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INVESTMENT OUTLOOK 05.2019

10 May 2019

The equity market rally continued in April and some equity indices, like the S&P500 and the Swiss SMI, reached new highs. The rally was fueled by decent US growth indicators, continued credit expansion in China, and the Sino-US trade talks, which seemed to be proceeding positively.

It was only recently, on 5 May, that markets were shaken by President Trump's surprise announcement that he would raise tariffs on USD 200 bn of Chinese imports, claiming that China was failing to honor previous commitments. This triggered a market correction, which was very severe for Chinese equity but much less pronounced for developed equity markets.

Macro indicators were mixed. While we saw further confirmation that Chinese credit expansion is continuing, many PMIs remained soft in April.

We did not change our tactical positioning and remain underweight on duration and credit, as well as neutral on equities. Our equity hedge had a negative performance impact in April but cushioned the equity sell-off in early May.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

TRADE WAR ESCALATION?

Financial markets

The equity market rally continued in April and some equity indices, like the S&P500 and the Swiss SMI, reached new highs. The German Dax outperformed and rose by 7.1%, followed by the US S&P500, rising 3.9% and the MSCI Europe, climbing 3.2%. Emerging markets underperformed; the MSCI Emerging Markets rose by just 2%. The rally was fueled by decent US growth, continued credit expansion in China, and Sino-US trade talks, which seemed to be proceeding positively. In early May, however, after President Trump announced his intention to impose tariffs on Chinese goods, the CSI 300 fell sharply, and most other equity markets corrected as well, albeit by much less.

The bond-market rally in March reversed in April. Bond yields rose by about 10 basis points in the US and in Europe. This move was mostly driven by rising inflation expectations. As a result, yield curves steepened.

High-yield spreads tightened in April, which pushed the high-yield performance index up by 0.7%. Emerging-market bonds had a more difficult month. Hard-currency bonds rose 0.25%, whereas local-currency bonds fell slightly, by 0.18%.

After the US announced on 22 April that it was not extending its six-months waivers, which allowed eight countries to import oil from Iran until early May, prices for Brent oil surged further to reach almost USD 75 per barrel. However, better US inventories and growth concerns led to falling oil prices thereafter.

The gold price fell slightly, by 0.7%. REITS gave back some of their previous gains in April. Listed private equity continued its remarkable rally, and rose by almost 23% year-to-date.

Most currency majors remained unchanged in April. The CHF, however, weakened vis-à-vis the EUR and gave back most of its March gains. The TRY came under strong selling pressure after political tensions rose when president Erdogan nullified the result of the mayoral election in Istanbul, which the opposition had won.

Macro economics

In April global PMIs remained on the weak side. The US ISM index fell to 52.8 after 55.3, the EMU PMI rose slightly to 47.9 after 47.5, and the Chinese PMI fell to 50.2 after 50.8. Meanwhile US GDP growth remained robust and rose 3.2% QoQ annualized. US non-farm payrolls rose by 263,000 in April, which clearly exceeded expectations. Meanwhile, average hourly earnings rose by 3.2%.

US Inflation rose to 2.0% from 1.9%, but was below expectations. Strong US productivity gains can partly explain the continued softness of inflation. EMU inflation rose to 1.7% after 1.4%, the March reading probably having been depressed by an Easter effect.

Central banks

At its 30 April to 1 May policy meeting, the Fed kept rates unchanged. The Fed said it will be patient in determining the next future adjustment of the target range for the federal funds rate. Fed chairman Jerome Powell said that he considers the policy stance appropriate, as solid fundamentals support the economy. Earlier Jay Powell pointed out that he sees the current softness of inflation as rather transitory. Those comments support our view that a Fed rate-cut appears to be very unlikely unless the US economy should start stuttering unexpectedly. Before the policy meeting the Fed came under renewed pressure from President Trump, who openly asked the body to cut rates.

At its policy meeting on 10 April, the ECB reiterated its accommodative policy stance, including the introduction of a new series of targeted longer-term financing operations (LTRO-III). Meanwhile, inflation expectations, as measured by the five-year, five-year inflation swap rate, fell to a three-year low at 1.35%. This is an important measure for long-term inflation expectations and could encourage the ECB to stay accommodative for longer. The next ECB meeting is on 6 June, when the ECB will update its macroeconomic projections. This meeting may turn out to be very decisive for the future path of monetary policy in Europe.

Outlook

The major risk for global growth and financial markets is an escalation of the Sino-US trade dispute. After President Trump announced his intention to raise tariffs on 5 May and when trade talks on Friday, 10 May, failed to produce a result, the US raised tariffs on virtually all Chinese imports to 25%. China announced retaliation measures. So far it is not clear what those measures will look like. Nevertheless, it seems that both parties expressed their willingness to continue the trade talks. It looks as if both sides should have strong incentives to solve the trade dispute. Nevertheless, there is considerable risk that negotiations could end without resolution and that the trade war will escalate, with negative consequences for world trade, growth and financial markets. Overall, we still see a higher chance of a positive outcome, since it is in the vital interests of both sides to avoid a full-blown trade war.

In addition to the trade dispute other geopolitical risks loom. The US could decide to intervene in one way or another in Venezuela. The conflict with North Korea is still boiling. Furthermore, tensions between the US and Iran have risen recently, after President Trump ended the waivers allowing eight countries to import Iranian oil. Iran announced it would no longer feel bound by the deal which limits Iran's nuclear program in return for economic relief. The US has sent an aircraft carrier strike group to the Persian Gulf.

The recent market reaction, a merely moderate sell-off of developed equity markets, seems to suggest that markets assign a higher probability to successful trade talks.

On the back of the above-mentioned political uncertainties, we remain cautiously positioned. The equity hedge gives us additional downside protection. We have not recently changed our tactical asset allocation.

ECONOMICS

Macro indicators were mixed in April. Most major PMIs softened in the month. Meanwhile there was additional evidence that credit expansion in China is continuing. Non-farm payrolls surprised on the upside, with 263,000 jobs created in April. Average hourly earnings rose by 3.2% YoY, unchanged from the previous month.

Fig. 1: PMIs

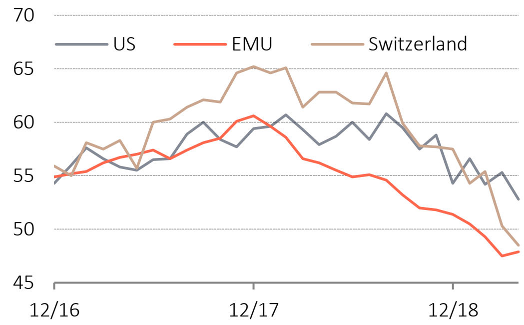


Fig. 2: PMIs

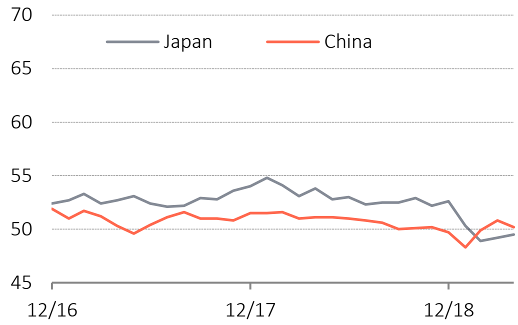


Fig 3: Consumer price inflation, in % YoY

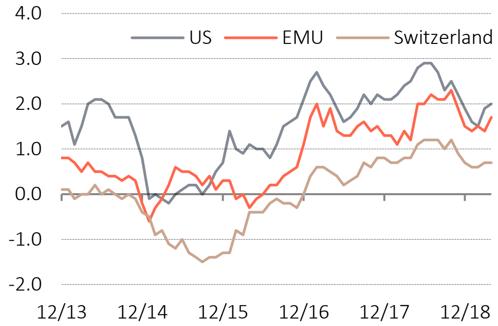


Fig. 4: Consumer price inflation, in % YoY

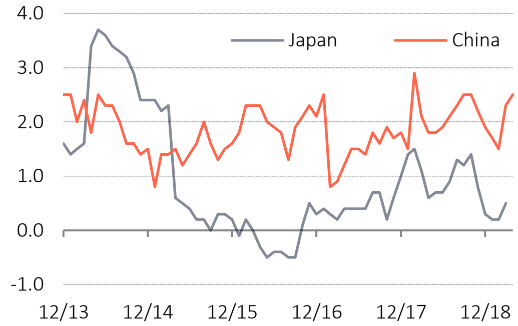


Fig 5: Unemployment rates, in %

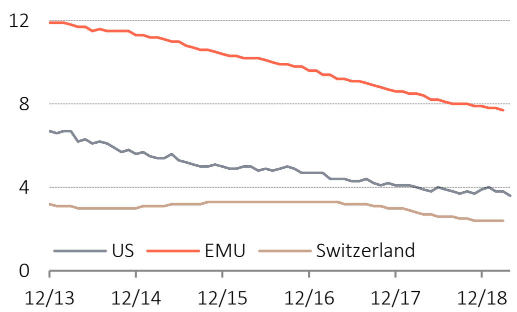
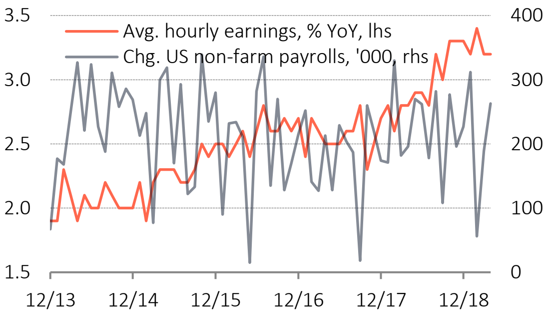


Fig 6: US labor market



FIXED INCOME

The bond-market rally in March reversed in April. Bond yields rose by about 10 basis points in the US and in Europe. This move was mostly driven by rising inflation expectations. As a result, yield curves steepened somewhat. High-yield bonds continued to rally, while emerging-market bonds remained almost flat.

Fig.7: 2Y government bond yields

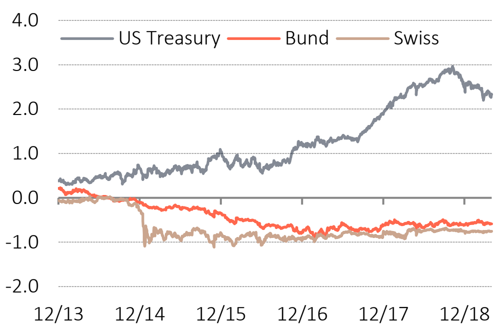


Fig. 8: 10Y government bond yields

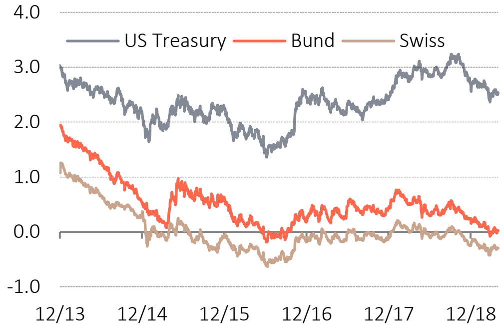


Fig 9: 10Y break-even inflation

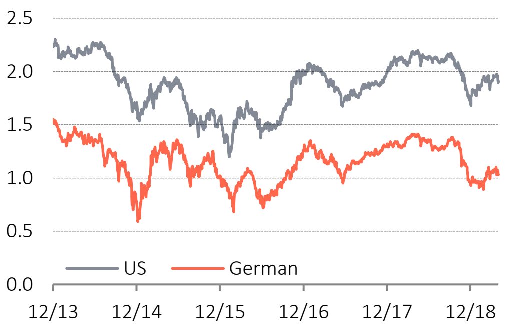


Fig. 10: Credit spreads, 5Y credit default swaps

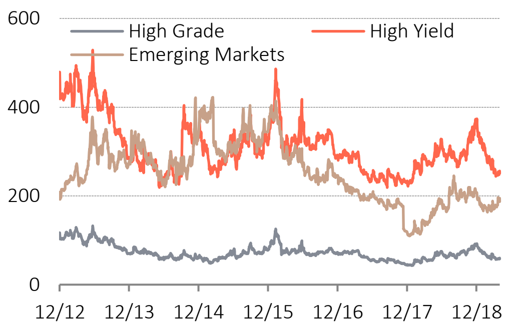


Fig 11: Money market spreads (3M-2Y)

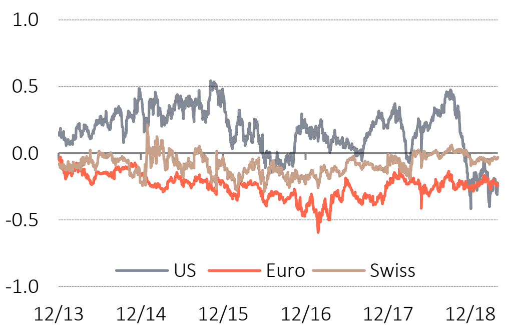
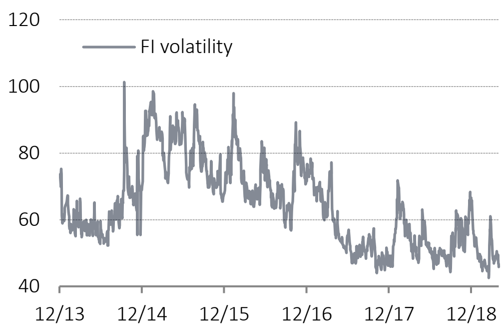


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

In April equity markets continued their rally. The German Dax outperformed and rose by 7.1%, followed by the US S&P500, rising 3.9% and the MSCI Europe, climbing 3.2%. Emerging markets underperformed, the MSCI Emerging Markets rose by just 2%. In early May, after President Trump announced his intention to impose tariffs on Chinese goods, the CSI 300 fell sharply.

Fig. 13: MSCI equity indices – major regions

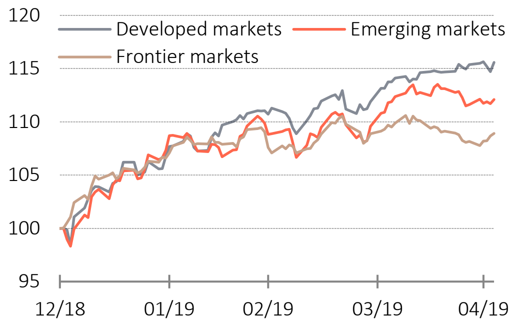


Fig.14: Equity indices – major developed markets

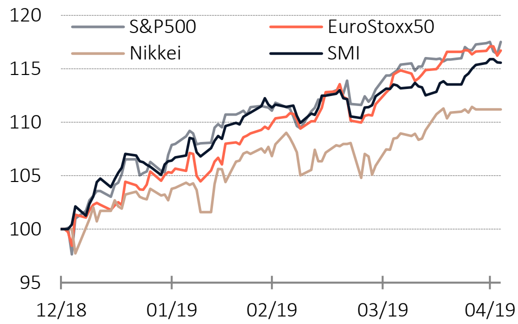


Fig 15: Equity indices – major emerging markets

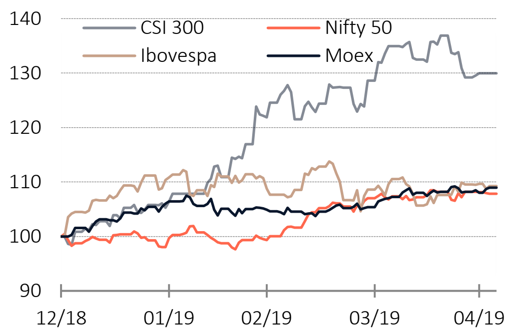


Fig. 16: Sector performance, MSCI Europe, 2018

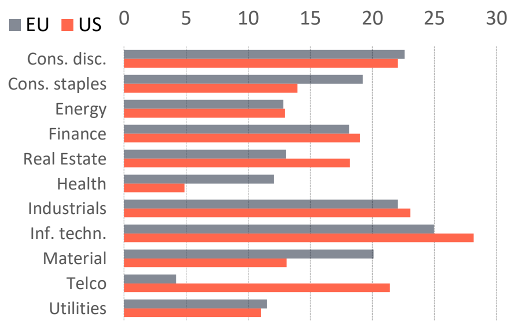


Fig 17: Price-earnings ratios

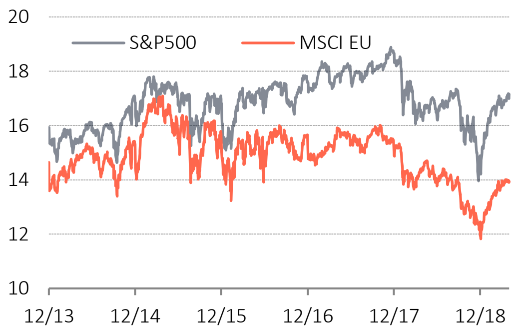
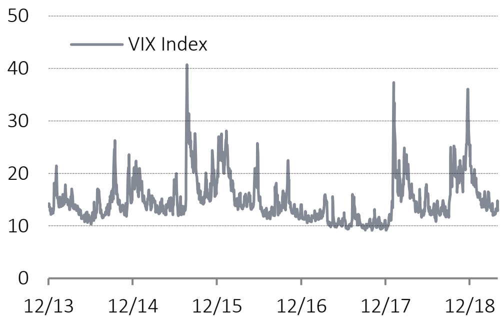


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

In April, the price for Brent oil rose by 6.4%, mostly driven by President Trump's abandoning of the waivers for buyers of Iranian oil. The gold price fell slightly, by 0.7%. REITS gave back some of their previous gains in April. Listed private equity continued its remarkable rally, up by almost 23% year-to-date.

Fig. 19: Gold price, USD/oz

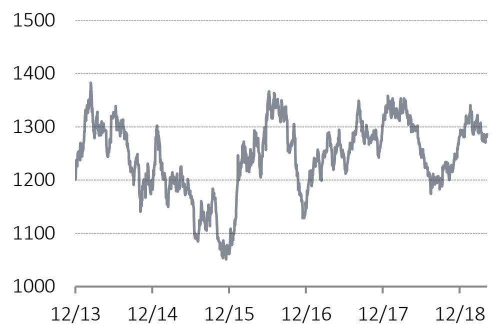


Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

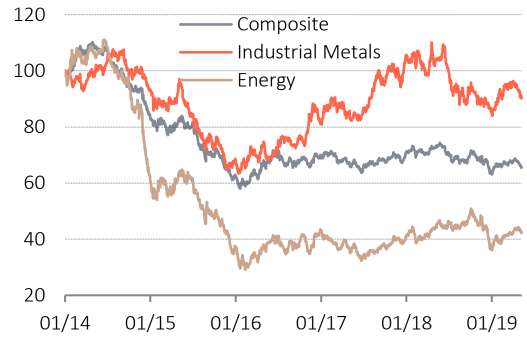


Fig. 22: HFRU hedge fund indices

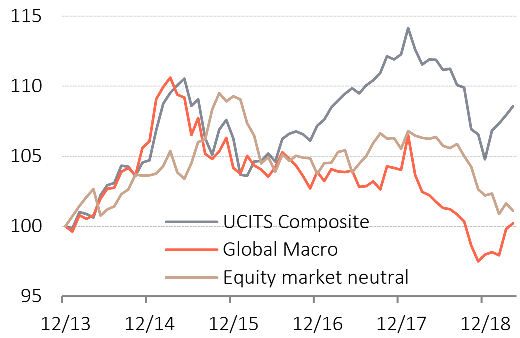


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: LPX global listed private equity

CURRENCIES

In April there was little movement among major currencies. The CHF clearly weakened though. The TRY fell by 7% against the USD, on the back of fresh political uncertainties in Turkey, which announced a re-run of the mayoral election in Istanbul in June. The Turkish central banks reacted to the weakness of the TRY with higher money-market rates.

Fig. 25: EUR-USD exchange rate

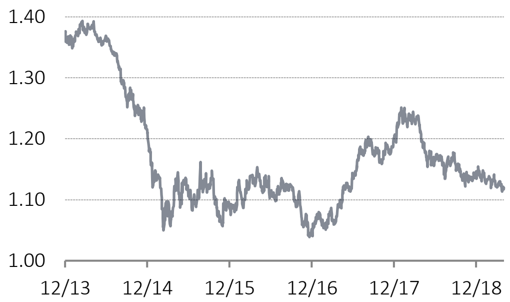


Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

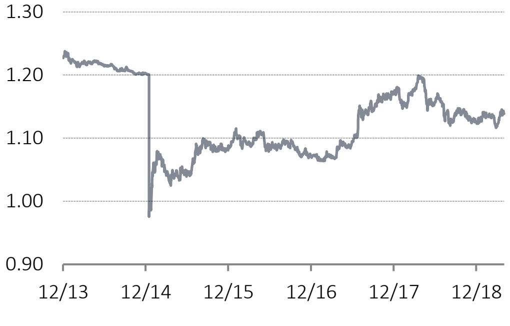
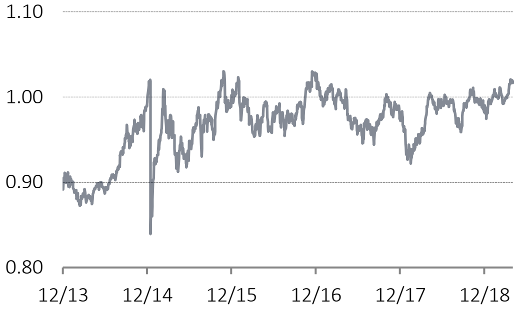


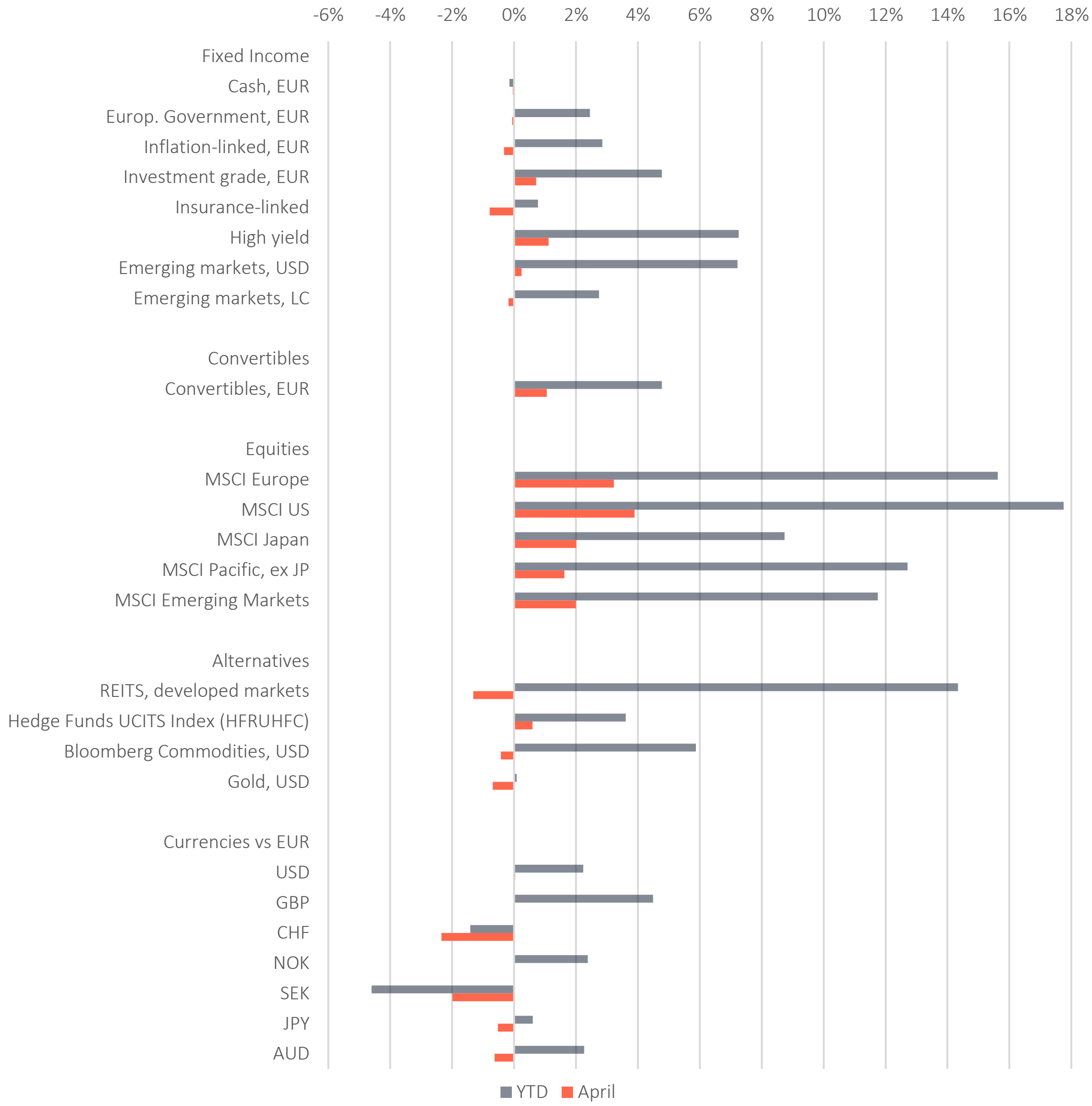
Fig 30: USD-CHF exchange rate



ASSET ALLOCATION

April was another strong month, with positive returns in most asset classes. Risky assets, especially equities, outperformed by a wide margin. Insurance linkers, REITS, gold, and the broad commodity index retreated somewhat. Year-to-date most major currencies appreciated vis-à-vis the EUR, with the exception of the CHF and the SEK.

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

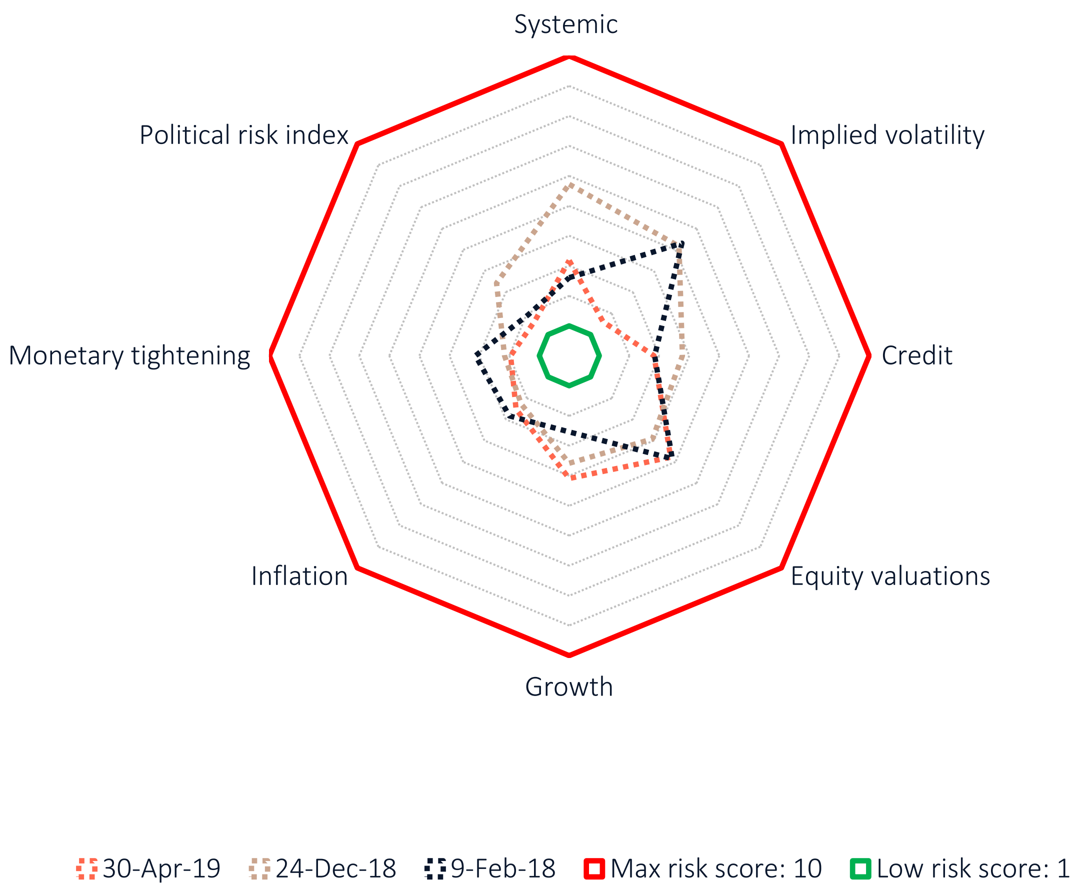


RISK MONITOR

The risk landscape remained very benign. Systemic risks declined in recent months and implied volatility fell to very low levels historically. As central banks became very dovish, monetary tightening risks clearly fell. However, falling growth indicators pushed growth risks up and the recent equity market rally elevated equity valuation risks.

Fig. 32: IMT Risk Monitor

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



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