



# MONTHLY INVESTMENT OUTLOOK

April 2019



# AT A GLANCE

- Global GDP growth keeps decelerating but some hopes for a stabilisation are building.
- Current equity rally has been only fed by a P/E multiple expansion.
- Tiny credit risk premia call for some cautiousness.
- Yield spreads and carry remain supportive for the US dollar in the near term.

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

German factory orders slumped the most in a decade in February, confirming that the manufacturing sector is facing a full blown recession. Consequently, economic growth revisions continue to be negatively oriented and the largest European country is now expected to grow at its slowest pace since 2013, below 1%. Thus, the much-awaited macro-economic stabilisation in Europe is yet to materialise, so far.

Nevertheless, there are some pockets of hope. Both the IFO and ZEW publications, two leading indicators, are pointing to a welcome improvement. On top of this positive development, some relief might also come from China. The Chinese authorities have endorsed different policy stimuli to ensure that target GDP growth will be reached this year and a positive impact will start to kick in, as evidenced by the latest business conditions survey. The relationship between the two countries is strong (c.f. exhibit 1) as China is one of the biggest export markets for Germany. In the US, the last labor report showed a solid recovery in job creation to 196k, up from 33k in February, confirming that the US economy is still resilient despite the recent world economic strains.

As a result, we can argue that equity markets, up 15% year-to-date on average, have been correct to price in an economic recovery, as fears of an imminent

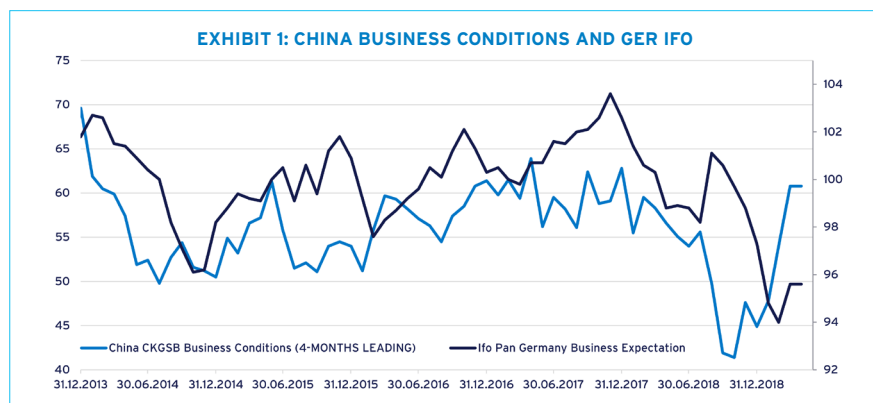
recession have diminished after the dovish U-turn in main central bank monetary policy. However, there remain some questions to be answered. First of all, even if the global economy is poised to recover in the coming weeks, it will not achieve the same growth level that has been seen over the last two years, meaning that EPS growth will remain relatively subdued in 2019. P/E forward valuations are back above the 10-year average (close to one standard deviation), thus moving to the expensive side. Put differently, almost 100% of the current rally comes solely from multiple expansion. Finally, sentiment indicators are back to complacent levels, meaning that any news, positive or negative, tends to be seen as supportive for risky assets.

Chasing the market at current levels does not seem wise, as potential is fading. A defensive positioning, expressed with a solid portion of cash and a mild underweight in equities, remains appropriate as long as we do not foresee a clear improvement in the earnings trend. We will get more insights in the coming days, when large US companies are due to report their results. The moment of truth is coming.

## THE QUOTE OF THE MONTH

*“The stock market has called nine of the last five recessions.”*

Paul Samuelson  
1966



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# EQUITIES

The MSCI All Country World index gained 12.3% in Q1 2019, regaining most of the 12.65% loss seen in Q4 2018. In December last year a global growth scare led market participants to undershoot and reverse course in January, when the Fed completed a dovish U-turn. This V-shape recovery marks the strongest rally since 1987.

Despite earnings momentum having slightly improved since the start of the year, absolute earnings revision remains firmly anchored in negative territory at the global level. For the S&P 500, consensus is now expecting a -3.9% yoy decline in EPS growth in Q1 (vs a 2.9% growth at the start of the year), and a 3.7% growth rate for CY 2019 (vs 7.4% at the start of the year). Since the December 24th trough, the US equity index 12-month forward PE expanded from 13.5x to 16.7x currently (c.f. exhibit 1), meaning US equities advanced purely on the back of a PE multiple expansion. Therefore, even after 10 years of unprecedented monetary stimuli, equity markets continue to rely on central banks, as the economic backdrop is not strong enough to live without artificial support. After such an impressive rise in the S&P 500 since December and as valuations came back above historical averages on most metrics, what kind of potential might we reasonably expect for the coming months? The answer is probably low single digit.

While we acknowledge that accommodative central banks, coupled with low interest rates and inflation might continue to lift valuations, we see two caveats to this rosy scenario. Firstly, a sharp repricing of the Fed's monetary path is a possibility as the market is likely exaggerating Fed's dovishness in pricing in a cut this year. Secondly, in our opinion, analysts' consensus for 2019 EPS growth remains too optimistic. Wage pressure is visible, impeding further margin expansion, in a context where revenue growth is limited given the current economic deceleration. Therefore, the market would rely even more on multiple expansion and on the Fed's dovish outlook.

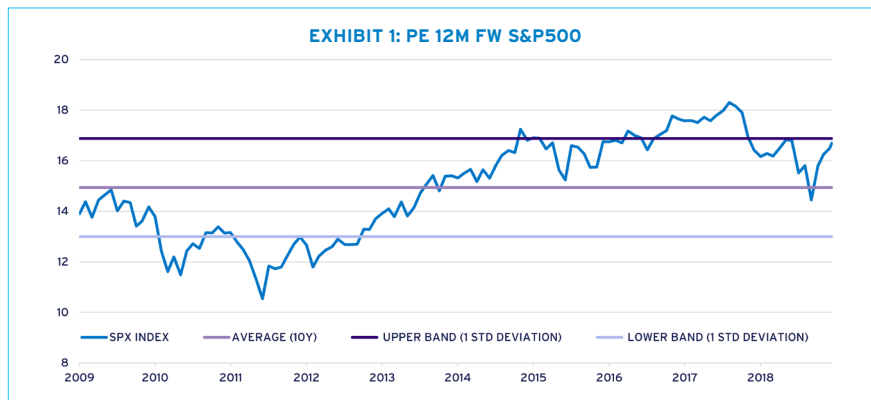
The earnings season will kick off soon, bringing some insight about the 2019 outlook, a key factor to help gauge the state of corporate companies.

under-weight	neutral	over-weight
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-		+

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				



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# BONDS

If March has been as usual celebrating the return of Spring, with a promise of warmer weather for the months to come, it has also welcomed the return of Central Banks at the bedside of faltering economies, with their share of cheap and ample monetary conditions.

The message from the market not to “take the punch bowl out of the party” has been clearly understood by Monetary Authorities. On March 7th, the ECB surprised by its dovishness, pushing back any possible rate hike to end 2019 /early 2020 and deploying new cheap refinancing operations (TLTRO3) starting in September. On March 20th, the Fed anchored its prudent approach by revising its dot plot to no rate hike this year and announced the end of its balance sheet reduction, also for September.

Of course, official economic forecasts were revised downwards following these statements and strangely it was differently interpreted by market segments: on one side, equities and credit initially retreated somewhat on fears of a worsening economic climate; but this was short-lived as market participants quickly realized the benefits of Central Bank support to financial conditions. On the other side, core government bonds acknowledged this “lower for longer” yield promise but decided to ask for more as their reading

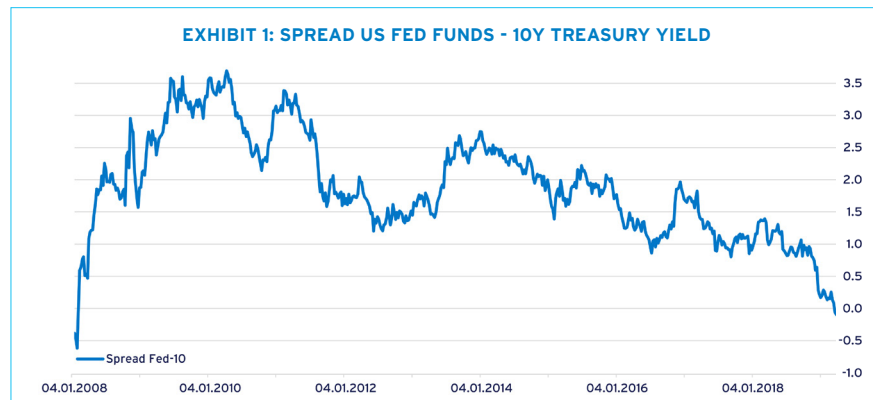
of the macro situation was much more severe: the US yield curve inverted (Fed Funds - 10y spread) for the first time since 2006 as interest rate cuts were priced in and longer remunerations plummeting to below the 2.40% mark for 10-year US treasuries.

How will this weird dichotomy be resolved in the near future? Will core yields reprice upwards as macroeconomic fears dissipate or will risk premia and volatility rise, as equities take off their rose-tinted spectacles and start falling? At the current stage, we are not at ease with either the rate nor the credit risk, as we believe both sides are overshooting in their respective outlook scenario and we tactically favor a short duration stance and a more cautious credit allocation.

However, we would take the opportunity of a rebound in yields to reposition on longer core government bonds maturities as we fear the negative cycle momentum is robust and as we trust a yield curve inversion has been historically a very reliable indicator of a recession to come. Probably not imminent but a clear risk for next year. And credit is usually leading equities in the cycle, meaning spreads - starting from the lowest quality - start to widen months before equity markets realize the party is over.

under-weight	neutral	over-weight
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FIXED INCOME				
		US Government		
EU Government				
		Inflation-linked		
		IG Credit		
	High yield			
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		Emerging Local CCY		
		SUB Financials		



# FOREX

After the Fed's dovish pivot in January, the US central bank doubled down in March, hence completing its policy U-turn. The ECB followed suit by postponing its next hike to end 2019/early 2020. In fact, we saw several G10 central banks turning dovish recently, sparking a decline in 10-years yields across the G10 FX spectrum. Market participants are now skeptical about the Fed's guidance and are pricing in increased dovishness with a high probability of an interest rate cut this year. That may be the reason why US 10-years yields recently undershot to 2.33%, but this looks exaggerated to us. Given these expectations we see yield spreads remaining broadly supportive for the USD in the short term.

Since last year, relative growth expectations have been a stronger driver for EUR/USD than monetary policy. The US economy is slowing down and the probability of a recession happening in the next twelve months is mounting, but proving that the recent disappointing US data is more serious than the 2016 soft patch is impossible at this stage. Still, higher wage growth is likely to hurt margins and profits, the boost from fiscal policy is behind us, and, even if a US-China trade deal would be struck, global trade activity will take a long time to recover. In summary, if the US economy can't avoid recession, the dollar is likely peaking.

In the Eurozone, the economy has been slowing since H1 2018, with a downward acceleration in Q1 2019. Hence the euro remains anchored by very soft growth and very low rates/yields, and will likely remain vulnerable as long as macro data does not materially improve. In the near term we expect the US dollar to remain resilient vs the Euro on the back of supportive yield spreads and attractive carry.

The amazing risk assets rally that we have seen since the end of last year has been a strong headwind for the JPY. For the past year, USD/JPY has tracked fairly well the 2-year yield spread (c.f. exhibit 1), but in recent weeks USD/JPY remained resilient despite a narrowing of the yield spread. It appears that capital flows have provided an opposing force in recent weeks with foreigners selling Japanese equities and Japanese investors buying foreign bonds. Now that US 10-year yields post an intermediate bottom at 2.33% and are expected to moderately recover, we believe the interest rates differential will again favor the USD vs the JPY in the short term. Unless, of course, risk aversion makes a sudden comeback.

under-weight	neutral	over-weight
--	=	++

FOREX			
	EUR/USD		
GBP/USD			
	USD/JPY		
		XAU/USD	
AUD/USD			

EXHIBIT 1: USD/JPY VS US-JP 2Y YIELD SPREAD



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MANAGEMENT



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HEAD OF FIXED  
INCOME



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MANAGER

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