Für Ihr Vermögen.

FACTUM

Investment Report

April 2019

Strategy overview

Ten years ago, specifically on 9 March 2009, the American S&P 500 Index bottomed out of the crisis at precisely 666 points. Since that memorable day, the S&P 500 has risen by a staggering 410%. The impressive run is known as a so-called secular bull market, that is to say, a long-term bull market that continues to this day. It was interrupted by three cyclical downturns, namely in the years 2011/12, 2015/16 and 2018/19. The last quarter of 2018, in particular, remains omnipresent. If no recession materialises in the United States by June of this year, this will be the longest expansion since the Second World War, lasting 120 months.

"Since March 2009, the S&P has gained a stunning 410%."

S&P 500 Index March 2009 - March 2019

The big question now is how markets are likely to perform going forward. The first quarter of 2019 was completely contrary to the fourth quarter of 2018, with the broad-based S&P 500 Index in the US gaining around 13.5%, the best first quarter since 1998. Major central banks around the globe –

"The S&P 500 Index recorded the best first quarter since 1998."

now also including the ECB – recently confirmed their determination to counter global growth weakness with more monetary liquidity – the oxygen of the financial markets. In our view, the Fed's suspension of interest rate hikes in the USA is one of the main reasons for the historically above-average stock-market rally recorded since the beginning of the year.

Economic downside risks have undoubtedly increased, but an imminent recession is not our scenario. So-called "tail risks" associated with the trade dispute, Brexit and the European elections have not changed significantly. Central banks are providing material support. Bond market yields have fallen to even less attractive levels, which is why we continue to underweight this asset class. We are also maintaining our more cautious positioning with regard to equities, which we have taken into account by partially hedging our equity exposure. We do not rule out positioning our portfolios more cyclically over the next few months by overweighting so-called "high beta markets" such as Europe or emerging countries. At present, however, we still lack the conviction to do so. Credit growth has been stagnating for years in the Eurozone, and banks remain undercapitalised relative to their counterparts in the United States. Emerging economies have foreign currency debt burdens, making them very vulnerable. Additional problems arise out of their dependence on China and their lack of structural reforms.

"We are sticking to the partial hedging of the equity ratio – in our view, it is too soon to give portfolios more offensive profiles."

Politics

The British parliament rejected Prime Minister Theresa May's deal for the third time on 29 March. While the result was closer than previous ballots, the May deal still fell 29 votes short of acceptance. In our view, the probability of a soft Brexit (customs union or similar) or of Britain remaining fully in the EU (via a second referendum or a new general election) has increased. On the other hand, we consider a withdrawal without a treaty on 12 April to be extremely unlikely, as neither the British parliament nor the EU wants this.

"Long deadline extension moves closer."

There is still nothing clear-cut to report in the matter of the trade dispute. At the end of March, however, a high-ranking US delegation spent time in Beijing for further talks. According to the news agency Bloomberg, an agreement is on the table. Currently, it is said, the wording of this agreement is being reviewed in detail. Above all, efforts are being made to prevent English and Chinese versions allowing different interpretations.

"When will there be hard facts to report in the trade dispute?"

US Secretary of State Mike Pompeo has raised the prospect of a third summit between Donald Trump and North Korean ruler Kim Jong Un within the next three months. He is hoping that the two leaders will then take a substantial step towards the denuclearisation of North Korea, although no target date has been named.

"Third summit meeting between the USA and North Korea likely."

After almost two years, the so-called "Mueller Report" was published at the end of March. Special Investigator Mueller found no evidence of illegal collusion between the Trump campaign and Russia to influence the 2016 presidential elections. According to current information, this may be seen as a victory for the US President and the Trump Administration. Over the past two years, though, charges have been brought against 36 persons and there have been eight convictions.

"The Mueller Report was published at the end of March."

Economy

Economic growth in the USA is likely to have suffered a significant setback in the first quarter of 2019. Major US banks expect growth in the region of 1% to 1.5%. The Federal Reserve Bank of Atlanta, which is expecting GDP growth of only 0.4%, does not see the picture in such rosy light. The primary reason for the decline in growth, however, was the lengthy "government shutdown", which is likely to have trimmed growth significantly. For this reason, it is our assumption that this is only a temporary slowdown in growth and that the US economy will again grow by more than 2% in the second quarter.

"US economy weak in Q1-19 – the situation should improve thereafter."

The composite indicator for Eurozone economic confidence eased from 106.2 points to 105.5 points, thereby declining for the ninth consecutive month. The last time sentiment was worse was two and a half years ago. In a long-term comparison, however, economic confidence remains above average. The main driver for the renewed decline was the weakening German industrial sector, which is struggling with a sharp decline in production and decreasing orders. The separately collated business climate indicator also unexpectedly dipped sharply from 0.69 points to reach 0.53 points in March. Following the stabilisation in February, analysts had been expecting another sideways movement. All five sub-components contributed towards the marked decline. The hoped-for stabilisation of sentiment indicators has therefore not yet materialised.

"The Eurozone continues to stagnate."

On the other hand, however, there were also the aforementioned, albeit still modest, rays of economic hope. The most important leading indicator for the German economy, the Ifo Business Climate Index, brightened unexpectedly in March. This key indicator rose from 98.7 points to reach 99.5 points, the first increase in six months. Companies expressed greater satisfaction about their current business situation than in the previous month. The index for the current business outlook rose slightly from 103.6 to reach 103.8 points. On the other hand, companies were much more upbeat about their business prospects. The outlook index for the coming six months recovered from its 75-month low and climbed from 94.0 to 95.6 points. According to the Ifo Institute, this means the German economy is resisting the downturn. In addition, contrary to expectations, retail sales in Germany increased significantly in February. Retail revenues increased by 0.9% relative to the previous month, while expectations had anticipated a significant decline of 1.0%. As a result, the annual rate jumped from 2.6% to 4.7%, the highest level recorded since October 2018.

"German Ifo Index brightens."

The business climate index for the French economy also brightened unexpectedly in March. The economic barometer rose from 103 to 104 points, its highest level since November. In addition, French households were looking to the future with confidence for the third month in succession. The situation in Spain was different: Both companies and households became even more pessimistic about the economic situation in March.

"Diverging signals coming out of European economies."

Consumer confidence amongst Brazilian consumers dampened markedly in March. The consumer barometer fell from 96.1 to reach 91.0 points, declining for the second straight month. In the immediate aftermath of last autumn's presidential elections, confidence had soared. In the interim, however, sobriety has returned. The economic recovery is slower than expected and the important pension reform is encountering considerable resistance, as this would entail significant but necessary reductions in benefits. Accordingly, expectations in particular have deteriorated considerably. The expectation index dropped from 109.0 to 101.4 points, while that for the current situation fell from 78.1 to 76.6 points.

"Consumer confidence collapses in Brazil in March."

Hard data for the real economy in China proved to be mixed for the months of January and February. While the economic momentum in the retail sector and in the case of capital investments turned out as expected, the figures from industry were disappointing. Industrial production increased only 5.3% relative to the previous year, following growth of 5.7% in the previous month. An increase of 5.6% had been expected. The last time growth had been so

"China's industry with lowest growth in 17 years."

low was 17 years ago. Adjusted to take account of the effects of the Chinese New Year, growth would have been 6.1% in January and February according to the Chinese Statistics Authority. Car production continued to decline sharply (-17.8%). Coal production (-1.5%) also declined compared to the previous year, while the textiles industry (+0.2%) and the cement industry stagnated (+0.2%). As anticipated, retail sales grew 8.2%. Nevertheless, this corresponds to the lowest growth recorded in 15 years. Investment in plants and equipment increased 6.1%, having gained 5.9% in December. The slight uptick in momentum was driven by housing construction, where investment increased 11.6%, the strongest figure in five years. Infrastructure investment increased 4.3%.

Overall, most economic data point to a sustained slowdown in growth, particularly in industry. However, the rise in the unemployment rate from 4.9% to 5.3% in February is also likely to slow consumption. The slowdown has come notwithstanding the many stimulus measures undertaken by the Chinese government, which have not yet had any significant impact on the real economy. It is safe to assume, however, that the stimuli will begin to take effect in the second half of the year, and that growth will be kept above 6%.

"We are expecting the Chinese government's stimulus measures to begin having an effect during the second half of the year."

Equity markets

As the following chart shows, the hoped-for "V shape recovery" has materialised. The MSCI World Index covers 2,800 companies from 47 countries, whereby the US accounts for 55% of the index. It is worth noting that US companies have never been so dominant as they are today. Following the strong rally, the US equity market – S&P 500 – is still 3% short of the all-time high reached on 20 September 2018. In the wake of the crash in December last year, prices have risen by 20%.

"The hoped-for V-shape recovery has materialised.

FACTUM

The sparkling first quarter of 2019 contrasts with the general economic environment and the development of corporate profits. Expectations for earnings growth have been revised sharply downwards in recent months. Estimates for the following quarters, on the other hand, reflect more confidence. Various sentiment indicators and surveys also reflect a great deal of optimism. Since leading economic indicators do not yet point to stabilisation, there is a danger that the markets will be slowed or set back by the disappointment in earnings. In terms of price-earnings ratios, valuations are still well below the peaks of early 2018 and just above the 10-year average. If estimates had to be revised even further downwards in a persistently weak economic environment, valuations would effectively be pushed higher.

"Are investors being overly optimistic?"

In general terms, the decline in implicit volatility in many stockmarkets reflects revived optimism amongst market players. Markets are in particular expecting positive results to emerge from the trade dispute negotiations between the United States and China, but this is by no means assured. A renewed rise in historically low market volatility would not come as a surprise. This could cause cyclical stocks to correct more strongly than the market.

"When will volatility start rising again?"

Bond markets

As broadly expected, at its meeting at the end of March the Fed left the target range for its key interest rate unchanged at 2.25% to 2.50%. At the same time, however, US currency watchdogs significantly reduced their forecasts for the outlook for interest rates, thereby raising the prospect of a prolonged interest rate pause. A majority of the monetary policy decision-making body are now signalling that they might not raise the key rate at all this year. 11 of the 17 Fed members share this view, contrasting with just two in December. Meanwhile, four Fed members were in favour of an interest rate hike and two currency watchdogs were in favour of two interest rate hikes of 25 basis points. In December, a majority had voted for two further interest rate hikes in 2019, and in September the Fed had actually announced three more interest rate steps. Now, currency watchdogs are still assuming an interest rate hike of 25 basis points for 2020, and an unchanged rate level for 2021. The long-term neutral key interest rate is still considered to be 2.75%. In our view, the aggregated interest rate projections of individual Fed members should not be overestimated in the so-called “dot plot”. The current assessment may well change over the course of time, in particular as new data comes in, as Fed Chairman Jerome Powell has repeatedly pointed out.

“Fed scraps base rate hikes for this year.”

The second surprise concerns the process of balance sheet normalisation. Starting in the autumn of 2017, the US Federal Reserve has been successively reducing its holdings of government bonds and mortgage bonds in its balance sheet. These had risen by about three and a half trillion dollars over the course of the quantitative easing programmes. In recent weeks there have been various indications coming out of the Fed that the process of normalising the balance sheet would be drawn to a close towards the end of this year. However, the actual resolution provides for this to be discontinued as early as September. The speed of the balance sheet reduction will be reduced in May (tapering). With effect from October, the balance sheet total is set to be kept unchanged at the level it has reached by then.

“The second surprise concerns the process of balance sheet normalisation.”

At its meeting in March, the European Central Bank (ECB) left base rates unchanged. However, the ECB’s Governing Council is now assuming that base rates will need to remain at the current level at least until the end of 2019, and in any case for as long as necessary. To date, it had been saying that interest rates would remain at current levels at least until the summer of 2019. At the same time, the ECB announced a new series of quarterly targeted long-term loans (TLTRO-III), each with a two-year maturity from September 2019 to March 2021. According to the ECB, these new instruments will help

“Definitely no interest rate moves from the ECB in 2019.”

maintain favourable bank lending conditions and the smooth transmission of monetary policy.

Also unsurprisingly, growth and inflation forecasts for the current year have been revised significantly downwards. The growth forecast has been cut from 1.7% to 1.1%, while the inflation outlook has been trimmed from 1.6% to 1.2%. By contrast, growth forecasts for 2020 and 2021 remained virtually unchanged, while inflation figures have been revised downwards by 0.2 percentage points in each case. This means the ECB recognises that the momentum of growth has declined further, and that the weakness phase is set to persist for longer than had previously been expected. The ECB currently rates the risk of recession as being low.

"ECB cuts its growth and inflation forecasts for the current year."

As expected, the Central Bank of Brazil left its key interest rate unchanged at a record low of 6.50% at the end of March. The decision was taken unanimously by the nine-strong Monetary Policy Committee. Roberto Campos Neto, the new head of the Central Bank, noted that the currency watchdogs will be cautious, calm and persevering. Economic activity has recently been weaker than expected and inflation risks have been balanced.

"As expected, the Bank of Brazil is leaving base rates unchanged at 6.5%."

As expected, at its meeting of mid-March, the Bank of Japan (BoJ) decided to stick to its existing ultra-expansive monetary policies. The deposit rate remains at -0.1% and the long-term yield continues to target a return of 0% with a tolerance range of plus/minus 0.2 percentage points. The decision was passed by 7 to 2 votes. The currency watchdogs are much more sceptical about economic prospects at a global level and in Japan than they were in January. In view of persistently very low inflation and the slowdown in growth, normalisation of its ultra-expansive monetary policy lies a long way off in the future. If growth continues to weaken, additional stimulus measures may be on the cards.

"Bank of Japan sticking to its established policies."

In short, it is possible to say that the normalisation of monetary policy has been shelved yet again. The broad-based economic upturn of recent years has not been used in Europe – and consequently not in Switzerland either – to raise key interest rates. Even in the United States, normalisation seems to have been suspended before moving into neutral interest rate territory. Irrespective of the 225 basis point hike in key interest rates seen since the end of 2015, America's monetary policy is still having a stimulating effect on the economy as a whole. There can therefore be no talk of a monetary policy turnaround in the USA either. Despite this, the situation in the USA is relatively comfortable. The Fed would be able to cut base rates by 225 basis

"America – you have it better – at least slightly."

points if a sharp economic slowdown materialises. On average over the past 50 years, the Federal Reserve has lowered interest rates by 655 basis points during periods of recession. This means the 225 basis points amount to only 35 percent of the long-term average, but a multiple of what would be available to Switzerland or the Eurozone if a new crisis had to be countered. In the "Old World", interest rate moves are unavailable. The only option on the table would be to resort to a further swelling of the Central Bank balance sheet. This would make the unusual monetary situation even more costly.

Commodities

Oil prices have been showing a significant upward trend again for some weeks, and gained around 30% in 2019 (WTI). They are benefiting from the sharp reduction in supply caused by OPEC's production cutbacks, particularly in Saudi Arabia. The US continues to face a lack of pipeline capacity that will continue for months, hampering higher US oil supplies on global markets for the present. In addition, oil prices have in the meantime clearly broken through the technical chart downward trend of the fourth quarter of 2018.

"The price of oil (WTI) rose around 30% in value in 2019."

The plunge in the price of palladium lasted only a few days, but it was all the more violent. The precious metal continued its steep rise in recent weeks to hit a new record high of USD 1,615 per troy ounce. It then plummeted and is currently trading at around USD 1,400 per troy ounce. A correction was overdue, as the price had almost doubled since mid-August of last year. A string of disappointing economic news came out of both China and Europe, including a 19% drop in car sales in China and weakening demand in Germany. Palladium is used, for example, to make catalysts.

The price of palladium corrected recently – although this came hard on the heels of an impressive rally."

At the technical chart resistance zone of USD 1,300 – 1,350 per ounce, gold has become vulnerable to profit-taking. Especially if economic figures were to improve – i.e. were to exceed expectations – gold, which is used as a safe haven, could lose out to other more cyclical commodities.

"Gold has become vulnerable to possible profit-taking at the technical resistance zone of USD 1,300 – 1,350."

Gold price over twelve months

In our view, an exposure to gold remains an effective way to reduce the overall volatility of a mixed portfolio. In the past, however, gold has also served well as a diversifier when geopolitical tensions have escalated significantly.

"We continue to see gold as an established part of our portfolio."

Currencies

The interest-rate hike by the US Federal Reserve did not bring about any marked weakness in the US dollar, but led only to a modest dip. The reason for this is the consistently stronger economic growth in the USA relative to Europe. In addition, the interest rate gap between US bonds and in particular those in the Eurozone has widened since the start of the year in favour of the USA. Thirdly, the still unsolved "Brexit problem" is weighing down on the European single currency relative to the US dollar. For emerging market currencies, the question of whether the recently manifested economic weakness of various emerging markets will stabilise once again relative to the stronger US economy will become an important factor.

"Suspension of base rate hikes in the USA did not lead to a marked weakness in the US dollar."

As already mentioned here in January, we do not expect any major exchange rate shifts. Due to evaporating interest rate speculation, we do not see any further upside potential for the US currency relative to the Swiss franc or the euro. For the medium term, we see a positive outlook for the euro. Most of the factors that weighed down on the euro last year are disappearing. For example, political risk in Italy has been reduced and recent economic data is encouraging. The saying "If you are scared, buy Swiss francs" is likely to return in the event of a sudden rise in risk aversion.

"The rise in the value of the US dollar is likely to have come to an end, at least for the present."

Market overview 29 March 2019

Equity indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	9,477.84	2.14	13.77
SPI	11,241.19	2.52	14.36
Euro Stoxx 50	3,351.71	1.86	12.29
Dow Jones	25,928.68	0.17	11.81
S&P 500	2,834.40	1.94	13.65
NASDAQ	7,729.32	2.70	16.81
Nikkei 225	21,205.81	-0.11	6.81
MSCI Emerging Countries	1,051.13	0.83	9.90
Commodities			
Gold (USD/fine ounce)	1,292.38	-1.59	0.77
WTI oil (USD/barrel)	60.14	5.10	32.44
Bond markets			
US Treasury Bonds 10Y (USD)	2.41	-0.31	0.28
Swiss Eidgenossen 10Y (CHF)	-0.38	-0.14	-0.13
German Bundesanleihen 10Y (EUR)	-0.07	-0.25	-0.31
Currencies			
EUR/CHF	1.12	-1.64	-0.82
USD/CHF	1.00	-0.30	1.33
EUR/USD	1.12	-1.35	-2.17
GBP/CHF	1.30	-2.02	3.57
JPY/CHF	0.90	0.21	0.21
JPY/USD	0.01	0.48	1.12

Author: Christof Wille, Dipl. Private Banking Expert NDS
Editorial deadline: 2 April 2019

If you have any questions, please do not hesitate to contact us at any time. Die Factum AG is a licensed, independent asset management company that is subject to the Liechtenstein Financial Market Authority. It is the exclusive purpose of this publication to inform; it is neither a request nor an offer nor a recommendation to purchase or sell financial instruments or to take any other decisions on investments. It is therefore not a financial analysis in terms of the Marktmissbrauchsgesetz (Act on Market Misuse). The information and opinions contained in this publication originate from reliable sources and have been prepared with the utmost diligence. Nevertheless, we exclude any liability for accuracy, completeness and topicality. All information contained and all prices stated in this publication may change at any time without notice. The value of financial instruments may rise or fall. Future performance cannot be deduced from the past development of prices. Under particular market-related or security-specific circumstances, financial instruments may be sold only with delay and at a reduced price. For this reason it is essentially difficult to quantify the value of an asset and the risks to which this is exposed. We would like to point out that Factum AG Vermögensverwaltung and its employees are allowed in principle to hold, purchase or sell the financial instruments mentioned in this document, without however putting clients at any disadvantage. This publication as well as the information it contains are subject to Liechtenstein law. In the event of any disputes, jurisdiction rests exclusively with the Liechtenstein courts at the legal venue of Vaduz.