Investment Report

August 2019

Strategy overview

"Don't fight the Fed" is a stockmarket buzzword that has developed over the decades. It warns investors not to bet against the Federal Reserve (Fed). At the end of July, as anticipated, the Fed cut interest rates by 0.25% to between 2% and 2.25%, for the first time since the 2008 global financial crisis. In the run-up to the meeting, stockmarket sentiment was buoyant. At the end of July, for example, the S&P 500 in the USA rose to over 3,000 points for the first time in its history. This corresponds to an increase of slightly more than 20 percent for the current year, if dividends are factored in. The gains posted by international stockmarkets can also be attributed to the growing investment crisis and the lack of alternatives. Around the world, the volume of bonds with negative yields has risen to around USD 13,000 billion. In July, central banks in Australia, South Korea, South Africa and Turkey also lowered their interest rates.

"Investors remain focused on central banks, which has helped support equity prices."

In July, the European Central Bank (ECB) signalled its intention to cut interest rates in the autumn and announced that it would be examining the need to resume bond purchases (quantitative easing / QE). In addition, the ECB also stated that inflation rates in Europe were too low and that the outlook, especially for the industrial sector, had further deteriorated. As a result, the Swiss National Bank (SNB), which already has the world's lowest base rate, remains under pressure. The Swiss franc reached a two-year high against the euro. The SNB can likewise cut interest rates or intervene in the foreign exchange market in response to the measures taken by the major central banks. However, as we believe that the scope for these measures is limited, the value of the Swiss franc is likely to continue edging higher.

"The ECB is paving the way for an interest rate cut in the autumn, putting the SNB under pressure."

In our view, there are a number of signs that give grounds for caution. These include, inter alia, economic warning signals such as weaker purchasing managers' indices in the current year, low inflation and falling growth forecasts. The trade conflict between the USA and China is also likely to remain contentious, despite the resumption of talks. This is compounded by geopolitical tensions, such as for example those between the United States and Iran.

"Many investors are currently sticking to the motto – there is no alternative to equities – which might have a sting in the tail."

What are the implications of the above remarks for our investment policy? We made no changes to our positioning last month. As a result, we remain neutrally weighted in equities, once the partial hedging of the equity ratio is taken into account. Following the strong equity price gains of recent months, we are not persuaded, at least in the short term, of the need to increase our equity ratio; if equity prices were to fall by five percent or more, we might consider increasing this. At the same time, history shows that equities tend to perform positively over a period of three to six months after the start of interest rate cuts. This applies in particular to the current situation in the USA, where we believe that interest rate cuts are in fact a safeguard by the Fed to cushion the possible negative impact of heightened global risks. In similar situations in 1995 and 1998, the Fed succeeded fairly well in prolonging the economic cycle by precautionary interest rate cuts and giving new impetus to stockmarkets.

"We did not change our positioning last month."

Politics

US President Donald Trump and Congress have avoided a new budget dispute. Agreement was reached on the need to raise the debt cap. This means budget finance is secured until 30 September 2021. The spokeswoman of the US House of Representatives Nancy Pelosi and US Senate Democratic leader Chuck Schumer confirmed the agreement. A budget dispute at the end of last year led to a government shutdown that lasted 35 days. Numerous federal authorities and institutions were forced to close temporarily.

"USA is raising the debt cap."

As expected, the Brexit hardliner Boris Johnson has become the new British Prime Minister, beating his rival Jeremy Hunt in an internal party ballot, to succeed Theresa May. In his first speech Johnson confirmed that Great Britain would be leaving the EU "with no ifs and buts" on 31 October. Despite the tight timeline, he promised that he would renegotiate the Brexit deal. The EU has strictly rejected this to date. As a precaution, therefore, Johnson has already made Brussels responsible for any failure of the negotiations and a chaotic no-deal Brexit. We can certainly look forward to an exciting three months.

"Theresa May steps down, Boris Johnson steps up to the plate."

Economy

US GDP grew 2.1% in annual terms during the second quarter. Following a strong start to the year, this means the US economy lost less momentum than had generally been feared, exceeding the 1.8% that market-watchers had been expecting. Growth was supported by strong private and state consumption. Following a weak winter semester, private consumer spending picked up noticeably once again, growing at an annualised rate of 4.3% – a rate not seen since the end of 2017. There was in particular a massive increase in spending on consumer durables (+12.9%). Spending on services rose by 2.5%. All in all, private consumption boosted growth by almost 2.9%. Government spending benefited from catch-up effects following the government shutdown at the start of the year. This is likely to have accounted for around 0.4%, or just under half, of the growth contribution from the government side. Growth was slowed by corporate investment (-0.1%), which fell for the first time in three years, inventory adjustments (-0.9%) and foreign trade (-0.7%), which suffered from the trade conflict and the weakening global economy.

"US growth more robust than forecast."

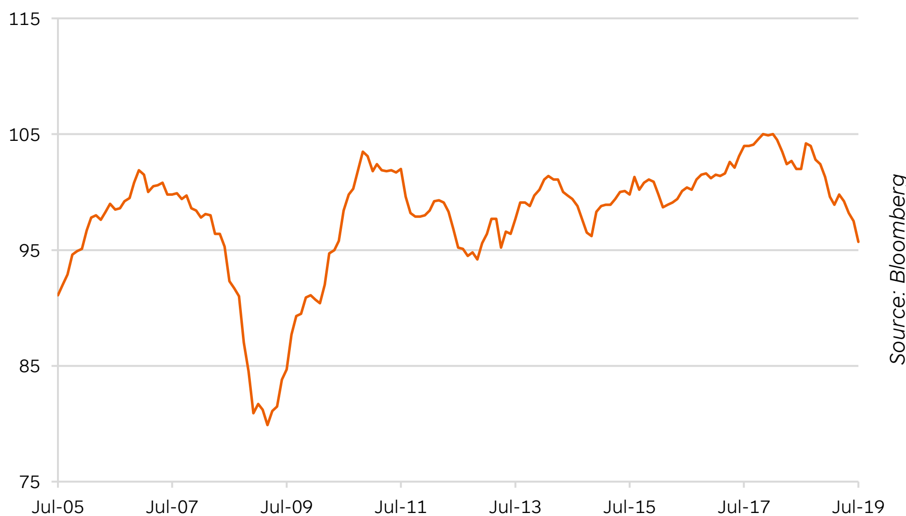
To date, most economic indicators coming out of the Eurozone have been disappointing, undermining hopes of an economic recovery. Pressure on the ECB has correspondingly increased, especially as the gloomy economic outlook has reduced the likelihood of higher inflation within the Eurozone.

"Most economic indicators in the Eurozone continue to disappoint."

The Ifo business climate index is continuing to slide. The Ifo index, which includes reports from around 7,000 companies in the manufacturing, services, trade and construction sectors, fell from 97.5 to reach 95.7 points in July, meaning that it fell more significantly than expected (97.2 points). In overall terms, this is the fourth consecutive decline and has pushed the key German economic barometer to its lowest level since April 2013.

"Ifo is signalling a further weakening of growth."

Ifo business climate index



The business climate in the manufacturing sector, which according to the Ifo Institute is in free fall, has deteriorated particularly sharply. With the exception of the construction sector, however, other economic sectors are also beginning to be impacted. The German economy is likely to have shrunk in the second quarter, and the start into the third quarter was not much better.

The quarterly Bank Lending Survey also provided grounds for intervention by the Central Bank. Contrary to expectations, the conditions for granting corporate loans tightened during the second quarter of this year. The survey conducted in July showed that, on balance, 5% of banks have tightened their guidelines for corporate loans, mainly due to concerns about future economic developments and the lower risk appetite of banks.

"Tighter credit conditions for companies in Europe."

Equity markets

The reporting season for the second quarter is currently in full swing, and is so far providing a similar picture as in the preceding quarters. Most companies have exceeded the expectations of analysts. Of the 65% of S&P500 companies (as at the end of July 2019) that have already published their figures for the second quarter, 78% exceeded the earnings expectations of analysts and 60% exceeded their sales forecasts. Sales grew 4% and earnings increased 2.8%. In both categories, the positive surprise component is above the respective 5-year averages. However, the business outlook statements are dominated by uncertainty brought about by the trade conflict and the global slowdown in growth. Within this context, it is interesting to note that S&P500 companies with a stronger global exposure report significantly

"US reporting season in full swing."

weaker results than those with a more local US focus – the trade conflict is beginning to bite. The reported and expected earnings of all S&P500 companies are expected to fall 2.6% in the second quarter compared to the same quarter of the previous year. Companies that generate more than 50% of their sales in the USA are however expected to record earnings growth of 3.2%. By contrast, companies that generate less than 50% of their sales in the United States are likely to suffer a 13.6% decline in earnings.

Bond markets

In recent weeks, bond markets have in particular benefited massively from the interest rate cuts announced and now implemented by the US Federal Reserve as well as by the statement issued by the European Central Bank, signalling even more negative interest rates or a resumption of bond purchases by the ECB this coming autumn. Lower quality corporate bonds performed particularly well, due to the reduction in risk premiums. As this could lead to excessive movements, a focus on quality and market liquidity is also important when it comes to bonds. A focus on maturities that are too long could come back to bite investors, if market anticipation of the interest rate cuts signalled by central banks proves less than euphoric. Good quality corporate bonds appear more interesting, in view of the huge fall in yields on government bonds.

"The mad world in combination with lower interest rates and floods of money."

We are assuming that the ECB will cut the deposit rate by 10 basis points to -0.50% in September, at the penultimate meeting presided over by Mario Draghi. In order to limit the impact on the banking system, this interest rate move will be accompanied by the introduction of exemption thresholds for banks. In view of Mario Draghi's remarks, the ECB is also likely to recommence its bond purchases, which were discontinued at the end of 2018. This means that monetary policy is set to remain decidedly expansive for some years to come.

"The ECB is likely to cut interest rates in the autumn."

Commodities

Continuing geopolitical tensions between Iran and the West, evidenced by Iran's attacks on Western oil tankers in the Persian Gulf, underscore the uncertainties surrounding oil supplies. This aspect, along with the production cuts extended by OPEC and Russia, is currently keeping oil prices relatively stable, despite rising US production. Inventory changes are therefore likely to remain the driving force in the coming weeks, alongside geopolitics.

"Geopolitics and inventory changes are driving oil prices."

The gold-silver quotient has risen to a figure of 93 in recent months. That is how many troy ounces of silver can be bought for the equivalent of one ounce of gold

"Investors have discovered silver."

– the highest figure in 27 years. This is likely to have prompted many investors to build up or increase their silver holdings. As a consequence, the price of silver rose 10% within three weeks.

In July silver ETFs, exchange-traded funds, saw significant inflows. The inflow in July amounted to 1,900 tons of silver, while the figure in June was just 470 tons. Despite the recent sharp rise, silver has only risen 5% since the start of the year, while gold has gained 10%. In the interim, the gold-to-silver quotient has edged closer. At a figure of 86, however, the quotient is still well above the level seen in previous years, and above all still well above the long-term average, which is in the region of 63. The technical chart situation provides a further argument for the silver price. The silver price has broken out of its downward channel of recent years, and has room to rise if the USD 16.60 level is consistently exceeded. Central banks are providing additional grounds for optimism, as these are expected to loosen their monetary policies once again.

While we at Factum AG are keeping a close watch on the performance of the silver price, we are refraining from making an investment at present. The price of silver can be very volatile, meaning that it is not suitable for risk-averse investors. If investors are looking for a safe haven, then in our view gold has clear benefits over silver.

"Silver is not suitable for risk-averse investors – if a safe haven is wanted, gold is by far the better option."

Currencies

What is currently noticeable on currency markets is the low implied volatility within a historical context. This suggests that currency markets are expecting extremely low exchange rate fluctuations, especially in the case of G7 country currencies. This is explained by the fact that monetary easing is expected from both the US Federal Reserve and the ECB. However, economic growth in the USA is clearly more vigorous than in the Eurozone. At the same time, the United States is able to cut interest rates by more than the European Central Bank, as the Fed raised key US interest rates from 0.25% to 2.50% in recent years. Mario Draghi has clearly stated that the ECB is not keen on a higher euro, which prompted criticism from Donald Trump. We assume that currency market volatility will inevitably increase, partly because the Brexit issue is entering a hot phase. The recent strengthening of the Swiss franc as well as that of the Japanese yen shows that monetary policy is not always smooth, but that there are risks when such so-called “safe havens” are sought.

“Within a historical context, the currently low implicit volatility is noticeable.”

Market overview 31 July 2019

Equity indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	9,919.27	0.21	21.47
SPI	12,064.45	0.73	22.73
Euro Stoxx 50	3,466.85	-0.05	19.15
Dow Jones	26,864.27	1.12	16.69
S&P 500	2,980.38	1.44	20.24
NASDAQ	8,175.42	2.16	23.95
Nikkei 225	21,521.53	1.16	8.80
MSCI Emerging Countries	1,037.01	-1.15	9.46
Commodities			
Gold (USD/fine ounce)	1,413.78	0.30	10.24
WTI oil (USD/barrel)	58.58	0.19	29.00
Bond markets			
US Treasury Bonds 10Y (USD)	2.01	0.01	-0.67
Swiss Eidgenossen 10Y (CHF)	-0.76	-0.23	-0.51
German Bundesanleihen 10Y (EUR)	-0.44	-0.11	-0.68
Currencies			
EUR/CHF	1.10	-0.83	-2.17
USD/CHF	0.99	1.81	1.21
EUR/USD	1.11	-2.61	-3.41
GBP/CHF	1.21	-2.48	-3.47
JPY/CHF	0.91	0.99	2.01
JPY/USD	0.01	-0.82	0.77

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