive of the gold price.

**JEWELLERY DEMAND**

We see investment demand as the main driver of the price of gold, despite its accounting for less than 30% of total gold demand. However, we should not forget that jewellery demand, accounting for roughly half of total gold demand, may remain weak in the coming months in conditions of economic contraction, lower global income and a high gold price. Nevertheless, as shown in the first three month of this year, a collapse in jewellery demand is not an issue if investment demand is strong. While the likely reduced affordability of gold in the next few years suggests subdued jewellery demand, we see investment demand as strong enough to lift the gold price. However, this may lead to higher volatility should investment temporary falter as the usual support provided by jewellery demand has weakened.
REACHING THE GOAL OF THE INVESTOR JOURNEY

Behavioural finance has challenged traditional portfolio management theory. The development of goals-based investing not only looks at how investors behave in the real world, it also recognises their inherent need for comfort with their decision-making.

When it comes to investing, it is by now well understood that human beings have many dysfunctional behaviours hardwired into their thought processes. One of the most notable is mental accounting: the tendency to regard money differently depending on its provenance or its intended use. One consequence of this, for example, is that people treat money derived from a windfall event differently – and often less seriously – than that earned through regular work.

This behaviour conflicts with a core tenet of modern portfolio theory which, consistent with the fungibility of money, assumes that people treat their assets as a single pool. From this pool they construct investment portfolios that seek to optimise returns for a given level of risk. The reality, however, is that people consciously or subconsciously portion up their wealth into separate “mental accounts”. An example of what this could mean for investment goals is contained in Figure 2. These tend to match financial goals such as buying a house, paying tuition fees for children or funding a round-the-world trip.

Goals-based investing (GBI) seeks to accommodate this and aims to maximise the probability of achieving investors’ goals by putting them at the heart of the investment process. GBI has grown substantially in recent years, with assets managed using this methodology now around USD2 trn.

In 2010 a landmark paper, ‘Portfolio Optimization with Mental Accounts’, sought to reconcile the two approaches and, instead of focusing on a specific risk factor such as standard deviation, tried to answer the question: “What is the maximum probability of failing to achieve this goal that you are willing to accept?”

The traditional approach to portfolio asset allocation involves two main stages: first, calculating return expectations for individual asset classes and, second, determining the ideal allocation to maximise the portfolio’s profitability within the constraints imposed by resources and return expectations. Using this framework, two broad parameters for asset allocation can be identified—desired returns (for example, inflation +2%) and the level of volatility one is willing to accept.

However, the factors that investors consider may be much too varied to be reduced to these two parameters alone, especially since risk cannot be measured merely in terms of an asset class’s price volatility. How goals are achieved is defined by the choices made and involve several parameters: Nominal profitability, Real profitability, Volatility, Drawdown and duration of drawdowns, Time horizon for achieving the goals and Liquidity.

Investors’ goals and the way they reach these goals are intimately linked. One might even say that for some investors how investment goals are achieved are as important as the goals themselves. The performance of GBI cannot be compared easily with indices or other standard performance measures, relying instead on the progress being made towards the goals that investors set out for their current allocation. Figure 1 illustrates the paths that might or might not be acceptable to an investor, depending on usefulness and investor biases.

CHOOSING RISK PARAMETERS

The ability or otherwise of the investor to stay the course of a particular investment journey is tied up with risk. Here, risk in an investment concept has three dimensions:
**Risk tolerance** is the level of risk investors are prepared to accept in order to achieve their goals.

**Risk capacity** is the risk that a portfolio can sustain without jeopardising the chance to achieve the investor’s goals.

**Necessary risk** is the risk that needs to be accepted to achieve the investor’s goals.

Ideally, risk tolerance should be greater than risk capacity, which in turn should be greater than necessary risk. In this stress-free scenario there is a high probability that investor goals will be achieved.

The notion of financial risk has long been equated solely with the volatility of returns. This proposition was well received because it greatly simplified calculations of portfolio optimisation. Yet volatility is only one measure private investors have of judging risk. Indeed, volatility is a very short-term phenomenon, which is not much help when formulating financial objectives over a horizon of several years.

Instead, behavioural finance’s approach recommends private investors with a longer-term horizon use three main risk parameters. These are:

- A sharp decline in the portfolios during the time horizon under consideration (maximum drawdowns)

- The likelihood of recording a loss at the end of the period of investment (loss probability)

- The time needed to recover the initial capital after an unexpected sharp drop in assets (recovery time)

Academic studies suggest equivalences between these different measures and each client can choose the risk parameter that seems most relevant. This approach to risk is compatible with the strategic asset allocation (SAA) approach which contains the idea that drawdowns are a more relevant risk indicator than volatility.

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### FIGURE 2: DEFINITIONS OF INVESTMENT GOALS, SOME EXAMPLES:

<table>
<thead>
<tr>
<th>Individual motivation/utility function</th>
<th>Investment goals</th>
<th>SAA profile</th>
<th>Required returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Safety</td>
<td>Capital preservation</td>
<td>Conservative</td>
<td>Inflation + taxes + fees = R₁</td>
</tr>
<tr>
<td>Lifestarnd and safety</td>
<td>Lifestyle</td>
<td>Balanced</td>
<td>R₁ + Lifestarnd spendings = R₂</td>
</tr>
<tr>
<td>Wealth increase</td>
<td>Enrichment</td>
<td>Growth</td>
<td>R₂ + capital appreciation</td>
</tr>
</tbody>
</table>

#### SEVEN MAJOR ADVANTAGES OF GBI

1. Gives greater insight into investor’s emotional and behavioural biases
2. Clearly sets out the capital required to achieve goals, a definition of the longer-term commitments, and the amount that can be spent annually before jeopardising the goals
3. Is just as suitable for bespoke asset allocation as for mass customisation
4. Enables probability of achieving investors’ goals to be calculated
5. Allows investors to measure how much value a wealth manager is adding according to their own goals rather than with reference to a benchmark or competitor performance
6. Enables advances in behavioural finance to be integrated into the investment process “naturally” and in a coherent way
7. Enables a more accurate and relevant definition of risk

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### FIGURE 3: THE ‘GOALS’ IN GOALS-BASED INVESTING

Source: Pictet WM-AA&MR, January 2020
FIGHT AND BE BOLD: PRIVATE EQUITY LOVES A CRISIS

Private equity deals have been slowed by poor visibility on the economic outlook, the impossibility of conducting on-site due diligence and the current scarcity of bank loans. But this will be temporary and there are good reasons to believe bold investors might be rewarded.

The current crisis is bad news for many but history shows us that for private equity operators a crisis should never be a wasted opportunity. Four reasons explain this.

1 STAYING LIQUID
Money is the sinews of war, said Roman statesman Cicero. Crises tend to reaffirm this. Today, liquidity is the most important asset for a business to have, which makes private-equity-backed companies better positioned to face the current crisis having capital at their disposal to recapitalise struggling businesses if necessary.

2 KNOWLEDGE IS POWER
The contribution of private equity firms goes beyond their deep pockets, with operational expertise playing a crucial role in a company’s survival at the present moment. Private equity firms are actively working behind the scenes to defer interest payments, negotiating with landlords to amend leases to abate or defer rent payments, drawing on credit lines and surgically cutting expenses in almost every line item. They are also vigilant in identifying any accounts receivable opportunities. General partners (GPs) who went through similarly difficult times in 2008 are naturally better equipped to deal with such issues. Their operational toolkits are broader, their playbooks more comprehensive.

3 RECESSIONARY VINTAGES FARE BETTER
For private equity firms, a downturn represents opportunity. Capital can be deployed on more attractive terms and bold, calculated moves are possible. It is therefore no surprise that funds launched in the middle of the last economic slump (post-2009) have outperformed earlier vintages.

4 MORE OPPORTUNITIES
Firms that were previously on watchlists but inaccessible could become easier targets in the wake of the coronavirus crisis. These are scary times for any business owner who lacks the capital or management capabilities required to navigate through the crisis. Some, who may never have considered selling or taking on a financial partner before, may be open to the discussion now, especially if there is a potential injection of capital into the company on the table. With covid-19 pushing the world’s major economies into recession, we are likely to witness the re-emergence of more opportunistic strategies, such as turnaround or distressed investing.

“A downturn like the one caused by covid-19 represents an opportunity for private-equity firms, which are able to deploy capital on more attractive terms than before”

Private equity firms that rely solely on financial engineering, quick cost-cutting measures and market momentum to drive performance after a company is acquired are destined for problems. A hands-on approach in recessionary times is necessary as companies will certainly be facing unprecedented challenges.

For limited partners (LPs), having access to and partnering exclusively with sophisticated and experienced GPs, preferably those that have proven their investment skills and operational capabilities in difficult markets, becomes paramount. LPs with sharp fund-selection skills and who are able to build a diversified and balanced exposure in private assets should continue to benefit from strong returns.
### HOW COVID-19 HAS CHANGED CONSUMPTION AND TRAVEL TRENDS

| **81.9** | The Stringency Index is a collection of publicly available information on 17 indicators of how stringent government responses have been to the covid-19 crisis. The index rebounded to 81.9 in China in June, higher than it was at the height of the pandemic there, as the Chinese authorities combated new clusters of the virus outbreak. Data include information on containment and closure policies and policies governing covid-19 testing.²  |
| **-99%** | In India, the Experian Footfall Retail Index, which measures the number of shoppers frequenting retail outlets, reached an all-time low of around -99% between late March and end-May. In mid-July, footfall was still 78% below last year’s level.³  |
| **-88%** | Based on numbers passing through security checkpoints, traffic in US airports hit an all-time low in April and has hardly picked up since. In mid-July, traffic in airports was still 88% below the previous year’s levels.⁶  |
| **26.1%** | TSA Total Traveller Throughput is at 26.1% of the previous year’s level. The series indicates the number of passengers passing a security checkpoint in the US.⁴  |
| **-90%** | Contraction in daily flights globally in the first week of May compared to the previous year.¹  |
| **61%** | By mid-July, car traffic in Italy was 61% above its level at the start of the year as people started to travel again. But use of public transport was still 21% lower than in January due to public concerns over crowded spaces.⁵  |

¹ US, China, Europe, Japan, rest of Asia, South America  
Source: Pictet AM – Tech-Insight & Pictet WM -AA&MR, 7 May 2020  
³ Source : Pictet WM – AA&MR, Quantitative Strategy, ShopperTrak, Bloomberg, July 2020  
⁴ Source: Pictet WM – AA&MR, Quantitative Strategy, TSA, 23 July 2020,  
⁵ Source: Pictet WM – AA&MR, Quantitative Strategy, Apple mobility trend report, July 2020  
⁶ Source: Pictet WM – AA&MR, Quantitative Strategy, Complementics, Barclays Research, July 2020
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