

INVESTMENT OUTLOOK

03.2019

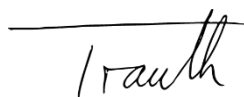
10 April 2019

In March the market rally continued, albeit at a slower pace. In the first quarter, the MSCI Developed Markets index gained 11.9%, followed by the MSCI Emerging Markets index, which performed 9.6%. The Chinese CSI 300 index even climbed by 28.6%.

Market participants have become very optimistic about the prospects of a revived Chinese economy and a positive outcome of the Sino-US trade talks. Central banks, especially the US Fed and the ECB, turned considerably more dovish, which inspired markets further. As a result, equities and bonds rallied. Bond yields of 10-year US treasuries and Bunds fell as much as 30 basis points in Q1.

The Brexit chaos did not seem to worry markets much. The MSCI Europe rose 12.0%, the FTSE 250 9.2%, and the GBP gained 2.2% vis-à-vis the EUR.

Despite the strong market rally, we are keeping our cautious stance regarding bond markets and our neutral stance regarding equity markets. We used the positive market environment to buy put options, i.e., equity down-side protection.

A handwritten signature in black ink, appearing to read 'Trauth', written over a horizontal line.

Thomas Trauth
CEO – IMT Asset Management AG

TOO GOOD TO BE TRUE?

Financial markets

The rally of risky assets continued in March, albeit at a slower pace. Most major equity markets performed positively, with the notable exceptions of the UK FTSE 250, which fell 0.3% and the Japanese Nikkei 225 index, which fell 0.8%. The S&P500 index slightly outperformed the MSCI Europe with 1.8% vs 1.6%. US tech stocks showed a sharp recovery in the first quarter and gained more than 20%. Chinese stimulus measures and improving economic data pushed the CSI 300 up by 5.5% in March, which brings the Q1 performance to 28.6%. The broad emerging markets index was up by 0.7%.

Credits rallied in tandem with equity markets. In March the high-yield index rose 0.78% and the emerging-markets hard-currency bond index 1.4%.

Usually, when risky assets rally, government bonds tend to lose value. In Q1, however, and especially in March, bonds rallied together with risky assets, driven by dovish central banks. In Q1 10-year yields fell about 30 basis points, both in the US and in the Euro area.

The broad commodities index fell slightly, by 0.2%, in March. Oil and other energy commodities continued to rise, with Brent oil gaining 3.6% in March. Optimism over US-China trade talks and the political situations in Venezuela and Libya pushed oil prices higher.

REITS had another strong month. The global REITS index rose 4.5%. With a Q1 gain of almost 16.0%. REITS have been one of the top-performing asset classes this year.

The USD remained on the strong side in March, gaining 1.3% against the EUR and 1.7% against the GBP. It fell, however, 0.5% against the JPY. The GBP traded sideways relative to the EUR, after it had advanced about 5% during January and February, despite Brexit uncertainties. The CHF gained 1.6% vis-à-vis the EUR, probably driven by a more dovish ECB.

Macro economics

The macro outlook is not entirely clear and shows diverging trends. The US economy, which slowed in Q4 2018 and at the beginning of 2019, has stabilized and is widely forecast to grow at about trend. The European economy continues to slow, however. The European manufacturing PMI even fell below 50 (the growth threshold) in February and softened further in March, reaching 47.5.

Meanwhile, the most positive recent development has been the recovery of Chinese leading indicators. For example, the Caixin PMI rose to 50.8 in March, breaking above the 50 level after having fallen below 50 in December. In addition, German leading indicators, like the ZEW and the IFO indices, which are sensitive to a better outlook for exports, have recently recovered. So far it is too early to state that China has made a clear recovery, which would carry the potential to revive other emerging markets and export-dependent Europe. But at least the state of the Chinese equity market, which gained more than 30% this year, suggests that there is a lot of optimism among investors.

However, markets remain vulnerable to geopolitical risks. Above all, the Sino-US trade dispute could put the brakes on the positive momentum we enjoyed in Q1. The rivalry between the US and China will not disappear anytime soon. However, for the short term, we continue to see a strong likelihood of a positive outcome to the trade talks. We think that the two leaders, President Trump and President Xi Jinping, currently have powerful incentives to find some kind of solution. President Trump, who is fighting to be re-elected on 3 November 2020, wants to avoid a bear market and an economic down-turn. President Xi Jinping may not be facing similar pressures, but stabilizing the fragile Chinese economy is very high on his agenda. In line with these facts, Matt Gertken, the chief geopolitical strategist of BCA, sees a 70% probability of a trade deal happening this year.

Central banks

At its 19-20 March policy meeting the US Fed kept rates unchanged. The Fed expects stable growth and well-anchored inflation. This was widely seen as confirmation of a soft Fed policy. However, the Fed meeting minutes, which were published on 10 April, revealed that Fed board members are keeping their options open. Several Fed members were reported as stating that their view regarding the appropriate interest rate could shift in either direction. Some members said that they would regard a rate rise as appropriate if economic conditions remained unchanged. Shortly after the publication of the Fed minutes, the market-implied probability of a rate cut at or before the December meeting fell from almost 56% to about 40%.

Jerome Powell came under repeated pressure from President Trump to loosen monetary policy and cut rates. Similar attempts to influence central banks have recently been made in Turkey and India. This imposes a clear threat to central banks' independence, which is a corner-stone of modern monetary policy.

The central banks' ability to steer monetary aggregates and inflation rests on the credibility and sovereignty of the central banks.

On April 10 the ECB held its monetary policy meeting and decided to keep rates unchanged "... at least through the end of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2%, ..". Further, the ECB will continue to re-invest the principal payment from maturing securities for an extended period of time and will introduce a new series of targeted longer-term financing operations (LTRO-III). The ECB sees that "The risks surrounding the euro area growth outlook remain tilted to the downside, on account of the persistence of uncertainties related to geopolitical factors, the threat of protectionism and vulnerabilities in emerging markets." It was a no-surprise meeting, but clearly implies that the accommodative stance of the ECB will continue well past the tenure of President Draghi, which will end in October.

Outlook

Is the market development in Q1 too good to be true? We believe not necessarily. If the world economy stabilizes and China achieves a sustained revival of its own economy, we may see the rally continuing. With hindsight, Q1 may be seen merely as a reversal following extremely oversold markets in Q4 2018.

However, we think it is advisable to remain cautious and prepare for an equity market correction later this year.

First, geopolitical risks remain elevated. It seems that, for now, President Trump is facing stronger headwinds from the democrats, who hold the majority in the house of representatives, and he may want to avoid risks to the economy and the stock market in anticipation of the upcoming elections in November 2020. Nevertheless, he may re-surface with a more aggressive stance during the pre-elections to gain support from his voters.

Second, as discussed above, the macro picture is not so clear and we could see disappointing earnings or macro indicators during the course of this year.

Third, in our view, recent market moves reflect a lot of optimism regarding macro-economics, geopolitics, and central banks' support. Therefore, we are very cognizant of a large potential for disappointment, which could trigger a severe market correction.

As a result, we remain cautiously positioned, underweighting interest rate and credit risks. We remain neutral on equities and slightly overweight on energy.

In the first quarter we gradually reduced the energy overweight to realize gains. The same applies for the equity-market gains.

In addition, we have decided to use a part of the portfolio gains to hedge about 40% of the equity quota. This hedging measure consists of a basket of put options and will offset a proportion of the losses that would be incurred in the event of a share-market correction.

ECONOMICS

In March, we saw further confirmation of the divergence of the European and US growth paths. While the US ISM index rose to 55.3 after 54.2, the European PMI fell further to 47.5 after 49.3 and indicates a contracting manufacturing sector. The Chinese PMI

rose to 50.8 after 49.9 and confirms the recovery of the Chinese economy. US non-farm payrolls made up for a weak February reading, rising solidly by 196,000 in March. Average hourly earnings rose 3.2% YoY.

Fig. 1: PMIs

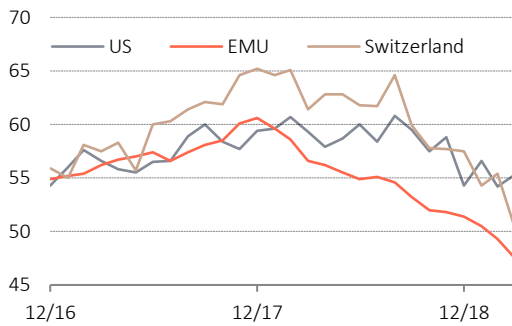


Fig. 2: PMIs

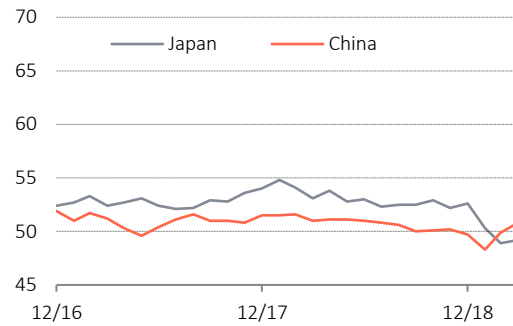


Fig 3: Consumer price inflation, in % YoY

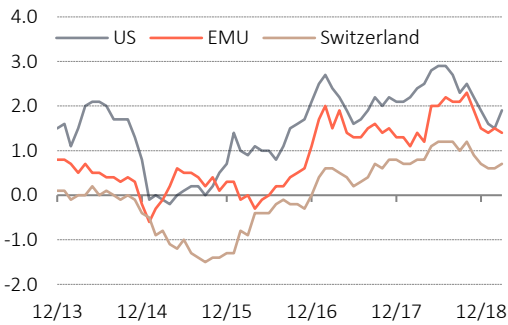


Fig. 4: Consumer price inflation, in % YoY

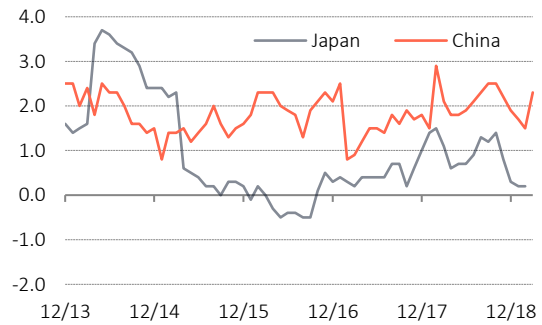


Fig 5: Unemployment rates, in %

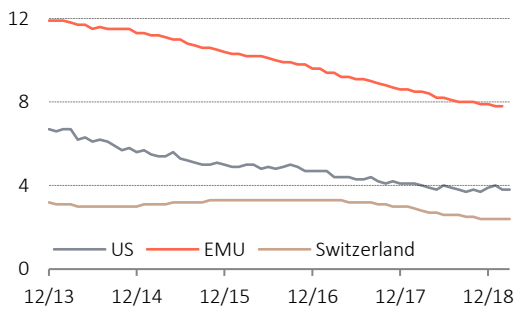
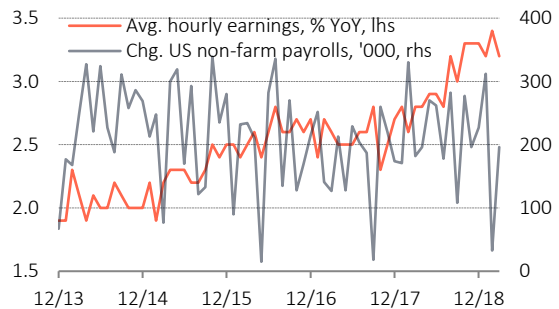


Fig 6: US labor market



FIXED INCOME

After US Fed and ECB became clearly more dovish in recent months, fixed-income markets reacted significantly. Yield movements were especially strong in March. The US 2-year yield fell below the 3M libor, suggesting that the market had started to discount a

Fed rate cut this year. US 10-year yields even fell 30 basis points. Since at the same time break-even inflation rose, real yields dropped even more, which made inflation-linked bonds a well-performing asset call in March. Credit spreads tightened across the board.

Fig.7: 2Y government bond yields

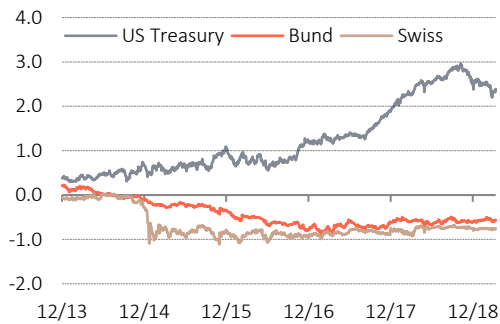


Fig. 8: 10Y government bond yields

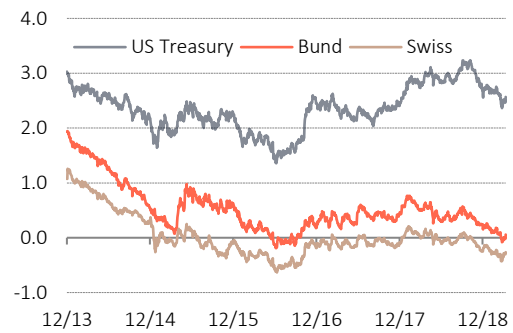


Fig 9: 10Y break-even inflation

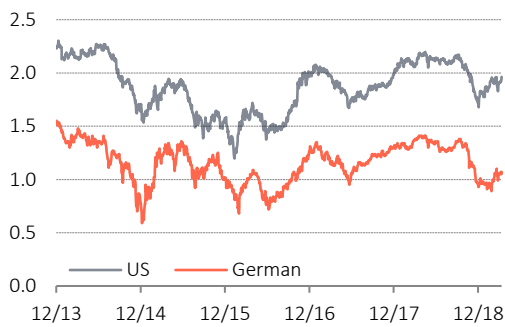


Fig. 10: Credit spreads, 5Y credit default swaps

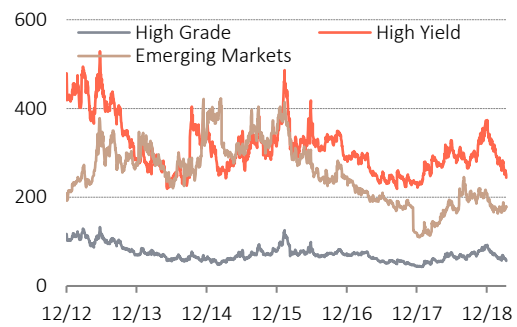


Fig 11: Money market spreads (3M-2Y)

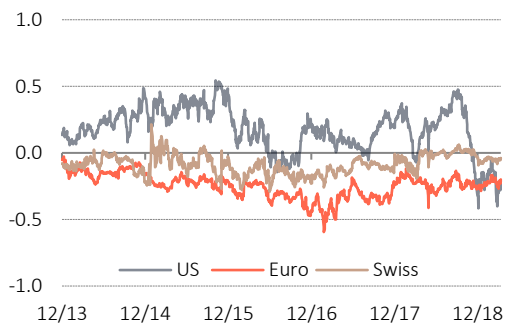
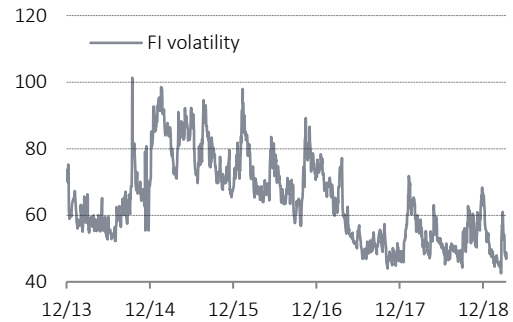


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

In March the equity market rally slowed down. Nevertheless, most major equity markets performed positively, with the notable exceptions of the UK FTSE 250, which fell 0.3% and the Japanese Nikkei 225 index, which fell 0.8%. The S&P500 index slightly outperformed the MSCI Europe with 1.8% vs 1.6%. US

tech stocks showed a sharp recovery in the first quarter and gained more than 20%. Chinese stimulus measures and improving economic data pushed the CSI 300 up by 5.5% in March, which brings the Q1 performance to 28.6%. The broad emerging markets index was up by 0.7%.

Fig. 13: MSCI equity indices – major regions

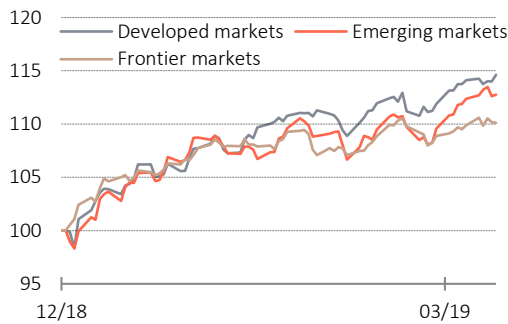


Fig.14: Equity indices – major developed markets

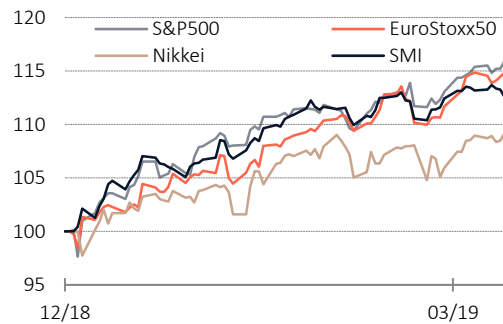


Fig 15: Equity indices – major emerging markets

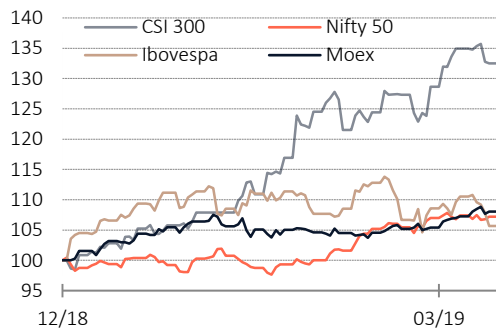


Fig. 16: Sector performance, MSCI Europe, 2018

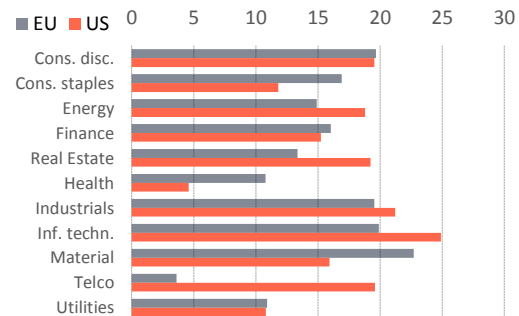


Fig 17: Price-earnings ratios

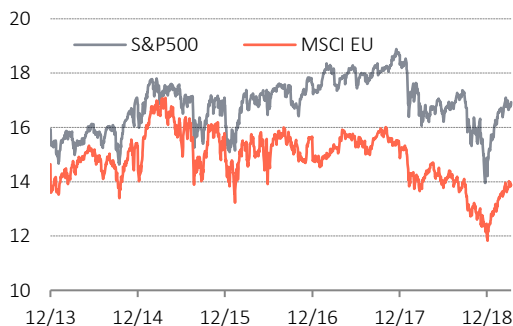
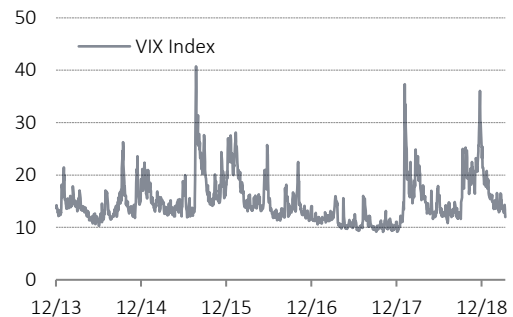


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

Gold is hovering around 1,300 USD/oz. Oil and other energy commodities performed well in March, although the price movement slowed somewhat. REITS continued to rally. The global REITS index gained 4.5%

in March. Hedge funds have performed reasonably well recently, while market-neutral managers still seem to have problems with the current market environment.

Fig. 19: Gold price, USD/oz

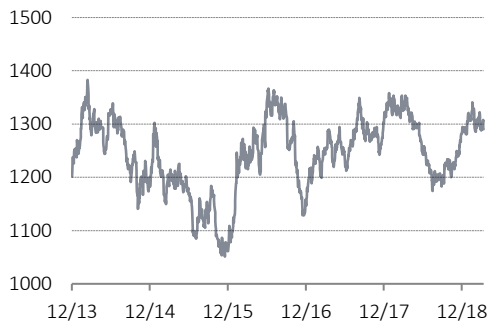


Fig.20: Brent oil price, USD/bl



Fig 21: Bloomberg commodity indices

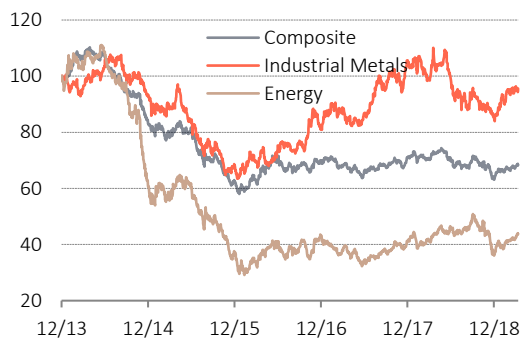


Fig. 22: HFRU hedge fund indices

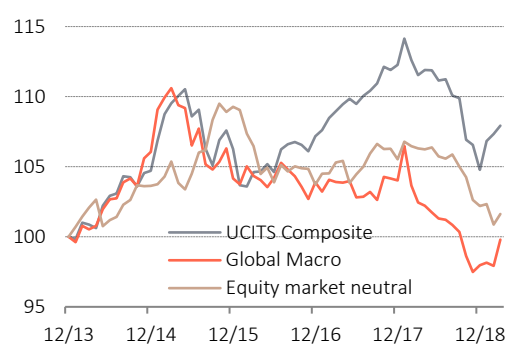


Fig 23: FTSE EPRA/NAREIT global REITS index



Fig 24: LPX global listed private equity



CURRENCIES

Despite falling US yields the USD remained on the strong side. In March the USD gained 1.3% against the EUR, 1.7% against the GBP, but fell 0.5% against the

JPY. The GBP traded sideways relative to the EUR, after it had advanced about 5% during January and February, despite Brexit uncertainties.

Fig. 25: EUR-USD exchange rate

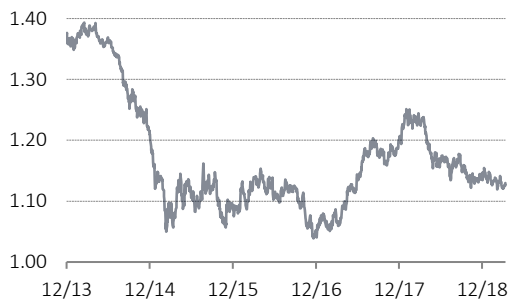


Fig. 26: GBP-USD exchange rate



Fig. 27: USD-JPY exchange rate



Fig. 28: USD-CNY exchange rate



Fig. 29: EUR-CHF exchange rate

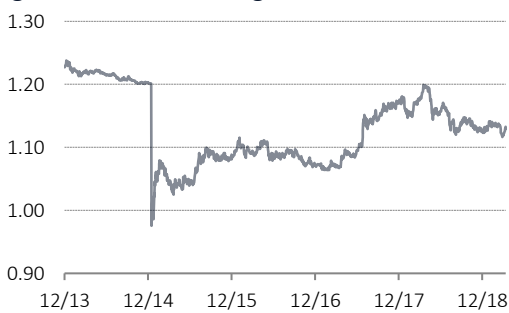


Fig. 30: USD-CHF exchange rate

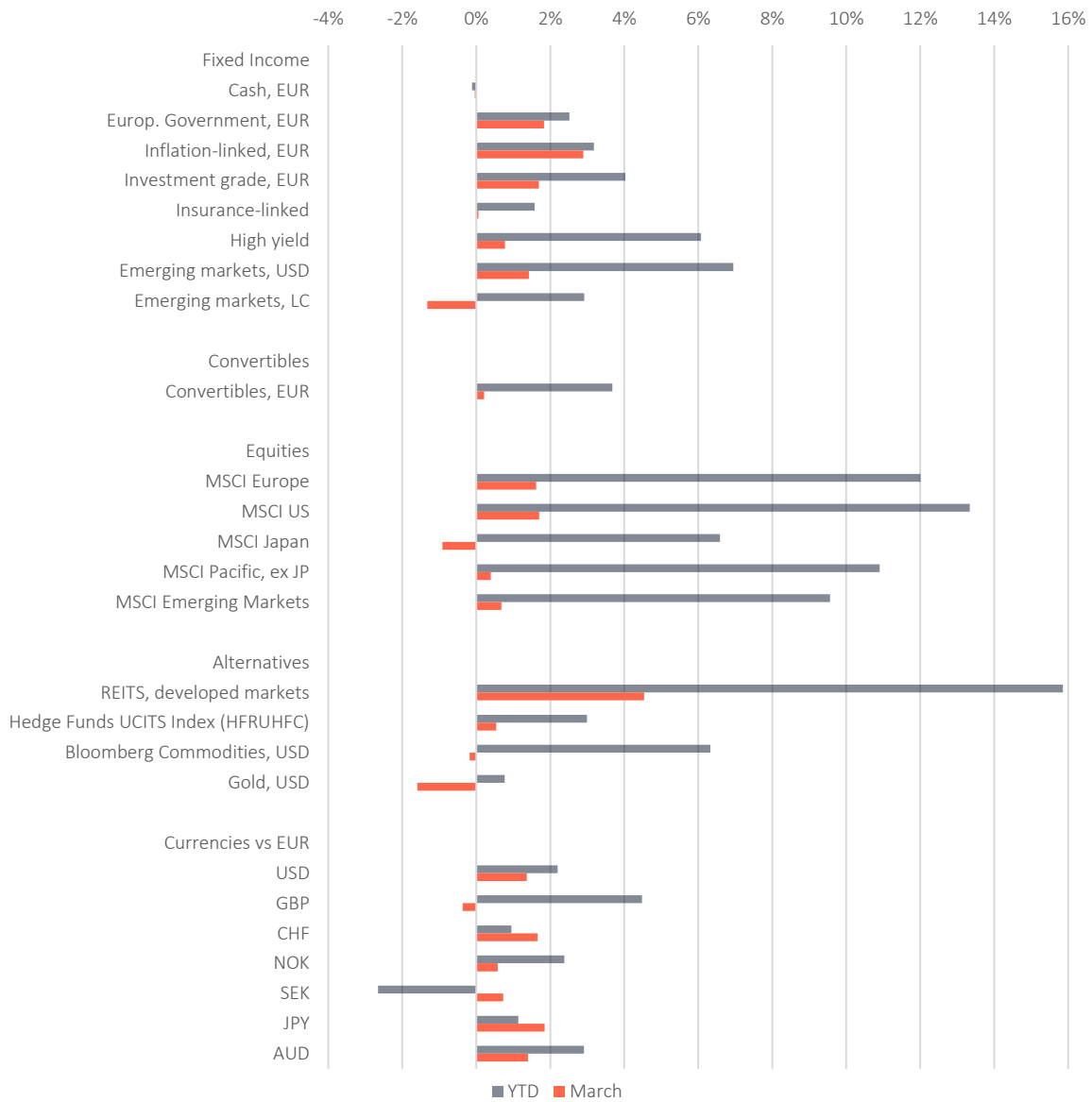


ASSET ALLOCATION

It is very remarkable that during Q1 all asset classes with the exception of cash performed positively. This was made possible by better investor sentiment, supported by very dovish central banks, which allowed yields to fall and risky assets to rally

at the same time. REITS gained almost 16%, followed by US and European stocks. The EUR lost value against most major currencies, which helped EUR-denominated portfolios additionally.

Fig. 31: Performance of major asset classes, based on our EUR portfolio strategy



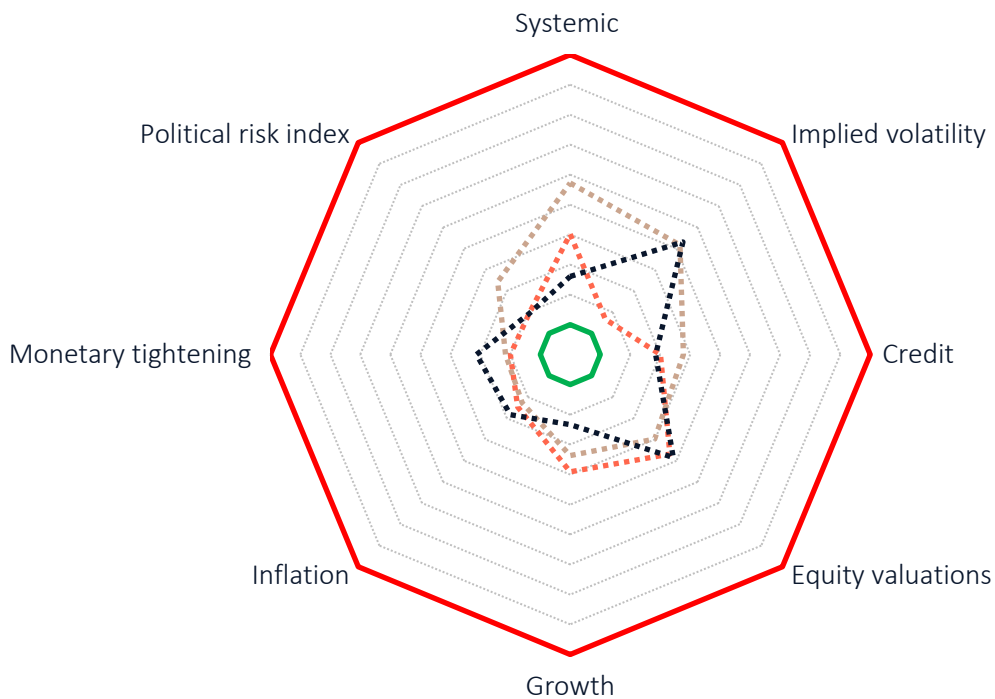
RISK MONITOR

It is remarkable how the risk landscape has changed since 24 December last year, when markets troughed. Only growth risks and equity valuation risks have risen since then. Most other risk indicators have fallen. Credit spreads have tightened,

systemic (financial sector) risks, and implied volatilities have clearly dropped.

Fig. 32: IMT Risk Monitor

24 Dec 2018: Growth and monetary tightening fears
09 Feb 2018: Inflation fear and technical correction



9-Apr-19 24-Dec-18 9-Feb-18 Max risk score: 10 Low risk score: 1

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