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MONTHLY INVESTMENT OUTLOOK

November 2019

AT A GLANCE

- Some early signs of economic stabilisation
- Adopting a barbell strategy between cyclical and defensive stocks is appropriate
- Central Banks liquidity to the rescue again
- Receding tailwind for the Japanese Yen

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

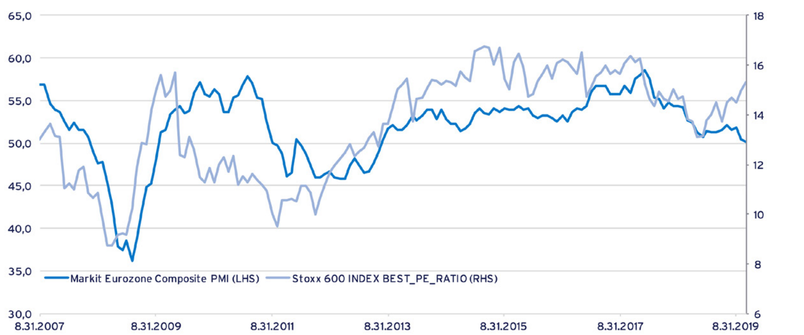
INVESTMENT INSIGHTS

Risky assets enjoyed a sharp reversal in October, with the S&P 500 turning in positive territory (+2%) after an intra-month loss of 4%. The index is now hovering around new all-time high, thanks to an abating escalation in trade war between the US and China and as fear of a no-deal Brexit dissipated. Moreover, market participants have been keen to endorse the rosy scenario of a stabilisation in some macro indicators and a brighter economic outlook for 2020, thanks to the new round of monetary policy easing around the world. Indeed, the Fed cut interest rates for the third consecutive time, while the ECB is relaunching a quantitative programme. On top of that, and according to some analysts, (Merrill Lynch), there have been 54 global interest rate cuts in 2019. Whilst we acknowledge that such accommodative moves by central banks is a game changer for avoiding a global recession in the next six-nine months, there are some valid arguments calling for diminishing effectiveness of monetary policy in the developed world, notably in the countries where negative rates are already in place.

The current European economic landscape might actually be a good illustration of this situation. Indeed, despite the very supportive interest rate environment (10-year yield of the German Bund were in negative territory since April 2019), the European Commission in early November cut its 2019 growth forecasts for the Eurozone to their lowest levels since the sovereign debt crisis, from 1.2% to 1.1%. In Germany, the country is on the edge of a mild technical recession after the publication of the first estimate of the Q3 GDP growth. For 2020, the institution also cut its 2020 growth projection to 1.2%, from 1.4%. It appears dovish monetary policy in Europe is slowly reaching its limit in terms of economic impact. At least, however, the ECB has been able to avoid the worst, as recent macro data are displaying a shy stabilisation. Some leading indicators such as the ZEW survey in Germany are strongly recovering, while the PMIs finally bottomed out.

Is this economic stabilisation enough to justify an addition to the equity exposure? We do not believe so, for several reasons. We are witnessing a sharp earnings slowdown in 2019 (close to 0% EPS growth for the Stoxx 600 and the S&P 500), which means that 100% of the current market price appreciation is based on a multiple expansion. For 2020, EPS growth expectations are high, at a rate of around 8-9% according to the Factset consensus, meaning there is a high risk of disappointment. Last but not least, based on the historical relationship between P/E forward valuation and PMI composite (exhibit 1), investors are already discounting a sharp recovery in the leading survey number (above 55) for the coming months, leaving only little room for further multiple expansion, which will likely cap the upside potential on equities. Therefore, we prefer to be mildly underweight on equities, waiting for better entry points.

EXHIBIT 1: EUROZONE PMI COMPOSITE VS STOXX 600 PE FWD VALUATION



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THE QUOTE OF THE MONTH

“Long-term negative rates have adverse consequences we don’t fully understand.”

Jamie Dimon
November 2019

EQUITIES

In the US, the earnings recession is extending to a third quarter, as EPS growth for the S&P500 is negative y/y after 90% of companies reported their results. However, with US equity benchmarks hitting all-time highs, we believe that market participants have focused much more on EPS momentum and surprises instead of absolute levels. Firstly, the short-term earnings momentum is positive since the reported y/y earnings growth for Q3 is -2.4% versus -4.1% expected at the beginning of October. Interestingly, the widest gap between realized and expected EPS growth is in the technology sector at -5.7% vs -10.4%. Secondly, earnings surprises were particularly strong for the two largest sectors, technology and health care. Both sectors displayed the highest beat ratio and magnitude: 85% beat and 7% magnitude for technology, 86% beat and 6.8% magnitude for health care. We believe this should alleviate some of the worries about the technology, which remains the leading sector of this bull market.

Nowadays, some pundits are calling for the end of the structural growth theme and for the comeback of value stocks. Whilst we acknowledge that momentum stocks are currently underperforming, structural growth stocks are not, recently hitting an all-time high (c.f. FAAMG in exhibit 2). Therefore, as long as technology and large structural growth players trend higher, there appears no need to panic. Regarding the value vs growth debate, we believe that whilst the comeback of value is starting to be a significant phenomenon, it is still early days in terms of historical perspective (c.f. exhibit 1). Nevertheless, as cyclicals are staging a convincing come back, we decided to reduce our overweight on utilities back to neutral, locking some profits. However, in the current environment, we still believe that a barbell strategy with a mix of quality cyclicals and defensive is a strategy to favour.

With VIX close to 12, we acknowledge that global risk sentiment has improved as of late, fuelled by both the economic and the political channels. Recent macroeconomic data increased hopes that the global decline in manufacturing is about to trough both in the US and in Eurozone, thereby decreasing probabilities for a recession in coming months. As for the US-China trade war, it appears that phase 1 of an eventual agreement is being put in place, with some tariffs supposedly being rolled back. Less tail risk from trade volume declines further boosted hopes that the global economic momentum could regain traction in coming months. Overall, sentiment and macroeconomic conditions marginally improved in October, thereby propelling both equity indexes and valuation to an 18-month high. Therefore, we prefer to stick to a mild underweight in equities, keeping dry powder to seize future opportunities.

EXHIBIT 1: MSCI USA VALUE/GROWTH

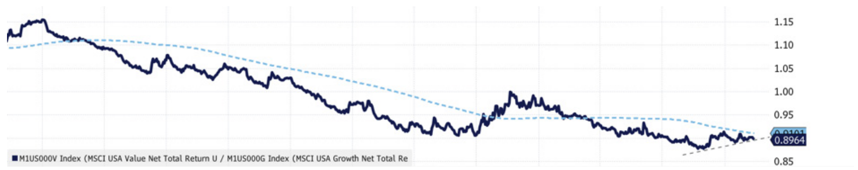

EXHIBIT 2: US CYCLICAL/DEFENSIVE AND THE FAAMG INDEX

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	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 latest FOMC meeting at the end of October was noteworthy. Firstly, as the US monetary authorities delivered what the market was asking for, a 25bps interest rate cut. Secondly, because the institution signaled it would now remain on hold, unless a "material reassessment" of its economic outlook would happen. On the one hand, this pushes back any potential rate hike too far in the future, (Powell said they "need to see a really significant move up in inflation that's persistent before we would consider raising rates"), which is supportive for risky assets. However, on the other end, this falls short of market expectations that were counting on several more cuts by the end of next year, and which now just price in one single -0.25% possible easing move. Post FOMC meeting, both bonds and equities were relatively unchanged, as if market participants were caught in between these two contradictory signals.

A new impetus was found in the following days, as good news came on the front of the US-China trade war with a high probability of a "phase one" deal between the two parties. This propelled risky assets to new highs and safe-haven core yields rose markedly to a point whereby we believe a lot of this good news is now priced in. But let's get back to the Fed and in particular to what Powell insisted are "purely technical measures" during the FOMC Q&A session. Following the US repo market dislocations in September, the Central Bank was quick to intervene by injecting liquidity in the system, and announced on October 11th it would, on top of continued repo operations, buy 60bn of T-Bills per month through at least the second quarter of 2020. Well that's very much like another round of QE isn't it? Fed officials have been defending against this idea, saying it is different this time: is the measures are aimed at increasing reserves and not to stimulate the economy, and the securities bought are short term ones compared to longer maturities during QE. Hence, not really pushing down the term premium. Still, this is a huge balance sheet increase, especially if we factor in the current 20bio monthly buying of securities which remains in place today (reinvestments). Over six months, this amounts to close to a 500bn USD liquidity injection and securities buying. In 2010, Fed's Dudley estimated that "some simple calculations based on recent experience suggest that $500 billion of purchases would provide about as much stimulus as a reduction in the federal funds rate of between half a point and three quarters of a point". Admittedly, he was referring to medium and long-term Treasuries, and T-Bill purchases should have a much smaller impact. However, risky assets love liquidity injections and this one is quite spectacular and is only just beginning!

EXHIBIT 1: The Fed's Balance Sheet

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FOREX

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

The current dominant theme in the FX market is the pricing out of two tail risks: a no-deal Brexit and an escalation of the US-China trade war. Whilst it is still relatively early days, these developments have the potential to reverse the prevailing tailwind for defensive currencies and headwind for cyclical ones. Even if the metaphorical "Brexit can" is still being kicked down the road, it appears that both parties have agreed to avoid a no-deal scenario. Regarding Sino-US trade tensions, with the recent ceasefire, we believe we are now entering a de-escalation phase.

In the meantime, the Fed delivered another rate cut which somewhat disappointed markets by signaling it will remain on hold for the time being. However, we argue (c.f. fixed income outlook) that the re-expansion of the Fed's balance sheet is QE in disguise. Regarding the ECB, for its last policy meeting at the helm of the institution, Mr. Draghi refrained from further putting pressure on politics to activate the fiscal lever. Global developed yields have been increasing since the start of October with an acceleration in November and consequently, the short-term trend in yield differential might become again a driver in the currency market.

Then there is the global economy. Data continued to be mostly bleak on both sides of the Atlantic, but arguably less disappointing in the Eurozone than in America. The Eurozone-US spread of the Citi Surprise Index turning in favor or the Eurozone (c.f. exhibit 1) illustrates this, hence providing fundamental support to the single currency. Despite the marginal improvement, the euro is still facing strong headwinds. Negative yields continue to weigh heavily and, with the recent failure at the 1.12 resistance cluster, our technical analysis confirms that it is too soon to warm up more decisively on the euro. We first need evidence that Eurozone manufacturing has bottomed out as an indication that the medium term outlook has improved. Therefore, we stick to our neutral view.

The main G10 victim of higher yields is the Japanese yen. Coupled with the improvement in global risk appetite, (new all-time highs in US equities), and a likely stabilization (at a low level) of the US economic momentum, the bullish case for JPY becomes more uncertain. Moreover, Japanese investors buy more foreign equities than foreigners buy Japanese equities, leading to negative portfolio flows. We decided to downgrade our JPY outlook one notch back to neutral.

Fading probabilities of the UK being pushed out of the Eurozone without a deal kick-started a rally in sterling crosses as the Brexit risk premium is being priced out. However, we are not out of the Brexit wood yet, and thus refrain from upgrading our neutral view on GBP for the time being.

EXHIBIT 1: EUR/USD VS Citi Economic Surprise Spread Eurozone-US

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