

MONTHLY INVESTMENT OUTLOOK

May 2019



AT A GLANCE

- Is it time to sell in May and go away?
- Emerging markets assets might continue to underperform in the short term.
- Reduce risk in the credit space.
- Too early to become more positive on euro.

| 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

Is the investment axiom “sell in May and go away” still applicable? This well-known financial world adage is based on the fact that summer months (between May and October) tend to be thinner in term of volume, exacerbating market moves, often to the downside. Contrary to conventional wisdom, when looking at the last seven years, the S&P 500 actually only endured a loss in 2015 (-1.3%) while the other years in this period showed average returns of +5.4% from May to October. By applying this strategy, the level of missed opportunities would have been high.

This year, there are good reasons to believe that a risk reduction among portfolios is wise. The global economic backdrop remains fragile and not as strong as last year. The positive Q1 US GDP growth looks good on the surface (3.2% vs 2.3% expected) and bolstered hopes that the US economy is on track to rebound after its recent soft patch. However, when drilling down into the details, the picture is not so rosy, with consumer spending only rising 1.2%, while business investment decelerated. Moreover, the main positive contributors were a rise in inventories and trade balance (downturn in imports), meaning that this trend should not continue into the coming quarters and can easily reverse. Weak indicators in the US manufacturing sector keep rolling in, with the ratio of new orders/inventories falling to the

2013 low (cf graph). If history is any guide, when reaching such a level, the fair value of the S&P 500 at the end of the current month is lower than current prices. This is based on a 0% YoY price appreciation and with a reference price of 2705 at the end of May 2018.

On the valuations side, most metrics (P/E forward, P/CFO, P/B) on equity indices are now moving back to the September 2018 levels, entering the expensive zone, hence limiting the future potential. Sentiment indicators, which tend to be good contrarian signals, are pointing toward euphoria, meaning a setback is a credible option. Last but not least, global risks have not really been priced in for 2019 and can resurface in the coming months, sparking some volatility's spike. And when everyone is betting for a calm market, i.e speculative positioning in short VIX is extreme, we will not be surprised to see the opposite to happen.

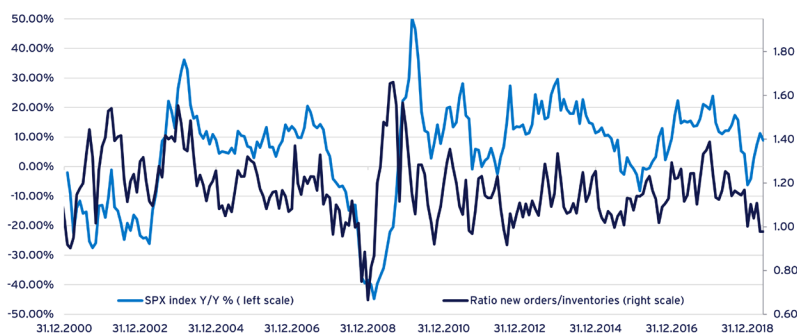
Sell in May and go away might sound attractive in this case. Raising cash, booking some profits and trying to partially preserve the accrued YTD performance seem appropriate after such a powerful rally in risky assets.

THE QUOTE OF THE MONTH

“What I think is that the fed doesn't believe their own “dots plot” anymore.”

Jeffrey Gundlach
May 2019

EXHIBIT 1: RATIO ISM NEW ORDERS/INVENTORIES VS SPX %



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EQUITIES

World equity markets kept rising in April, for a fourth straight month. The most striking development is linked to the Nasdaq 100, which was able to print a new all-time high at the end of April, up 23% YTD, reversing the 17% decline of the last quarter of 2018. The current earnings season for technology stocks was good, with a beat ratio of 77%, slightly above the 5-year average (around 75%). However, as EPS estimates have been slashed by 9.15% since September (cf graph1), it is definitely easier for companies to beat lower forecasts.

The US technology index is now trading on lofty multiples, at around 20.5x earnings (12m fw), or the same level as January and September 2018. It is worth noting that when previously reaching such valuations, subsequent monthly returns have been very poor (from -2% to -8%). Therefore,

for those who missed the rally, waiting for a better entry point seem wise.

In terms of regional exposure, there is no longer a preference for emerging markets, even if they have been underperforming the MSCI World by 4.5% in 2019 (at the end of April). First of all, the expected earnings growth for the region as a whole is lower than developed markets (2% vs 4%) and the negative trend in earnings revision has not been altered. Secondly, some leading indicators such as raw material prices are not exhibiting a rosy outlook (cf graph 2). Finally, the current dollar strength against emerging market currencies might start to bite. All in all, it is a good time to reduce the equity risk in portfolios, raising some cash and adopt a wait and see approach, being ready to seize opportunities in case of setbacks.

EXHIBIT 1: NASDAQ 100 EARNINGS PER SHARE 2019 GROWTH %

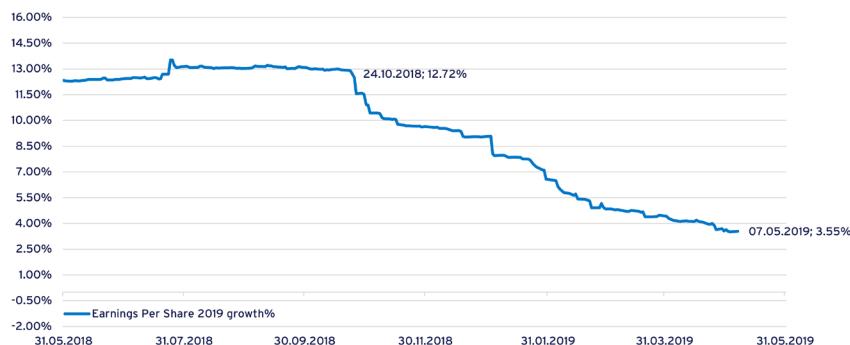
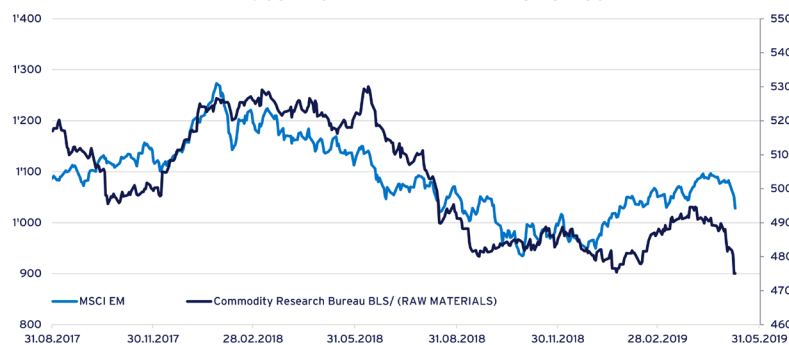


EXHIBIT 2: COMMODITY RAW MATERIALS VS MSCI EM



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| 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 | | | | |

BONDS

April has been another strong month for risky assets, which has given rise to additional outperformance of credit over core government bonds. The current low inflation - low yield environment coupled with friendly Central Banks have further spurred investor's risk appetite and hunt for yield, benefiting all fixed-income asset classes which have posted solid positive monthly performances. A notable exception: cracks have appeared in the Emerging Markets debt segment, which suffered a setback in April, Local Currency bonds in particular. Is it just a minor blip or does it announce more trouble to come? "Sell in May and go away"?

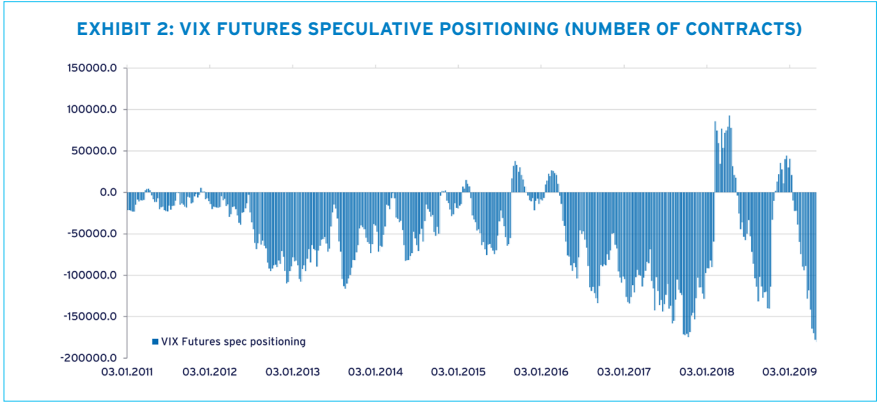
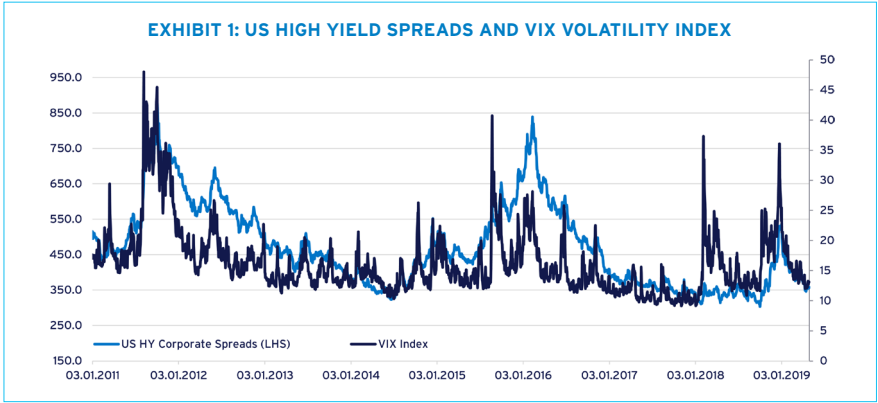
It is noteworthy that the sparks of credit stress appear generally first on lower quality and more narrow segments, of which EM are clearly representative, and where

reversals are very quickly exacerbated by outflows. Another vulnerable market in this situation is the High Yield one, which looks quite expensive and whose fundamentals have deteriorated. Furthermore, a key determinants of credit spreads, volatility (of equities in particular), lies at very low levels and may be subject to a quick repricing (speculative positioning there stands at historical extreme shorts).

One element that may be of good advice here is simply common sense: after solid market gains and in an environment of tiny risk premia with financial assets flirting with expensive valuations, it is wise to take some risks off the table and to start to protect the performance accumulated so far. We have decided to increase our level of cash by selling some of our Emerging and also Financial Subordinated bonds exposure.

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

| FIXED INCOME | | | | |
|---------------|--------------------|------------------|--|--|
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| | Emerging Local CCY | | | |
| | SUB Financials | | | |



FOREX

EUR/USD was flat in April and implied volatility hit a low since 2014 with the pair entangled between opposing forces. Monetary policy remains broadly supportive for the greenback with the Fed's chairman Powell delivering a less-than-expected dovish message at the last FOMC. On the other side, the ECB has pushed forward the prospects of interest rates normalization. However, despite central bankers rhetoric, interest rates differential barely moved during the month (-3.9bps on 10-year yields; -8.2bps on 2-year yields), but negative absolute yields continue to be a strong headwind to any material euro appreciation. EUR/USD has been loosely linked to relative movements in yields since last November as relative macroeconomic momentum and growth expectations have been much stronger drivers. In this regard, green shoots are appearing in the Eurozone as country specific drags (Germany, Italy) dissipate: 1Q 2019 GDP growth surprised positively at 1.2% y/y, unemployment hit the lowest level since the global financial crisis at 7.7%, and core inflation accelerated from 0.8% to 1.2% y/y. For the time being, with the pair hovering around the key 1.12 handle, it seems that the market remains skeptical and needs confirmation that the economy is about to improve. We remain tactically neutral EUR/USD but acknowledge downside risk, mainly on a technical basis. Price action keeps a moderate bearish bias as

the pair is sitting close to the 1.1177-1.1187 support area, and a confirmed breakdown would open up the way toward 1.0860.

Since the start of the year USD/JPY has decoupled from yield differentials on the back of increasing risk appetite (fueled by the strongest equity markets rally since 1987) and Japanese buying of foreign securities. It is now likely that risk aversion will stage a comeback and that capital flows will be less of a support for USD/JPY. The pair posted a double top at 1.12 and failed at a key downtrend line (c.f. exhibit 1). Hence we remain moderately positive on the Japanese currency and like its defensive virtues, which are useful for portfolio construction.

From last December's low to the recent mid-March high, GBP/USD advanced by some 7% on the back of fading probabilities of a no-deal Brexit. Since a deadline extension became the main option in mid-March, sterling has then taken a breather with cable losing ca 3.8%. Now, with a long extension of the article 50 deadline to October 31 2019 priced in, the market is neutral (as indicated by speculative positioning close to zero) and stabilizing around 1.30. We continue to believe that the worst will be averted and that the pricing out of Brexit related uncertainties should enable sterling to appreciate in the medium term.

| under-weight | neutral | over-weight |
|--------------|---------|-------------|
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| FOREX | | | | |
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| | AUD/USD | | | |

EXHIBIT 1: USD/JPY DAILY



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