Für Ihr Vermögen.

FACTUM

Investment Report

July 2019

Strategy overview

Exorbitant price gains during the first half of 2019 have almost eclipsed memories of the challenging 2018 investment year. This has resulted in what is known as a "V-shaped recovery". The US S&P 500 Index gained 18.5% during the first half of 2019 – representing the best first half since 1997. In fact, the past month of June was the best June since 1955. The most important stockmarket indices reached new all-time highs in the United States as well as in Switzerland. As the chart below shows, the MSCI World Stock Index is not far behind.

"Stockmarkets post fabulous first half of 2019 – the S&P 500 in the USA recorded the best first half since 1997, gaining 18.5%."

In our view, the 2019 investment year, which has been outstanding to date, has been characterised by two factors: The US Federal Reserve U-turned and paused its schedule of interest rate hikes. In fact, it is very likely that interest rates in America will be reduced in the near term, which calmed nerves amongst market players. On the other hand, the recent G20 meeting

"The Fed's policy turnaround as well as a degree of rapprochement in the trade dispute have calmed market-watchers."

in Osaka showed that the US and China are getting closer. This means that talks on the trade dispute are likely to be continued.

The latest indicators suggest that global growth will continue to weaken. But as there are no classic signs of an impending recession, such as rampant inflation and high real interest rates, we do not think overall demand is likely to suffer a protracted contraction. For this reason we are expecting the US Federal Reserve to begin lowering key rates from July and the ECB to reduce its deposit rate.

"Still no signs of light on the economic horizon."

The situation on the Persian Gulf has also been coming to a head. In our view, the US will squeeze the Iranian regime with further sanctions, while a large-scale military intervention is probably not on the agenda. President Trump does not see himself as a warmonger and has repeatedly said that he is keen to withdraw troops from foreign abroad. Furthermore, against the backdrop of the upcoming US presidential elections in early November 2020, we consider the scenario of a major military intervention in Iran to be unrealistic.

"The situation on the Persian Gulf has recently worsened."

As mentioned in the introduction, the 2019 investment year has been characterised by positive price gains. One exception was the month of May, when markets switched to "risk off mode" and global equity indices lost between 5% and 8% in value. We took advantage of the weak phase in May and placed our portfolios on a slightly more offensive footing at the beginning of June. We did this by investing in the banking, automotive and energy sectors.

"We took advantage of the weak month of May to place our portfolios on a slightly more offensive footing."

Taking the partial hedging of the equity ratio into account – which we are sticking to – we are neutrally weighted. In overall terms, bonds have become less attractive. In the corporate bonds field in particular, risks are no longer adequately being offset, which is why we are underweighted in bonds. What we do like, by contrast, is gold – +8% in June – as well as a homoeopathic dose of gold mines, which gained significantly in value over recent weeks. Gold recently benefited from interest rate reduction speculation in the USA, a weaker greenback and assorted geopolitical tensions.

"We have weighted equities neutrally, have underweighted bonds and are favouring gold."

Politics

It was announced in mid-June that the USA and Mexico had reached agreement. At issue was the American threat to levy duties on all imports from Mexico. The US was demanding stricter measures by Mexico to curb the movement of migrants. At the end of talks that lasted several days, Mexico conceded. However, if any problems arise when it comes to adopting the necessary legislation in Mexico, the US administration reserves the right to impose the customs duties after all.

"Trump has dropped his customs threats against Mexico."

President Xi Jinping and US President Trump agreed to resume the bilateral negotiations that had become bogged down when the American side insisted on demands that went too far for the Chinese leadership. Trump promised not to impose the threatened further tariff increases against China, at least for the time being. This came after Xi Jinping had apparently promised that China would import more agricultural products from the USA. Trump's announcement that he will again allow the Chinese technology group Huawei to buy key components from US manufacturers is most likely tantamount to a genuine concession. Trump wants to discuss the measures imposed on Huawei for national security reasons only at the very end of the resumed negotiations with China. He is probably keen to keep this card up his sleeve until last.

"Thaw at the G20 summit in Osaka between Xi Jinping and Trump."

History was made at the end of June at Panmunjom, the site of the ceasefire line between the two Koreas. US President Donald Trump walked leisurely between blue military barracks towards the demarcation line. He paused for a moment to await North Korea's leader Kim Jong-un. They shook hands briefly. Then Trump took a small step over a low boundary stone that separates the divided nation. This makes Trump the first incumbent President of the USA to walk on North Korean soil. It currently seems that the United States and the United Nations (UN) are resuming negotiations with North Korea on the disarmament of North Korea's nuclear weapons and long-range missile programmes. This is a positive development, whereby it seems unlikely that a solution will be found any time soon.

"North Korea and the USA have returned to the negotiating table."

The European Union has also been able to announce two success stories. A major breakthrough was achieved in the negotiations on a trade agreement with the Mercosur states of South America (Brazil, Argentina, Paraguay and Uruguay). A trade agreement was even signed with Vietnam. Meanwhile, the filling of top positions within the European Union has become a protracted process. No agreement was reached at the special summit of EU heads of

"The European Union has also enjoyed a positive newsflow."

state and heads of government at the end of June. A successor to the President of the European Central Bank will probably not be named until September. Mario Draghi's period of office ends at the end of October of the current year.

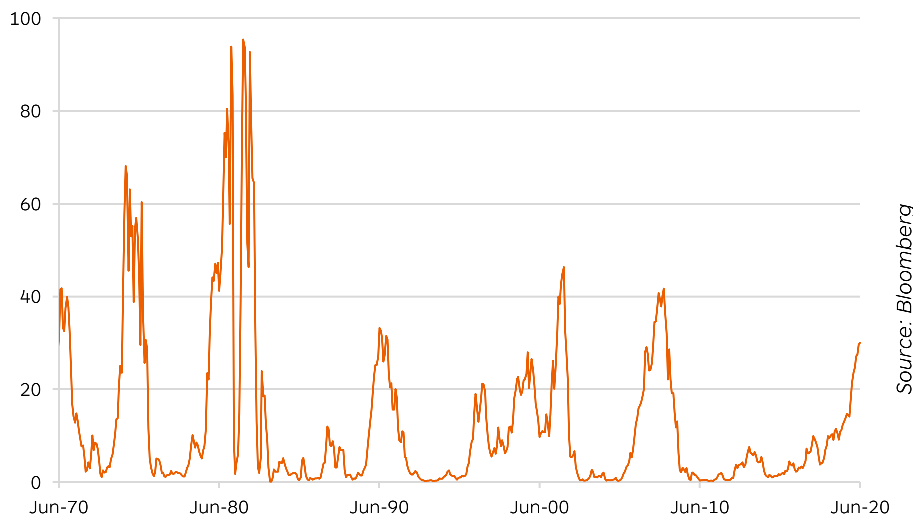
Economy

In overall terms, US economic data has been disappointing in recent weeks, confirming the downside risks to the economy. The Economic Surprise Index, which sets market expectations in relation to the data actually realised, shows that the US economy has been slowing since the start of the year and that the majority of the data is on the weak side. The Economic Surprise Index is currently at minus 68 points – its lowest level in two years. Against this backdrop, it is becoming clearer that the Fed now also considers economic risks to be greater than at the time of its meeting at the end of April. A base rate cut at the end of July has become very likely. Markets are anticipating this with a probability of 81%. We are expecting an interest rate move of 25 basis points. In our view, a 50 basis points cut is unlikely. The outlook for the US economy is not bad enough for this, that is to say the prospects still too good.

"US economy displaying unmistakeable signs of weakness."

In our view, however, the prospects of interest rate cuts will not in itself be sufficient to breathe new life into investment markets. A de-escalation of the trade dispute between the USA and China is urgently needed – which is what occurred at the end of June, at least temporarily. Worsening sentiment amongst investors and companies, which has already materialised, is likely to have a bigger effect than the direct negative effects of punitive tariffs. In the USA, the risk of recession has also risen markedly. In the interim, this is as high as it has been since August 2007. We believe that sooner or later there will be at least a partial solution to the trade conflict, not least with a view to the US presidential elections in 2020. Because there are no classic signs of an impending recession, such as inflation and high real interest rates, we do not think overall demand is likely to suffer a protracted contraction. The latter is supported by robust consumer demand, while the propensity to invest is likely to be affected by the trade dispute for some time to come.

"A rate cut by the Fed in July is practically certain."



The three major emerging markets of China, India and Brazil have published mixed sets of economic data in recent weeks. In China, for example, industrial production growth slowed in May to the lowest level recorded for 17 years. Investment in plants and machinery also grew more slowly than expected. By contrast, the retail sector saw sales rise slightly more than forecast. In May, revenues increased 8.6% compared to the same month of the previous year, while a gain of 8.1% had been expected. Exports also grew unexpectedly in May (+1.1%). Following the decline in April, the consensus had been expecting a further fall of 3.8%. The increase in exports might come as a surprise, given the higher US tariffs. However, fears of further punitive tariffs on the part of the USA probably meant that exports were brought forward. In any case, leading indicators, such as the purchasing managers' index for the manufacturing sector, point to continuing weakness on the exports side. The sharp fall in imports, which fell by a substantial 8.5% in May, also points to a weak economic trend. For this reason it is our assumption that the Chinese government will take additional stimulus measures to stabilise economic growth. A weaker yen is part of China's economic policy arsenal.

"Mixed data coming out of the major emerging economies."

By contrast, industrial production in India grew surprisingly strongly, expanding faster than it had for the past six months. Despite this, the pace of growth in India is also declining. In the 1st quarter of 2019, for example, the

The Reserve Bank of India is likely to raise interest rates during the 2nd half of the year."

economy expanded by 5.8%, which was the weakest figure recorded in four years. To stimulate the economy, the Reserve Bank of India recently lowered its key interest rate for the third time this year, and we are expecting a further rate cut during the second half of the year.

In Brazil, retail sales in April continued to fall far short of expectations. In a month-by-month basis, revenues fell 0.6%. In year-on-year terms, the gain was a modest 1.7%. The Brazilian economy contracted during the 1st quarter of the year relative to the previous quarter. Taken together with other important economic indicators, weak retail trade data indicates that the economic doldrums will continue into the second quarter.

"There is still no end in sight to Brazil's weak economic situation."

Economic indicators coming out of the Eurozone are also less than encouraging. With the exception of the construction sector, the European Commission's sentiment indicators slipped across the board in June. The collective indicator of economic confidence in the Eurozone fell much more sharply than expected from 105.2 points to reach 103.3 points, its lowest level for 34 months (August 2016). The sub-index for industrial sentiment worsened from -2.9 points to reach -5.6 points, recording the strongest decline in eight years and the lowest figure for 69 months. At the same time, all sub-components deteriorated. In particular, the surveyed industrial corporations reported declining orders and significantly lower production expectations. Confidence within the service sector declined from 12.1 points to 11.0 points, while confidence in the retail sector fell from 0.1 points to -0.9 points. It was only in the construction sector that the situation improved (from 4.1 points to reach 7.7 points). Consumer sentiment slipped from -6.5 points to reach -7.2 points. At the country level, economic confidence declined almost everywhere. Amongst the major economies, confidence in Germany fell most sharply (-2.9 points), followed by Italy (-1.5 points), France (-1.0 points) and Spain (-0.6 points). In a number of smaller economies, however, including Greece and Portugal, economic confidence actually increased.

"Further dampening of sentiment indicators in the Eurozone."

Equity markets

"Sell in May and go away" is an established stockmarket saying. It suggests that stockmarkets experience a difficult period from May to September – but this year it has not yet been corroborated. During the first half of the year, the SPI in Switzerland gained around 22% in value, the EuroStoxx 50 in Europe gained 19% and the S&P 500 in the USA rose 18.50% – when dividends are also taken into account.

"Sell in May and go away has not paid off to date."

In our view, the second half of the year will continue to be dominated by the topics of monetary policy, China's economic momentum and the trade conflict. The Fed U-turned and is not expecting any further interest rate hikes in 2019. The same applies, of course, to the European Central Bank. Lower government bond interest rates are the consequence. Interest on 10-year US Treasuries, for example, have declined from 2.60% at the start of the year to around 2.00% today.

"The topics of the first half of the year will continue to dominate headlines during the second half."

Bonds worth around USD 11 trillion with negative interest rates are currently outstanding. This is intensifying the investment crisis, and suggests that equities are a more promising category of securities. We are firmly convinced that the US administration is indeed keen to reach a long-term trade agreement with China. It is therefore increasing import duties in order to build up pressure and secure as many concessions as possible. During the second half of the year, we should therefore expect a persistently high level of uncertainty.

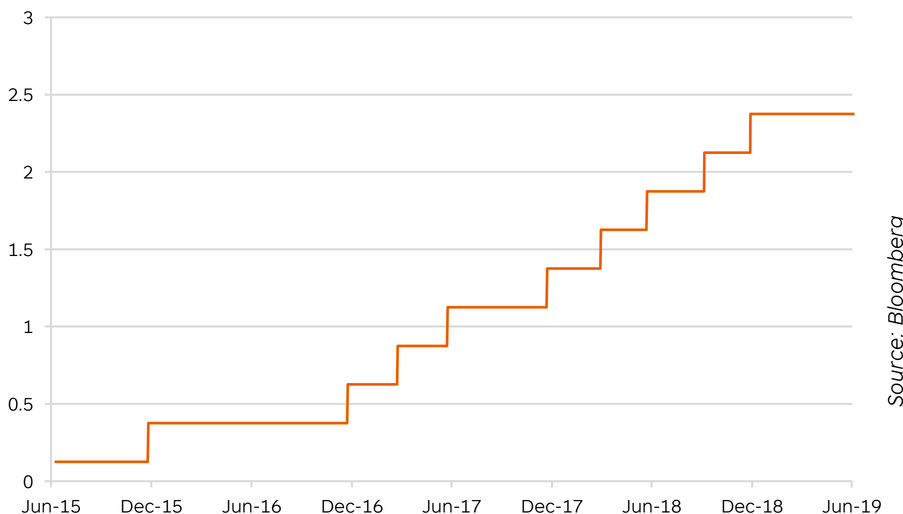
"Around USD 11 trillion in outstanding bonds have yields in negative territory – a positive factor for dividend stocks."

Bond markets

Positive sentiment is permeating the stockmarkets. And once again, central banks are responsible for this. The scenario of tightening interest rates seems to be off the table for the present. This applies not just to the European Central Bank, which has not yet even begun seriously addressing the normalisation of its monetary policy. US Federal Reserve Chair Jerome Powell recently signalled that every effort will be made to maintain the momentum of the economic upturn. The current cycle of rising interest rates in the USA has therefore probably drawn to a close, especially as the economic outlook in America has also deteriorated slightly. Following nine interest rate

"Central banks have again been creating a party atmosphere."

hikes in the USA, the target band is currently at 2.25 % - 2.50%, as the following chart shows:



Source: Bloomberg

The members of the Federal Open Market Committee (FOMC) have revised their projections markedly downwards. None of the 17 FOMC members had anticipated an interest rate cut in March. Now eight of them are expecting this. Seven of these eight are even expecting rate cuts of as much as 50 basis points. Compared to previous cycles, when the Fed shifted course relatively late in the day, the current change of direction seems to be of a preventive nature. Although the anticipated monetary stimulus will initially be barely measurable for the real economy, it has triggered euphoria within financial markets. On futures markets, interest rate cuts of almost 100 basis points are now being priced in. In our view, this scenario is not particularly realistic. For this reason, it is likely to be revised.

"In our view, interest rate cuts in the region of 100 basis points in 2019 in the USA are overly optimistic."

To confirm the change of course in June, the phrase "patient" was excised from the Fed statement. If the Fed keeps to the market script, it will be strongly reminiscent of the second half of the 1990s. Then too, the Fed (Alan Greenspan) micro-managed monetary policy. He also approved preventive interest rate cuts in order to extend an already very protracted upturn. This policy was successful to the extent that the bull market persisted until 2001. On the downside, however, a great deal of hot air was pumped into the stockmarket bubble during this period of preventive rate cuts, making its subsequent bursting all the more damaging.

"The Fed's approach is reminiscent of that taken in the late 1990s."

Due to the weakening momentum of growth recorded during the first quarter of 2019, resulting in expansion of 5.8%, which was the weakest GDP increase in more than four years, the Reserve Bank of India lowered its key interest rate in June for the third time in the current year. It changed its monetary policy outlook from "neutral" to "expansion" and is open to further interest rate cuts if the economic slowdown continues.

"The Reserve Bank of India changed the wording and is open to further interest rate cuts."

The Reserve Bank of Australia also cut its key lending rate by 25 basis points in June to the all-time low figure of 1.25%. In view of the economic slowdown, we are expecting a further rate hike in the near future. Philip Lowe, Chairman of the Reserve Bank of Australia, justified the interest rate cut with the weakening labour market and low inflation. In addition, he drew attention to the weaker state of the global economy and the trade conflict between the USA and China. Australia is particularly impacted by this because, as China's supplier of raw materials, it is one of the People's Republic's most important trading partners. For this reason, any economic slowdown in China affects Australia. Australia's economic growth has already slowed in recent quarters. The domestic real estate market, where prices had risen sharply for many years, and are currently declining, represents a particular burden.

"The Reserve Bank of Australia cut base rates to a record-low 1.25%."

Commodities

Attacks on tankers in the Persian Gulf near the Strait of Hormuz, through which 35% of global oil is transported, highlight the danger of a confrontation between Iran and the USA, which makes the geopolitical situation even more unstable. The price of WTI grade oil has risen around 30% since the start of the year. Of all asset classes, commodities are often the most volatile. In addition, uncertainties surrounding the two principal factors affecting commodity markets, i.e. supply and demand, are particularly high due to the unpredictability of the economic outlook. Because, unlike bonds and equities, no returns or dividends are available from commodities, virtually everything revolves around anticipating shifts in supply and demand.

"The two main factors of supply and demand are currently very difficult to forecast."

In the case of industrial metals, the trade conflict and worries about a further downturn in Chinese economic growth have put copper under particular pressure – because demand is dominated by China. In case of the oil market, hopes that a settlement might be reached in the trade dispute boosted demand during the first quarter. However, when the trade dispute actually intensified, investors took the view that demand would fall and this triggered a correction. Over the next few weeks, trade conflict headlines will continue to determine volatility levels. In the case of the oil market, prices are also being

"The trade conflict is throwing shadows over the commodity sector."

influenced by international inventories, which have recently risen, and possibly by a further production cut by OPEC. OPEC recently revised downwards its expectations for oil demand.

Things suddenly began moving very fast. For more than five years, the price of gold has moved sideways within a bandwidth of USD 200, and has repeatedly failed to advance over the USD 1,360 threshold. This was finally achieved at the end of June when, with minimum fuss, the price of the precious metal passed the USD 1,400 hurdle. This is considered psychologically important and, provided the price of gold remains above this threshold for a prolonged period, we believe there is further upside potential. In fact, a number of factors currently suggest that the price of gold could continue to rise. On the one hand, the expected turnaround in monetary policy is likely to boost prices, and this effect will be accentuated by lower bond yields. In the USA, discussions are focusing not so much on whether the Federal Reserve might decide to cut base rates, more on when and how sharply. The ECB has also declared itself willing to loosen its monetary policy belts.

"Faith in the yellow precious metal has returned – the price of gold has risen above an important threshold."

On the other hand, geopolitical and trade policy tensions do not appear to be going away. These have recently been fuelled by US plans to impose new sanctions on Iran. Uncertainty prevails, and gold is seen as a safe haven. This is compounded by strong demand from central banks in emerging countries and the recent decline in the value of the US dollar. However, the remarkable gains have also attracted numerous speculators. The price of gold rose 8% in June alone. It has risen around 10% since the start of the year.

"The price of gold rose 8% in June alone. Since the start of the year the price has increased by around 10%."

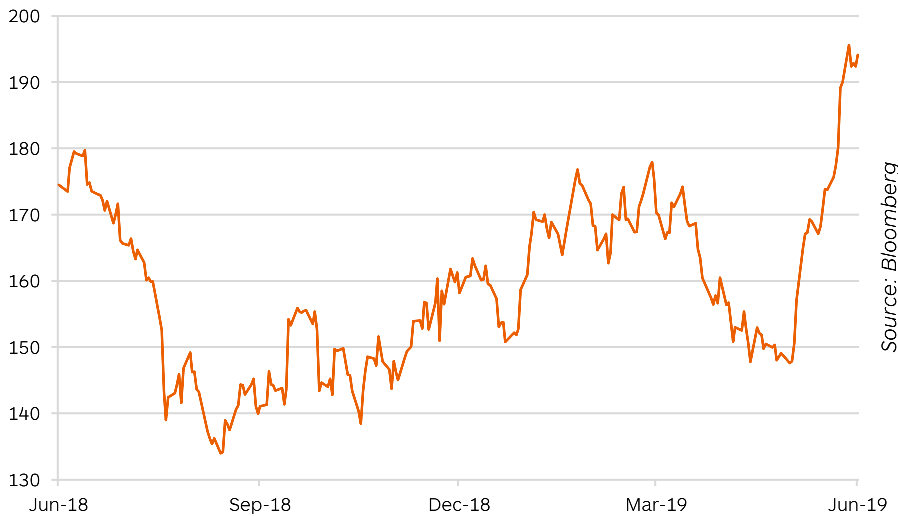
Even if there are currently few fundamental reasons for a weaker gold price, a degree of consolidation is also on the cards. In our view, this would be a healthy development. It will take time for a price rise such as that seen in June to be digested. Investors who lost faith in gold as a safe haven and valuable component of their portfolios as a result of the long dry spell could once again be given an opportunity to enter the market relatively cost-effectively.

"A consolidation of the gold price at the current level would be healthy, and would smooth the way for the next upwards movement."

Gold mines have been performing even more impressively than the price of gold. As the following chart shows, the NYSE Arca Gold Bugs Index gained 30% in value in the month of June. We continue to view gold as an integral part of a portfolio, and gold mines as an interesting supplement, in homoeopathic doses.

"We view gold as an integral part of a portfolio, and gold mines as an interesting supplement, in homoeopathic doses."

NYSE Arca Exchange Gold Bugs Index



Currencies

In overall terms, ongoing disputes between the USA and China, along with the risk of punitive tariffs against the Eurozone, mean a risk of rising volatility on global currency markets. During the first few months of the year, priced-in stockmarket volatility was too low in historical terms. Priced-in currency market volatility was also extremely low. It has risen in the interim, but still has further upside potential. It would not come as a great surprise if emerging market currencies in particular, while historically low, became more volatile. This will be determined by how the trade conflict plays out.

"The first half of the year was characterised by low volatility."

In trade-weighted terms, the US dollar has gained moderately against the other main currencies. The way this goes during the second half of the year will probably depend on whether the development of the growth gap between the USA and the rest of the world continues to justify the ambitious market valuation of the USD. In the medium term, we are expecting the value of the US dollar to decline. From a fundamental perspective the greenback is significantly overweighted in purchasing power parity terms. This is compounded by the ballooning trade and budget deficits. The consequence is sustained demand for outside capital and explains the net supply of USD. In addition, its status as the ultimate safe haven and central bank reserve currency is no longer inviolable.

"The US dollar benefited mainly from problems afflicting other currencies – in the medium term, the value of the USD is likely to decline."

FACTUM

Market overview 28 June 2019

Equity indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	9,898.24	3.93	21.21
SPI	11,977.38	3.75	21.84
Euro Stoxx 50	3,473.69	6.04	19.22
Dow Jones	26,599.96	7.31	15.40
S&P 500	2,941.76	7.05	18.54
NASDAQ	8,006.24	7.51	21.34
Nikkei 225	21,275.92	3.41	7.53
MSCI Emerging Countries	1,054.86	6.28	10.69
Commodities			
Gold (USD/fine ounce)	1,409.55	7.96	9.91
WTI oil (USD/barrel)	58.47	9.29	28.76
Bond markets			
US Treasury Bonds 10Y (USD)	2.01	-0.12	-0.68
Swiss Eidgenossen 10Y (CHF)	-0.53	-0.05	-0.28
German Bundesanleihen 10Y (EUR)	-0.33	-0.13	-0.57
Currencies			
EUR/CHF	1.11	-0.66	-1.35
USD/CHF	0.98	-2.43	-0.59
EUR/USD	1.14	1.83	-0.82
GBP/CHF	1.24	-1.93	-1.01
JPY/CHF	0.91	-2.08	1.00
JPY/USD	0.01	0.37	1.60

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Editorial deadline: 28 June 2019

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