Investment Report

October 2019

Strategy overview

Following the turbulence triggered by the short-lived escalation of the trade dispute between China and the United States in August, financial market tensions have eased in recent weeks. Equity markets have recovered, while yields on long-term bonds have seen a moderate rise. Despite this, macro data suggest that the global economy is continuing to cool.

"Following turbulence in August, tensions eased in September."

Central banks have been responding. In September they further expanded monetary supply on financial markets. This despite the fact that the efficacy of such measures has been questioned for some time, above all in Europe. To revive Europe's economy, in particular Germany's, fiscal policy impulses are probably needed in addition to the settlement of "long-running" political issues (such as Brexit and the customs tariff dispute). At his last meeting, the departing ECB President Mario Draghi once again underscored the need for such programmes. It is to be hoped that his successor, Christine Lagarde, will be heard by key policymakers. She certainly has the right background (former French Minister of Economics and Finance, most recently Head of the IMF). Another compelling argument for supporting the European economy is the fact that interest rates are at record lows. This, for example, would allow Germany to make investments in infrastructure, some of which are long overdue, without incurring additional costs.

"Central banks responding to weaker economic data."

In overall terms, equities remain neutrally weighted in our asset allocation. We have slightly reduced the interest rate risk for tactically underweighted bonds. By overweighting the alternative investment segment, we are endeavouring to stabilise the performance of our portfolios.

"The equity ratio is set to remain neutral for the foreseeable future."

Politics

"Financial markets have also been impacted by political events of late, with President Trump threatened with impeachment. So what happened? A tele-

"The Ukraine Affair has opened a new front against Trump."

phone conversation on 25 July between President Trump and Ukraine's President Volodymyr Zelensky, during which Trump allegedly asked Zelensky to initiate investigations against the potential US presidential candidate Joe Biden. An unnamed CIA agent assigned to the White House filed a whistleblower's complaint. Nancy Pelosi, the Speaker of the House of Representatives, responded by announcing a formal Trump impeachment inquiry. This prompted Trump to release an unredacted transcript of the conversation. While the situation is fluid and likely will evolve in the coming days and weeks, here is what we know now and our view of the potential economic, political and financial-market implications.

In our view, the chances of Trump actually being removed from office are negligible. Progressive Democrats in Congress have been impatiently searching for justification to impeach him since his election. To that end, Speaker Nancy Pelosi's move appears to be nothing more than political theatre – to energise the Democratic base.

"In our view, an impeachment is unlikely."

The Democratic-controlled House of Representatives certainly has the votes (235-198) to impeach Trump, but all that means is that this political hot potato will then be passed over to the Senate, which will hold a trial and ultimately reach a decision on whether or not to remove him from office. But in the Senate, the Republicans hold a 53-47 majority. In order to remove a president from office, the Senate needs a two-thirds majority (67 votes). At least 20 Republican Senators would have to join the Democrats. We believe the chances of that are negligible. Also, 55-60% of voters oppose impeachment. They seem to want Congress and Trump to get back to work solving the country's problems.

We believe the Ukraine situation will prove a nothingburger rather than a smoking gun, although stocks may remain volatile in coming weeks due to headline risk. Ultimately, economic and corporate profit fundamentals drive stocks. Congress would be better served working on bipartisan legislation to address the country's most pressing issues, such as immigration reform, infrastructure and global trade. In fact, we believe that Trump will now be more motivated to conclude the China trade deal, perhaps as early as the Asia Pacific Economic Cooperation (APEC) Summit on 17 November in Chile."

"Ultimately, fundamentals and corporate profits drive stocks."

Source: Philip Orlando, Chief Equity Market Strategist, Federated Investors, published 27 September 19

Economy

While economic indicators in Europe, above all in the manufacturing sector, remain weak and are below the 50 point threshold, corresponding indicators in the service sector are still showing moderate expansion. To date, US figures have been robust compared to Europe. Yet they too showed a massive decline recently, suggesting that the US is likewise unable to escape the sluggish economic trend (triggered mainly by the trade conflict). If Donald Trump wants to win next year's presidential election, he is going to have to address the causes of the current economic weakness. Otherwise he could find himself in a similar situation to George W. Bush sen., who failed to get re-elected in 1993 on account of the poor state of economy ("It's the economy, stupid").

"The US economy is not immune either."

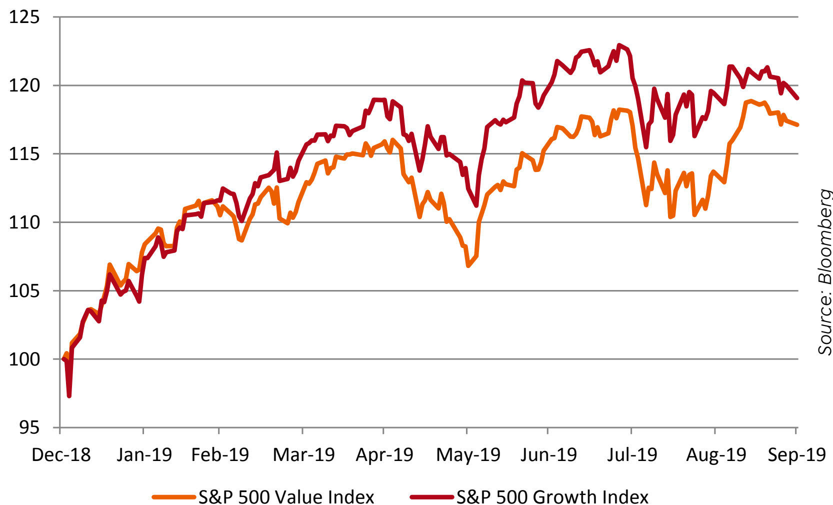
China has been a strong driver of the global economy in the past, and it is therefore not surprising that an economic slowdown worries many investors. The crucial factor, however, is that China's weight within the global economy has increased massively over the past decades. It now accounts for around 1% of global growth of 3% to 3.50%. Even if growth prospects have been trimmed from 6.50% to 6%, its share of global GDP remains substantial. To date, China has been cautious when it comes to implementing aggressive monetary policy measures. A change in this policy would therefore have a major impact.

"China remains a strong driver of the global economy."

Equity markets

Stocks in September were again able to present themselves in a positive light, whereby a change amongst index favourites emerged for the first time in a long time. The abrupt hike in interest rates that materialised at the beginning of the month enabled cyclical equities to outshine their defensive rivals. The coming months will show whether this is the beginning of a trend reversal or merely a flash in the pan.

"Temporary switch of equity market favourites."



Amongst established equity markets, the Japanese and European indices were for once the star performers (also see the Table at the end of the Report).

"Just for once, Japan tops Europe."

The 3rd quarter reporting season is set to start in mid-October. The sluggish state of the economy has already led to a significant reduction in earnings estimates. For the S&P500, expectations for the quarter under report point to average sales growth of 1.80% and earnings growth in the region of 9%. However, analysts are also likely to focus on the outlook and forecasts for the final quarter.

"The next earnings reporting season is approaching."

Bond markets

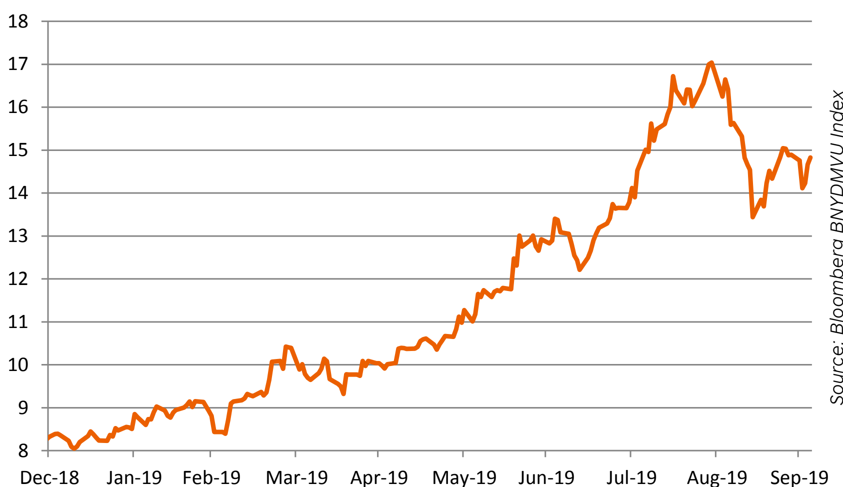
At its September meeting, the FED's Open Market Committee (FOMC) voted 7:3 for a quarter-point cut in interest rates. This was the second such decision in three months, lowering the target range for overnight interest rates to 1.75% to 2%.

"FED cut interest rates for the second time in 3 months."

What message should investors read into this when it comes to future interest rate decisions? Dot-plots show that seven members are of the view that the FED will cut interest rates once again this year, five believe that rates are now precisely where they should be, while five argue that interest rates should be a quarter point higher. For their part, investors have priced in a second rate cut this year – the last FOMC meetings are scheduled for 30 October and 11 December. Following the publication of ISM and ISM Non-Manufacturing figures at the beginning of October, the likelihood of interest rates being cut by a quarter of a percentage point implied by the interest rate futures has already risen from less than 40% to over 85% at the October meeting.

At its meeting of 13 September, the ECB also presented a wide-ranging package of measures: this included an interest rate cut of 0.10% to -0.50%, a staggered interest rate and new bond purchases to support the economy and boost inflation. The level of the monthly purchases fell slightly short of market expectations. However, the purchase programme is set to run “as long as necessary and until inflation approaches 2%” and will be terminated only shortly before ECB key interest rate hikes. The message shows that the ECB is set to remain very expansive for a very considerable period.

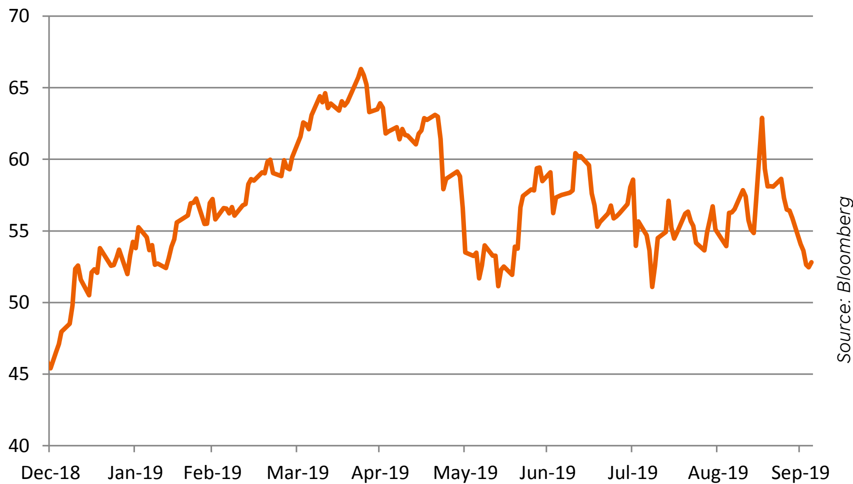
“Extensive package of measures from the ECB.”



Commodities

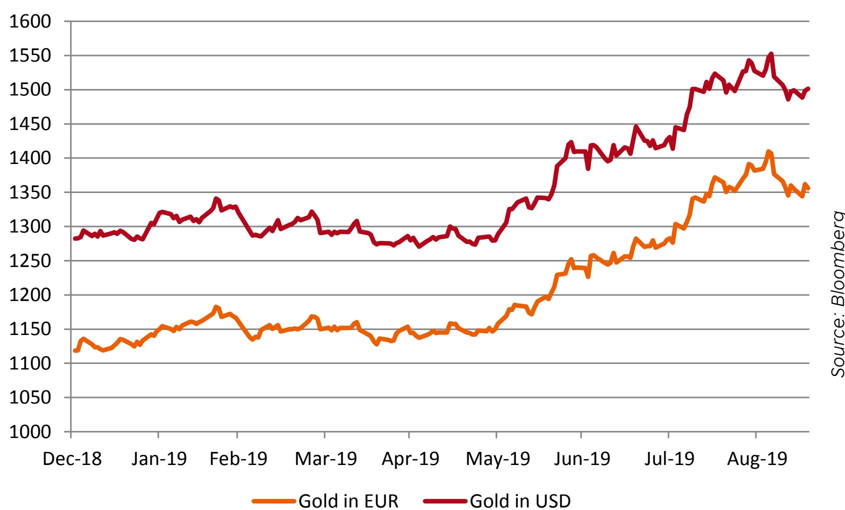
The performance of the energy sector was characterised by a supply shock in September. A drone attack on the central oil infrastructure in Saudi Arabia, which was blamed on Iran, severely damaged and put half of its production capacity or about 5% of the world market volume out of operation. This briefly pushed the Brent oil price 20% higher. However, the price shock was short-lived, as Saudi Arabia was able to continue to meet its delivery obligations from inventories at short notice. The restoration or provision of replacement capacity proved quicker than initially expected, and the market continued to be concerned about a slowdown in demand growth. By the end of the month, oil prices had lost the lion’s share of the gains.

“Temporary oil supply shock caused by drone attack.”



The return of risk appetite to financial markets also had an impact on base metals, whose prices initially rose across the board before weakening again towards the end of the month. Precious metals experienced a stronger correction, which had already been signalled in advance in view of extremely optimistic positioning data. In our view, the longer-term upwards trend remains intact, however.

"Precious metals experienced a stronger correction."

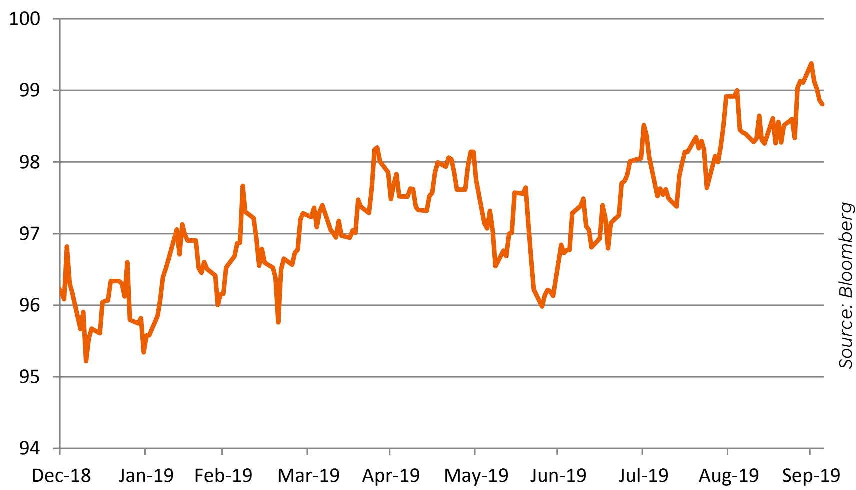


Currencies

The appreciation of the US dollar, which has been a persistent phenomenon, could slowly but surely be drawing to a close. Recently published economic data show that not even the US economy is immune to a sharp slowdown in momentum at the global level. As mentioned above, FED policies will further narrow the interest-rate gap between the different regions, meaning that

"US dollar – quo vadis?"

the proponents of a stronger US dollar will lose one of their main arguments. This would have the positive consequence that pressures on emerging markets and their currencies would diminish, enabling them to regain growth momentum, as a strong US dollar acts like a restrictive monetary policy in many emerging markets.



Market overview 30 September 2019

Equity indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	10,078.32	1.96	23.55
SPI	12,233.13	1.43	24.45
Euro Stoxx 50	3,569.45	4.29	22.94
Dow Jones	26,916.83	2.05	17.51
S&P 500	2,976.74	1.87	20.55
Nasdaq	7,999.34	0.54	21.56
Nikkei 225	21,755.84	5.74	10.76
MSCI Emerging Countries	1,001.00	1.90	6.14
Commodities			
Gold (USD/fine ounce)	1,472.49	-3.15	14.81
WTI oil (USD/barrel)	54.07	-1.87	19.07
Bond markets			
US Treasury Bonds 10Y (USD)	1.66	0.17	-1.02
Swiss Eidgenossen 10Y (CHF)	-0.76	0.26	-0.51
German Bundesanleihen 10Y (EUR)	-0.57	0.13	-0.81
Currencies			
EUR/CHF	1.09	-0.12	-3.38
USD/CHF	1.00	0.74	1.59
EUR/USD	1.09	-0.76	-4.95
GBP/CHF	1.23	1.92	-2.04
JPY/CHF	0.92	-0.91	3.05
JPY/USD	0.01	-1.68	1.42

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