REYL
innovative banking

MONTHLY INVESTMENT OUTLOOK

February 2019

AT A GLANCE

- The Fed is still your friend, for now.
- After strong YTD returns on equities, it is time to hedge your portfolios.
- Credit risk premia are less attractive after the strong rally.
- JPY exposure remains an attractive diversifying asset.

under-weight --	-	neutral =	over-weight +	++
ASSET CLASSES				
	Equities			
		Fixed Income		
		Alternative Inv.		
		Cash		
GLOBAL EQUITY REGIONS				
		USA		
	Europe			
		Switzerland		
		Japan		
		Emerging Markets		
FIXED INCOME				
		US Government		
EU Government				
			Inflation-linked	
				IG Credit
	High yield			
			Emerging Hard CCY	
			Emerging Local CCY	
				SUB Financials
FOREX				
			EUR/USD	
		GBP/USD		
	USD/JPY			
			XAU/USD	
	AUD/USD			

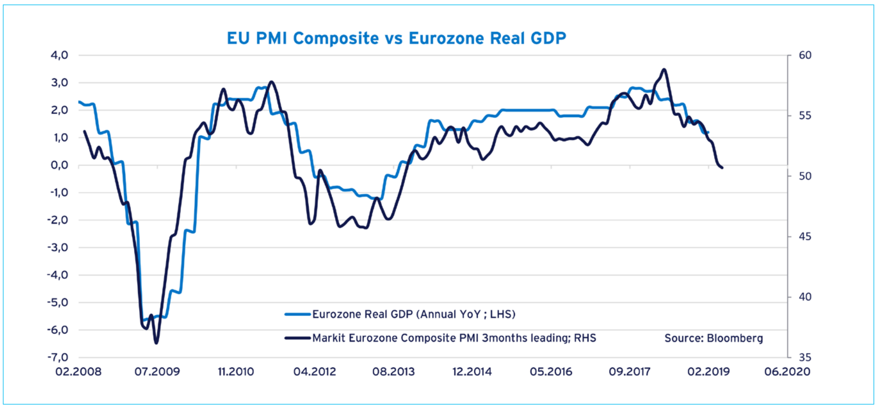
INVESTMENT INSIGHTS

January was one of the best starts for US equities since 1987, with solid gains of +7.87% for the S&P 500. This, however, was still not enough to clawback all the losses from a turbulent December 2018, one of the worst Decembers in history (-9.2%), but the "V" shape recovery is fascinating. What is the rationale behind such a drastic reversal? One of the most logical explanations is linked to the Fed. Indeed, after the bloodbath on equities indices last year, Jerome Powell capitulated at the last Fed meeting by marking a policy U-turn from hawkish in December to dovish in January, mentioning that patience is required before even contemplating the next interest rate hike. This shift in monetary policy has been more than welcome for risky assets, as the likelihood of a US economic recession in 2019 vanished. Moreover, Fed's Chairman eased investors' minds about the Central Bank "Put", which seems to remain alive, for now.

Does this signal the comeback of the "goldilocks" scenario, a friendly environment (such as 2017) for risky assets where economic growth remains steady with limited inflation pressures? There are some reasons to be sceptical. Global growth forecasts have been revised down, with the IMF slashing its estimates by 0.2% compared to October 2018, from 3.7% to 3.5%. Moreover, some countries are already on the edge of a technical recession, particularly in Europe. Germany will not be shielded from this situation and the latest PMI numbers were underwhelming at 49.5, entering contraction territory. The picture might be brighter in the coming months as positive effects from a lower EUR and oil prices might support growth, but overall, we remain in a deceleration path. While inflation expectations faded on the back of this economic slowdown, US wage growth remains elevated and might put the Fed in a difficult situation in the second half of the year should the economy show signs of recovery, as the market is not pricing any rate hike for the current year.

One consequence of this weak economic backdrop is the increasing risk for earnings disappointment in 2019. US EPS growth expectations have been already trimmed to 6% from 10% a few months ago, and the tone of the forward guidance remains downbeat.

Moreover, the MSCI all countries index rebounded by more than 14% since the Christmas Eve trough. Consequently, we remain cautious in our asset allocation and prefer to avoid being overweight in equities. We believe the current equity rally is offering a good opportunity to lock in some profits and to hedge portfolios as the agenda of the coming weeks will likely fuel some renewed volatility (Brexit negotiations, US-China trade negotiations).



THE QUOTE OF THE MONTH

"Growth in the Euro area is set to moderate from 1.8% in 2018 to 1.6% in 2019"

IMF
January 2019

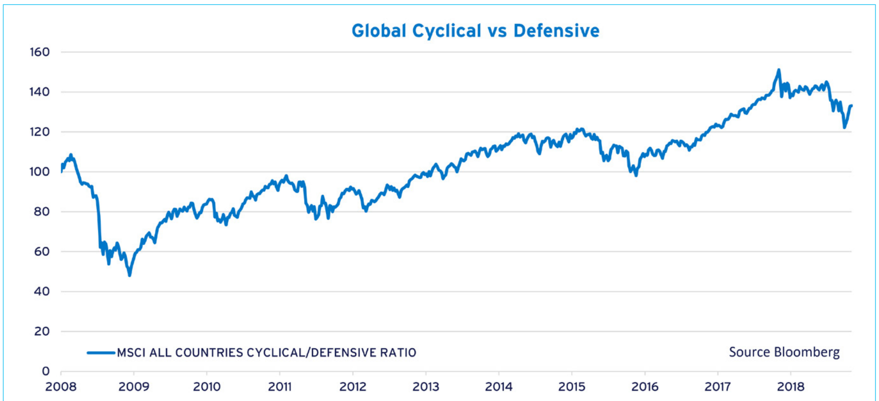
EQUITIES

Was January 2019's environment similar to that of January 2018? The most obvious parallel between the two periods is the robustness of equity performances, with both months enjoying solid gains, above 5%. Subsequent months in 2018 were painful, as volatility's comeback surprised market pundits. Should we be prepared for a new sharp sell-off in the coming weeks?

We have identified two elements that we deem currently very different with respect to beginning of last year. The first one is sentiment. Back in January 2018, investors were euphoric, ignoring risks in the context of solid economic growth. Today, we are moving out from the panic level reached in December (which was once again a good contrarian buy signal) but globally, market participants' remain relatively cautious. The second element is valuation, which stands at 15.8x 12M FW earnings for the S&P 500, or 2.8 points lower than last year. We believe that is not cheap enough to climb the wall of worry we are facing in coming weeks (Brexit negotiations, US-China trade negotiations, debt ceiling etc.) but it should help risky assets to better resist in case of drawdown, compared to last year.

As we are witnessing signs of overbought conditions, we might soon face a consolidation/pull back but the amplitude should not bring indices below their December low. Should we then chase cyclical stocks, which benefitted from the resurgence of the risk-on environment? We do not believe so, as this style already significantly outperformed in 2019 after the 2018 correction. We need more clarity about the potential recovery in economic activity in the second half of the year to be more constructive on them.

At the sector level, it might be time to further reduce exposure to European banks. A brittle economic backdrop, coupled with lacklustre results, will not help banks to restore their profitability, particularly if the ECB decides to postpone the first interest rate hike. While we acknowledge that the sector is a value sector, we fear that it is actually becoming a "value trap".



	under-weight --	-	neutral =	+	over-weight ++
GLOBAL EQUITY REGIONS					
USA			=		
Europe		-			
Switzerland			=		
Japan			=		
Emerging Markets			=		
U.S. EQUITY SECTORS					
Healthcare				+	
Industrials			=		
Financials			=		
Energy			=		
Cons. Discret.			=		
Cons. Staples		-			
Technology				+	
Utilities			=		
Comm. Services			=		
Materials		-			
EU EQUITY SECTORS					
Healthcare			=		
Industrials		-			
Financials	--				
Energy				+	
Cons. Discret.		-			
Cons. Staples					++
Technology					++
Utilities			=		
Comm. Services			=		
Materials	--				

BONDS

under-weight neutral over-weight

-- - = + ++

FIXED INCOME

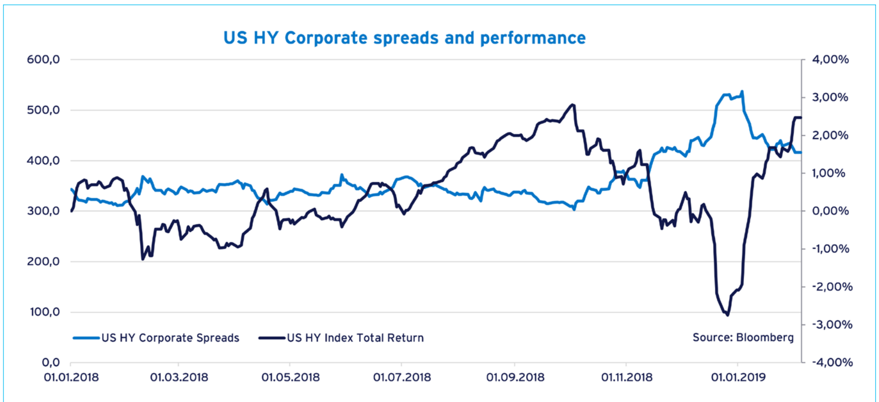
		US Government			
EU Government					
			Inflation-linked		
				IG Credit	
	High yield				
			Emerging Hard CCY		
			Emerging Local CCY		
				SUB Financials	

The first month of the year has been quite amazing for risky assets, notably for the different credit asset classes in the fixed income universe. We were expecting a rebound after the sharp selloff registered in December 2018, but the magnitude with which it occurred was surprising: the US High Yield market is up +4.5% in one month, EM sovereigns +3.80% in USD and + 3.65% in local currency, the US Investment Grade +2.35% - and the picture is almost as bright in Europe. Even the government bonds segment is in positive territory as yields failed to rise in this risk-on environment, supported by recent dovish Central Banks statements.

Indeed, this rally not only reflects the reversal of the markets' extreme bearishness in the last months of 2018 to a more balanced growth scenario, but also the reversal of the main Central Banks' rhetoric which acknowledges the risks to the economic landscape and have therefore moved away the spectre of future rate hikes... for the moment.

Where do we go from now? We think the risk premia in credit markets are not cheap anymore but neither on the expensive side yet. We suspect many investors are still positioned on the defensive side and they could increase their risk positioning in the coming weeks, which would add a bit of fuel to the current rally and move the mood gauge into complacency territory.

That would be a good timing to move some risk off the table as the risk / return profile of credit bonds becomes less attractive and hence more vulnerable to negative surprises. In this respect, the next inflation readings should be closely monitored as it is now completely out of the investors' radar and could lead to a sharp repricing of monetary policies path and consequently of the level of yields across the curves.



FOREX

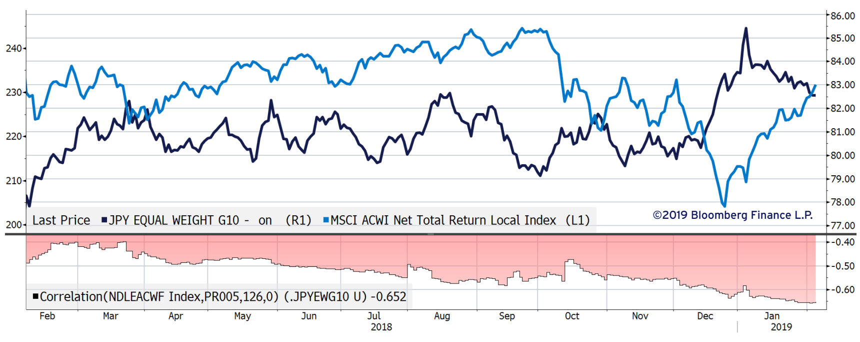
under-weight --	-	neutral =		over-weight +	++
FOREX					
			EUR/USD		
		GBP/USD			
	USD/JPY				
			XAU/USD		
	AUD/USD				

Our outlook for the U.S. dollar has been moderately negative since late Q3 last year, a view that we have reiterated since then. In the last quarter of 2018, markets finally realized that the U.S. economy, after a period of artificially strong growth in 2018 due to the fiscal boost, would not be immune to the global economic contraction. That led U.S. equities to catch up with the global equity downtrend that started in Q1 2018 in the rest of the world (RoW), and there was also a loss of momentum in the U.S. dollar as it became increasingly likely that bond yields at the long end of the curve had reached their cyclical peak and were starting to roll over. In this regard, the repricing of the US monetary policy path that led to a correction of bond yields and a narrowing of the sky-high interest rate differential US-RoW received further fuel with the January FOMC that marked a surprise dovish U-turn which is likely to remain a major headwind for the USD in coming weeks.

Despite recent mixed economic data (the labor market remains resilient) the government shutdown will most likely have negatively impacted Q1 GDP growth and we believe the U.S. economy will continue to slow down as the growth momentum stemming from the fiscal stimulus fades away. A rising awareness that the twin deficits keep expanding and that the trade war might start weighing on the U.S. economy at "not the best time" might also put further downward pressure on the greenback. Given the challenging economic backdrop and the downward pressure on margins stemming from tariffs and rising labor/funding costs, corporate earnings growth is expected to slow down (hence incentivizing buy side equity analysts to revise down their EPS forecasts), eventually leading to USD outflows. The U.S. dollar remains the most expensive G10 currency and positioning/sentiment remains excessively optimistic despite having started to decline since November 2018. Last but not least, our technical analysis points to more weakness in the short to medium-term.

We maintain our medium-term bullish outlook for the Japanese yen as we believe the currency could remain well-supported by three major tailwinds: renewed global risk aversion, the narrowing yield differential with the U.S., and its attractive valuation. Allocating to the JPY should be beneficial in a multi-asset portfolio since it is negatively correlated to global equities (c.f. chart below). Other idiosyncratic factors also bode well for the JPY, such as the still bearish positioning and potentially increasing expectations of a hawkish twist by the BoJ in H2 2019. After a healthy consolidation below the 110 resistance our technical work points to a continuation of the USD/JPY downtrend.

JPY Equal Weight Index vs MSCI ACWI



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