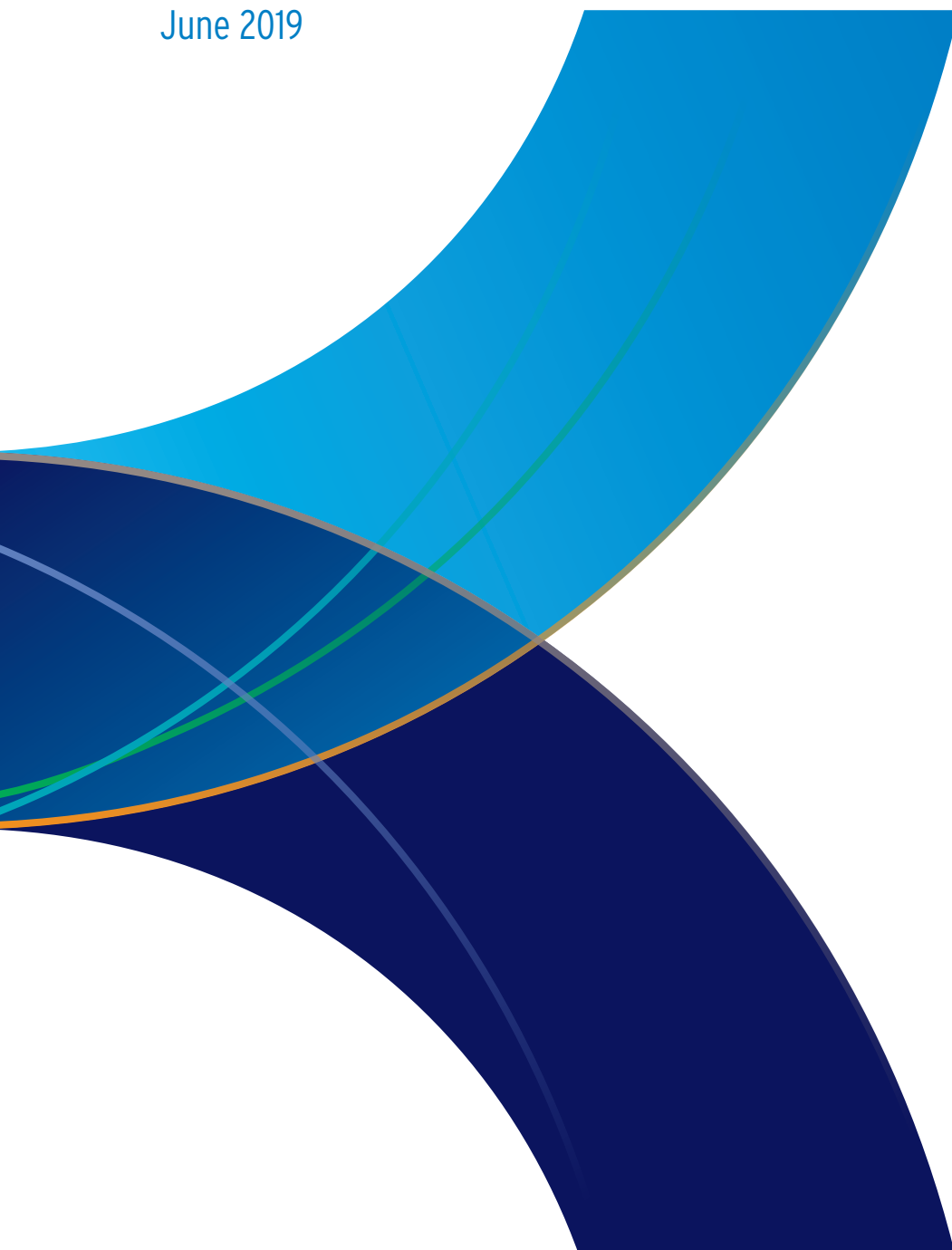




# MONTHLY INVESTMENT OUTLOOK

June 2019



# AT A GLANCE

- The return of the “Fed put”, episode II.
- Is the value style ready for a rebound?
- US Treasuries look expensive.
- JPY expected to pause momentarily.

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

# INVESTMENT INSIGHTS

After four consecutive monthly gains, equity prices fell sharply in May, with emerging markets enduring a loss of 7.3% and the Nasdaq 100 slumping by 8.4%. The main rationale behind such a drastic change is the re-escalation of trade tensions between China and the United States, as expressed by a raise in tariffs on USD 200 billion of Chinese imports to 25% from 10% and a US ban on Huawei products. This new wave of tariff hikes will cast a dark shadow over the global economy, which has already seen a global slowdown over the last 18 months. World trade activity therefore remains subdued and we are witnessing a sharp contraction in some leading indicators such as South Korea exports (see graph 1), which collapsed by 9.4% in May. Needless to say that reigniting the dialogue between the two largest economies is a prerequisite for finding a bottom in world trade volumes. Furthermore, and as weak manufacturing indicators keep rolling in, trade tensions will likely hinder a potential recovery in economic momentum.

In this context, is a global recession looming in the next 6-9 months? We don't believe this is the case, because when confidence starts to be dampened among investors and macro-economic conditions further deteriorate, there is always a wild card, acting as a put protection: the Fed. After 'Episode I' in January, when the Fed

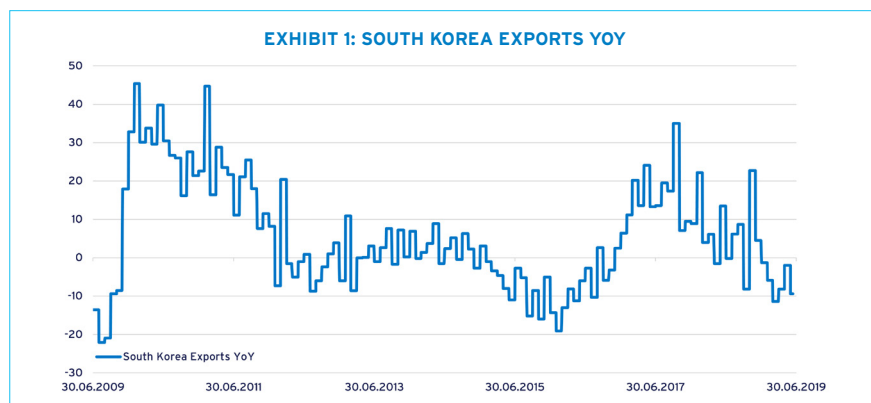
announced a U-turn in its monetary policy by deciding not to raise interest rates in 2019, 'Episode II' might come soon: several cuts in 2019, already priced in by the bond future market. James Bullard and Jerome Powell have just announced that if the trade war starts to bite and the economic outlook continues deteriorating, they will be ready to act, thus further easing the financial conditions, which in turn could spark a potential rebound in economic activity in the coming months.

Is it therefore time to put some money at risk, by buying back some equities, hence adopting the classical "buy the dip" mentality? For aggressive traders, there might be an opportunity given that equity markets were entering oversold conditions at the end of May. However, we prefer to be more patient at this stage, for several reasons. There is still no sign of panic among investors, meaning that a contrarian buy signal is not present. Meanwhile, valuations have eased somewhat, but remain above the 10-year average. Finally, as long as the economic activity is not reinvigorated, company earnings are at risk of further downgrades. To this regard, it is striking to notice that current EPS growth expectations for emerging markets and Japan are turning into negative territory, with a forecasted decline of 2 and 4% respectively.

## THE QUOTE OF THE MONTH

*“Current interest rates might be inappropriately high.”*

James Bullard  
June 2019



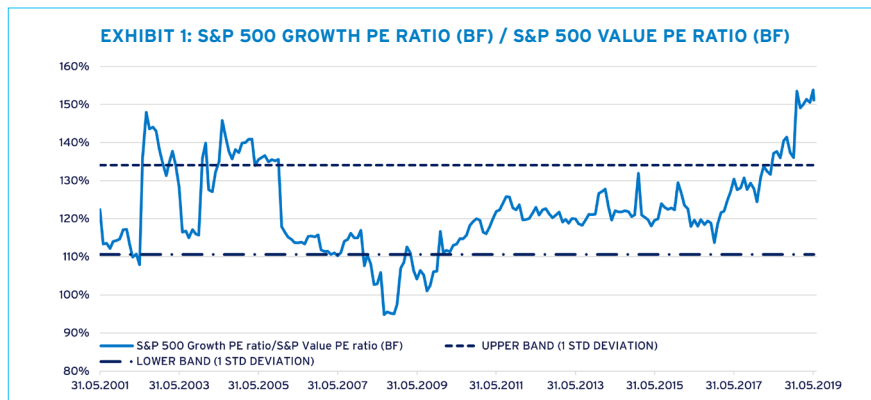
# EQUITIES

World equity markets suffered a blow in May, as almost all regional indices posted negative returns, ranging from -2.5% for the SMI (often perceived as the most defensive) to -8.4% for the Nasdaq 100 (a high beta of the S&P 500). The complacency among investors that was visible at the beginning of the year has been rattled as Trump decided to use his powerful new trade negotiation weapon: tariff hikes. The re-escalation of trade tensions between China and the US further dampened confidence and decreased the likelihood of striking a deal any time soon. It looks like the dissents between the two large countries are too wide to be resolved quickly.

Obviously, these developments are not supporting for equities in a context where the economic backdrop remains in deceleration mode, meaning that achieving decent 2019 EPS growth will be challenging for companies. In this regard, the recent slew of downgrades in earning revision is not a real surprise.

Unlike October or December 2018, the May correction has not been homogeneous. Defensive segments, such as utilities, real estate, healthcare or food & beverage displayed very limited losses while cyclical sectors, namely banks or industrials, collapsed by around 7-8%. This meant that investors were chasing stocks immune to a more pronounced slowdown in economic

activity. Moreover, growth stocks were also able to beat value ones by a large scale and while we acknowledge that structural growth stories are getting scarce, we are worried about the extreme valuation gap. Indeed, growth style is currently 50% more expensive than value on a 12 month P/E forward ratio, reaching two standard deviations above the 10-year average (see graph 1). This trend might be prolonged as long as interest rates remain low, but it is getting more dangerous to blindly invest in this style, as the risk-reward is deteriorating. Valuation is rarely a good investment argument for the short term, nevertheless, it is usually a good guide to detect a potential looming trend reversal. Therefore, we suggest not putting all your eggs in one basket and adopting a selective approach.



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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

The arm wrestling between the market and the Fed about the direction of interest rates has been playing out for years, and has most of the time ended up with the Central Bank giving in to pressure of the Street and delivering what was expected by market participants. This time is no different, and actually the dichotomy between the Fed's own announced interest rate path ("dot plot") and the market pricing has been divergent to a strong extent for the last 18 months, with Federal authorities signaling gradual rate tightening while financial futures were increasingly pricing cuts.

As if to make itself heard, the stock market posted a strong correction during Q4 2018 to the point where the -20% fall of the S&P500 finally frightened the Fed enough to suspend any plans to hike rates and to switch to a "patient" stance in January. This was the first surrender of J. Powell, which was later confirmed by March's new "dot plot" where any signs of interests tightening for 2019 had disappeared.

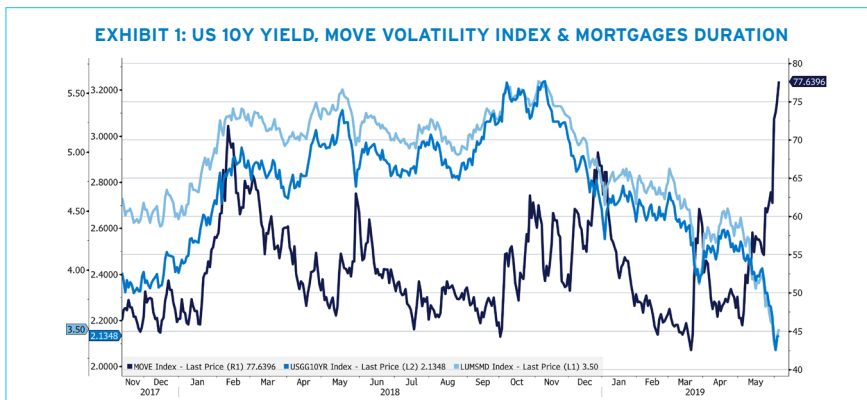
The market relief was short-lived, as a combination of deteriorating economic indicators and political uncertainties on a backdrop of trade war between the US and China quickly revived fears and led to a sharp flight-to-quality in the fixed income space. Anticipation of further rate

cuts pushed the 2-year Treasury yield to a 18-month low and longer yields near the 2% threshold (10y), leading to a significant flattening of the yield curve. Once again, the move didn't go unnoticed by Fed members and Mr Powell opened the door to possible monetary easing this year if warranted by the economic situation. Well this looks like a second submission from the Central Bank's chairman...

But is all that really justified? We can wonder about the nature of the collapse in US yields: is it just fundamentally-based with more and more strategists calling for a forthcoming US recession, or is there something else? Actually, technical factors have played a major role in this move, notably through the derivative market. The culprits are called negative convexity and gamma hedging. In short, the initial marked drop of long yields has constrained mortgage-backed securities players to add some duration exposure and to cover their "short OTM receivers" on the swap market, massively. The volatility of Treasury options (MOVE index) has been propelled to a 29-month high, triggering more and more hedging translating into a further acceleration of the yield drop, to a point which we now consider it overextended. We are therefore considering a sharp decrease in our US Treasuries exposure, waiting for better entry points at higher yield levels.

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



# FOREX

The recent rebound in EUR/USD from the 1.11 handle has been most likely sparked by 2019 growth forecasts and the interest rate differential turning in favor of the EUR. From a technical perspective the US dollar index is showing signs of fatigue with a likely double top in the 98-98.50 area. A pullback to the 200-day moving average below 97 may be the first stop of an eventual short-term reversal in the greenback. It has been our central scenario to see the US dollar peaking in the first part of 2019, before being dragged down by lower growth expectations and yield differential turning a headwind. As of late this scenario has changed with the expectation for the US economy to continue outperforming the EZ economy in 2020 (c.f. exhibit 1). Moreover, the dovish stance of the Fed and the ECB should not spark a new trend in the interest rate differential. Eurozone macroeconomic data remains weak and politics, i.e. Brexit and the Italian budget, are anchoring the EUR. Hence, aside from a short-term bounce in EUR/USD, we do not foresee a meaningful recovery of the single currency. Of course the risk to this scenario is that a lot of bad news is already priced in the EUR.

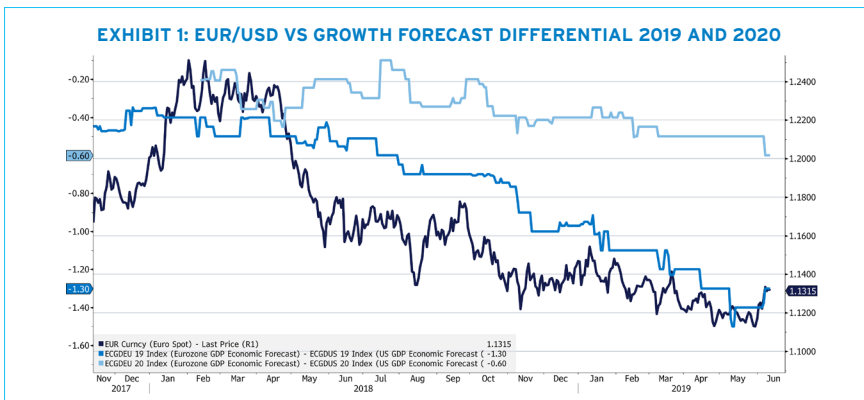
JPY finally caught up with our bullish view, albeit the pace was faster than expected. Sharply declining US Treasury yields and a correction in global equities provided two strong tailwinds for the JPY which

advanced by 3.8% in May (equal weight basis vs other G10 currencies). Now, with the undershoot in US yields potentially complete and equities rebounding after having retraced 38.2% of the December rally, we expect JPY to give back some of its recent gains on a tactical basis. Technicals also point to the 108 area to act as a strong resistance in the short term. However our longer term view remains moderately positive for the JPY as it is likely to remain well supported as long as global trade frictions remain elevated.

CHF appreciated by 2.6% in May (equal weight basis vs other G10 currencies) but is facing cross currents. Bond yields remain in deep negative territory (with the world's most negative interest rates) and the SNB is expected to continue with its dovish stance on the back of deteriorating macro conditions. Inflation is anchored well below the 1% target, confidence is plummeting and manufacturing activity is decelerating. Global trade weakness is taking its toll on the widely open Swiss economy and current US-China frictions do not bode well for a quick improvement. Negative yields inevitably dampen demand for the Swissie, which explains why it has become less of a safe haven currency in recent years. In the short-term, Italy's impudence and the renewed dispute with the EC provides some support.

under-weight	neutral	over-weight
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FOREX				
		EUR/USD		
		GBP/USD		
	USD/JPY			
		XAU/USD		
		USD/CHF		



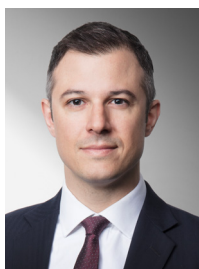
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