Vontobel

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Vontobel Asset Management

Vontobel Fund - Non-Food Commodity

Approved for institutional investors in: AT, CH, DE, ES, FI, GB, IT, LI, LU, NL, NO, PT, SE

Market developments

The Coronavirus continued to spread in March outside China with severe repercussions on the health and economic systems. Government measures aimed at slowing the spread of the virus have considerably restricted public life and curbed the real economy in many places across the world, in some cases even bringing it to a standstill. Consequently, initial jobless claims in USA spiked to 10 million within two weeks and global GDP was revised down by at least 3% p.a. (if lockdowns extend into H2). All of this culminated in a rapid surge in risk aversion and triggered enormous losses on capital markets, with investors initially fleeing to safe havens, such as government bonds and USD cash. Extensive fiscal and monetary measures started in the second half of March across the globe. Governments in many countries launched multi-billion rescue packages to stabilize the economy and improve the bleak prospects of many companies by emergency loans and guarantees. In q2 and q3 the US government is expected to inject 9% of GDP stimulus in their economy, while the EU is expected to inject 3% and China 4%. All relevant central banks decreased their interest rates and announced massive quantitative easing programs. The US-Fed balance sheet grew by 0.5 trillion USD in one week and the different liquidity measures will culminate in QE4. The big question is how long this sudden standstill of social and economic activity will last, when and how the quarantining will end and how swift the rebound in economic activity will be. For a swift normalization of economic activity, it is key that businesses survive the current situation, which means that governments and central banks need to mitigate the looming default cycle and prevent a further spike in unemployment numbers.

Energy commodities came under severe pressure in March, with the sector down a striking -35.1%. Oil prices came under fire from both sides, supply and demand, and dropped to 18 years lows (March: WTI -54.4%, Brent -43.2%). On the demand side, shutdowns in businesses and travel restrictions (driving and air traffic account for 55% of global oil demand) to fight the spreading of SARS-CoV-2 lead to an abrupt standstill. On the supply side, markets are being flooded by cheap oil, as OPEC+ talks broke down on 6th March by Russia and Saudi Arabia not agreeing to further reduce production or even maintain existing cuts. Saudi Arabia and Russia started a price war by trying to gain as much market share as possible. Saudi Arabia announced to raise production in April to 13 million barrel per day (mbpd) and immediately discounted the official selling prices by as much as 10 USD per barrel for oil delivered to Europe. Due to massive oversupply and erased demand, the world will run out of storage space both onshore and offshore very soon. Maximum storage capacity is expected to be reached in the coming 2 months, putting most pressure on short dated oil contracts and moving oil curves into so-called “super-contango” when buyers of spot oil have no longer access to storage capacity. However, these low oil prices should rapidly kill all high cost producers and are likely to turn US shale oil production growth deeply negative for 2020/21. Due to this prospective oil undersupply in future and the expectation of a normalization of oil demand later this year, longer dated oil prices remained relative stable. Gasoline showed the strongest loss out of all commodities in March (-59.9%), as social distancing reduced driving massively. Even though, a gasoline price decline of this size is working similar to a tax cut to consumers, president Trump started to interfere in the oil war and demands a production cut by OPEC which should result in higher oil prices. The reason for this is that US oil producers suffer substantially due to these low prices and job losses in important states as Texas may cost Trump´s re-election in November. Oil products outperformed crude oil, with gasoil down -32.9% and heating oil -32.0%. Natural gas lost only -5.3% in March driven by expectations of shale supply destructions as natural gas comes as a by-product of shale oil.

Base metals sector (-9.7%) was pressured when it became clear that it was not only a question of when China would come back to the market anymore, but also the rest of the world. Copper (-12.2%) and aluminum (-10.6%) suffered most due to the severe global economic slowdown. Again, base metals held up better than the energy sector as not only the metals demand was reduced but also supply started to suffer as logistics broke down and ports as well as mines were closed in several countries to prevent further spreading of the virus. Furthermore, metal producers benefited as low oil prices reduced cost of production. Nickel (-6.4%), zinc (-5.9%) and lead (-5.7%) could keep up better than copper as mine cuts were more severe. While several tracker indices showed that China gradually runs production up, the manufacturing industry in Europe came to complete halts. This was also observable in March European PMIs falling short of expectations. Though China’s manufacturing PMIs exceeded expectations, attention was on new export orders, which remained in contractionary territory. The massive $2 trillion

emergency spending bill in the US and massive stimulus by global central banks at the end of March helped to stop the drop of metals as it may lower borrowing costs and increase inflation.

Precious metals did not benefit as much as you would expect during a global stock market drawdown of that size. Alike the great financial crisis in 2008, gold could initially not meet its characteristics of a safe haven asset. The rush into cash and meeting margin calls from the drawdown in the stock market and other asset classes led to a liquidity issue. While the money market completely dried out, gold was used to generate the urgently needed cash. In addition, the market for USD linkers became dysfunctional – with US real interest rates spiking overnight from negative -1% to positive +1% – which gave systematic traders false signals to liquidate golds. Gold usually performs best with moderate uncertainty, but with volatility among the highest levels observed in the last decade it lost its diversification benefits. However, after global central banks announced to inject unlimited cash into the monetary system in order to stem the volatility, to ensure the proper functioning of money markets, to give the banks ammunition to provide unlimited credit lines to corporates, etc. gold regained some of its losses in the second half of the month and ended the month up +1.8%. On the contrary, silver lost -13.9% due to its high usage as an industrial component. With the global car manufacturing industry almost completely locked down, palladium suffered more than -45% within three weeks, showing intraday losses of up to -30%. However, not everything was justified fundamentally. With futures curve still in backwardation and being discounted more than 6% versus the spot price, it is a clear sign that physical demand is still tight. After South African government announced the shutdown of all its mines for at least three weeks, palladium and platinum recovered partially. Palladium ended the month down -7.4% and platinum -15.8%.

Portfolio review

Sector weights in the Vontobel Fund – Non-Food Commodity reflected the overall risk-off sentiment in the market by overweighting precious metals and underweighting energy in March. Sector weights do not change in April. However, within the sectors there is quite some movement: In the precious metals complex, gold is replaced by silver (next to palladium and platinum) due to higher roll returns. Keeping the overweight in precious metals complex mirrors the massive flow of monetary stimulus, driving global interest rates deeper into negative territory. In the base metals sector, nickel is replaced by zinc (next to copper and lead). The slight overweight compared to the benchmark is maintained due to supply concerns as more and more mines close to prevent further spreading of the virus. The energy sector stays underweight compared to the benchmark and allocates away from crude oil due to the super-contango in crude future curves. The fund replaces Brent and gasoline by heating oil and gasoil. Fundamentals continue to show increasing risk that global oil storage reaches tank tops and producers have to further discount oil in the spot market and ultimately have to close production which will lead to even higher contango in crude oil.

Performance analysis

The Vontobel Fund – Non-Food Commodity (I share class) showed another strong month in terms of relative performance in March. Absolute performance was down by -15.57% on demand concerns driven by the coronavirus spread and the collapse of OPEC+. However, the Bloomberg Commodity ex-AL Capped Total Return Index suffered by an even higher -18.12%, leading to a monthly outperformance of +2.55% and increasing the fund´s outperformance since the start of the year to +7.07%. Monthly outperformance was driven completely by curve selection (+5.5%), as allocation in longer dated contracts benefited from falling commodity prices, especially in the energy sector. However, the allocation in the energy sector, particularly selecting gasoline and Brent, attributed negatively to the outperformance (-3.0%). Contrary, allocation in the base metals sector was positive (+0.85%), based on selecting lead within the complex, whereas it is not a component in the benchmark.

Outlook

The decline in economic activity that follows from COVID19 remains extremely hard to quantify. US job losses amounted 16 million in the last 3 weeks, whilst US GDP might contract up to -30% in Q2 and -5% for 2020. Across the whole world, we see these unbelievable projections. For commodities markets this translates into deep demand contraction and rising inventories. Oil demand is set to drop by 26% (-25 million barrels per day) in q2, leading to an imminent end of storage capacity. Only production shut-ins can stop that process, but Saudi Arabia and Russia realized too late they would be outmaneuvered by storage logistics.

On Thursday April 9th, OPEC outlined plans to cut production by 10 mbps in May and June, and asking other countries to deliver a 5 mbpd cut (decided on April 10th). The positive sign is that the price war between Russia and Saudi Arabia seems to end, but indifferently of the G20 deal, several producers without nearby storage logistics (or tankers) will have to shut production in the coming weeks. This will keep the front end of the oil curves under pressure, but also lifts the prospects for longer dated oil futures. The current uncertainty (read volatility) will make the financing and hedging costs for long-term capital expenditures uneconomic.

The scale of monetary and fiscal stimulus we have seen is unprecedented. The Fed's balance sheet is already a record USD 5.2 trillion and grew by USD 1.09 trillion since the end of February. The Fed also announced it will purchase treasury, agency mortgage backed securities, and even High Yield bonds in whatever amounts are needed to support a smooth functioning of the markets and an effective transmission of monetary policy to the broader financial and real economy. Since early March, US M2 money supply soared at an annualised 108% growth rate. This monetary stimulus is supported by war-time alike fiscal stimulus. The US fiscal deficit (and debt) is set to grow by 19% this year. The case for holding precious metals has never been more appealing in our opinion.

Performance (in %)

Net returns			Rolling 12-month net returns			
USD	Fund	Index	Start date	End date	Fund	Index
MTD	-15.6	-18.1	01.04.2019	31.03.2020	-22.6	-29.0
YTD	-22.7	-29.7	01.04.2018	29.03.2019	-4.3	-0.5
2019	16.2	11.7	01.04.2017	29.03.2018	6.9	7.5
3 years p.a.	-7.5	-8.7	01.04.2016	31.03.2017	16.0	16.4
5 years p.a.	-6.3	-7.7	01.04.2015	31.03.2016	-21.3	-24.5
10 years p.a.	n/a	n/a	Index: Bloomberg Commodity ex-Agriculture and Livestock Capped			
Since launch p.a.	-7.9	-10.1	Index TR			
Launch Date		28.11.2014	Share class: I			
			ISIN: LU1106544999			

Past performance is not a reliable indicator of current or future performance. Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed, if applicable. The return of the fund may go down as well as up due to changes in the rates of exchange between currencies.

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Vontobel Asset Management AG
Gotthardstrasse 43, 8022 Zürich
Switzerland
T +41 58 283 71 11, info@vontobel.com

vontobel.com/am