

INVESTMENT OUTLOOK 10.2019

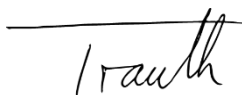
12 October 2019

In August, equity markets corrected on the back of renewed trade tensions and disappointing growth data. In September, markets then rebounded, with hope for a partial trade deal between the US and China driving the recovery. When that partial trade deal was announced on 10 October, markets for risky assets jumped significantly.

Meanwhile, economic data continued to disappoint. European growth had been stalled for many months, and the US manufacturing sector, which had thus far remained robust, started to contract.

Both the US Fed and the ECB decided to cut rates in September. Furthermore, the ECB started a new asset purchase program, and in early October the US Fed announced its intention to start buying US short-term Treasury bonds to ease a cash crunch in the interbank market.

Overall, we continue to see high geopolitical and economic uncertainties and remain cautiously positioned. We closed our energy overweight when energy prices spiked after the attack on Saudi Arabian oil facilities.

A handwritten signature in black ink, appearing to read 'Trauth', with a horizontal line above it.

Thomas Trauth

CEO – IMT Asset Management AG



GLOBAL MANUFACTURING SLUMP

Financial markets

In September equity markets recovered from August's losses. Developed markets equities rose 1.9%, emerging markets 1.7%. The Nikkei 225 index outperformed, rising 5.1%, followed by the DAX index, up by 4.1%, and the S&P500, up by 1.7%. Among emerging markets China clearly underperformed, with the CSI 300 rising merely 0.4%, while the Brazilian Bovespa index rose 3.6% and the Indian Nifty 4.1%.

Bond yields remained at ultra-low levels, despite climbing by about 10-15 basis points, in September. Also, break-even inflation rates, a measure for inflation expectations, remained very low. US inflation is expected to stay at 1.5% on average for the next 10 years, and European inflation at below 1%. Credit spreads continued to tighten in September, but widened somewhat during the last week of the month.

After gold rallied strongly, reaching USD/oz 1,550 in early September, the price of gold then decreased and stabilized around USD/oz 1,500. Oil prices rose by 20% after the drone-attack on Saudi crude facilities, but fell back to pre-attack levels thereafter. REITS continued to perform strongly, both in August and September, making it the best performing asset class of our portfolios.

The EUR weakened, owing to further easing by the ECB and falling export demand. Three-month implied volatility of the EUR stands at 5.5% and thus at the lower end of the spectrum, suggesting that the market is not expecting sharp EUR movements either upwards or downwards. Despite recent political ups and downs the GBP remained relatively stable. Nevertheless, three-month implied volatility stands at above

12%, suggesting that the market is factoring in the possibility of sharp GBP movements.

Macroeconomics

The global manufacturing slump intensified in September. The US ISM fell as low as 47.8 after 49.1 in August and the European Markit manufacturing PMI even dropped to 45.7 after 47.0 in August. Meanwhile we saw a clear improvement of the Chinese PMI, which rose to 51.4 after 50.4 in August. US non-farm payrolls increased by 136,000 in September, slightly below expectations. The US unemployment rate fell to 3.5%, the lowest figure since 1969. Wage growth slowed in September to 2.9%, which suggests that the US labor market has recently cooled off.

President Trump is only the fourth president of the US to face an impeachment inquiry in the House of Representatives. During a phone call, President Trump pressured the Ukrainian president to investigate the son of former vice-president and 2020 democratic presidential candidate Joe Biden over his role on the board of a Ukrainian oil company.

After markets had become more optimistic about at least a partial trade deal between US and China, senior Chinese officials resumed negotiations with US counterparties on 10 October. This marked a new milestone after discussions had been on standstill for a couple of months. On 11 October the long-awaited partial trade deal was announced. President Donald Trump said that this was "... a substantial phase one ..." agreement. As a result, risky assets rallied strongly, while safe-haven assets and especially bonds sold-off.

However, the substance of this agreement looks very meager. Basically, the US agreed to hold off on further tariff increases in return for some Chinese concessions, especially regarding food imports. At the same time, the US did not agree on any tariff cuts nor did the Chinese give in on more substantial issues. Furthermore, there are a number of topics, which are likely to remain the subject of fierce debate, among others the US's attempt to crack down on Chinese contraband goods, the currency regime, Chinese industrial subsidies and treatment of intellectual property rights, and the debate about Chinese technology companies like Huawei.

Central banks

On 12 September the ECB published its long-awaited policy meeting decisions. As widely expected, the ECB cut the deposit rate further, to minus 0.5% from minus 0.4%, and announced that it was going to restart its quantitative easing (QE) program. The ECB will buy EUR 20 bn of bonds each month, starting in November and until inflation expectations return close to 2%. Then interest rates could also start rising, the ECB said. ECB's chairman, Mario Draghi, who will leave office at the end of October and will be replaced by Christine Lagarde, urged European governments to loosen fiscal policy to add additional stimulus to the European economies.

Within the ECB the decision on further monetary easing was controversial. The German camp especially feels increasingly uncomfortable with the ultra-loose monetary policy. Sabine Lautenschläger, a German member of the ECB's executive board, resigned end of September over reservations about the latest policy decisions.

On 19 September the US Fed cut rates by 25 basis points to a range of 1.75% to 2.0%. This was the second rate cut this year. As last time, markets took the Fed rhetoric to be rather hawkish, since the Fed signaled that interest rates may stay at the current level

for a longer period. In contrast to what future markets imply, i.e., two more rate cuts up to the end of 2020, the Fed's so-called dot-plot projection shows that the FOMC members expect rates to remain unchanged until the end of 2020.

In early October the US Fed announced that it would buy US short-term Treasury bonds to ease a cash crunch in the interbank market, which had boosted overnight lending rates. On 11 October, when the Fed announced the details of the program, many observers were highly surprised by the sheer volume of the buying program. The US Fed will buy USD 60 bn of (short-term) Treasury bills each month for at least six months. The Fed is making an effort to differentiate this program from former QE programs. The intention is to ease cash scarcity in the money market. Furthermore, the Fed is buying short-term instead of long-dated bonds. But clearly it will boost the Fed's balance sheet and increase the supply of liquidity in the banking sector.

On 19 September the Bank of England (BoE) announced the unanimous decision of the Monetary Policy Committee to hold rates constant at 0.75%. At the same time, the statement was rather dovish, citing high uncertainties regarding Brexit and the outlook for the global economy. Even in the case of a no-deal Brexit, this could warrant a rate cut. The BoE expressed itself even more precisely when, on 27 September, Michael Saunders, a member of the rate-setting Monetary Policy Committee, said in a speech that it was quite likely that the next interest rate move would be down rather than up, since the UK economy had weakened markedly in recent quarters.

The Swiss National Bank (SNB) held its policy meeting on 19 September. It decided to hold rates steady at minus 0.75%. The SNB lowered its inflation and growth forecast, due to headwinds from weakening global growth and a strong Swiss franc.

Outlook

The outlook for financial markets is clouded by very high economic and geopolitical uncertainties. The global manufacturing slump has also hit the US. Political uncertainties regarding a variety of domestic issues coupled with the impact of trade disputes have finally dragged down the US manufacturing sector. It remains to be seen whether the leading indicators manage to bottom-out sometime soon. So far, the US consumer and the US services sector, which are far more important than the manufacturing sector, have remained very resilient. US real GDP is on track for a growth of 1.8%, which would match US trend growth. Also, consumer spending is healthily growing at about 2.5%. While the US business cycle needs careful monitoring, we see a good chance that the US economy will remain robust and will re-accelerate in 2020.

When looking at global manufacturing the automobile sector stands out. Global automobile demand fell by more than 5% in the first half of 2019, by far the biggest drop since 2008 and 2009. Automobile production fell even more drastically. There are various reasons for this: more stringent emission rules, expiring tax breaks, tighter loan standards, and the trade war. Nevertheless, auto production may bottom-out

soon. There are indications that auto loans standards have normalized and inventories are declining.

Overall, for financial markets to stay strong in a sustainable way, we would need global growth to trough and an enduring solution of the trade dispute. In our view, there are early signs that both could happen.

Furthermore, monetary conditions have eased substantially in recent quarters, and there is no sign of monetary tightening in the foreseeable future.

China's stimulus measures have been half-hearted so far, on the back of the Chinese leadership's attempt to reduce financial leverage. Recent Chinese PMI data, however, look promising. China has reduced bank reserve requirements recently and is expected to add additional stimulus measures soon.

Major risks to a benign scenario are the US-China trade dispute and the Iran-Saudi conflict, which could further escalate.

We remain positioned cautiously with few tactical tilts against our strategic asset allocation. We have reduced duration, credit and equity risks, the latter via a put strategy.

ECONOMICS

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non-farm payrolls increased by 136,000 in September, slightly below expectations. The US unemployment rate fell to 3.5%, the lowest level since 1969. Wage growth slowed in September to 2.9%. This suggests that the US labor market has cooled off.

Fig. 1: PMIs

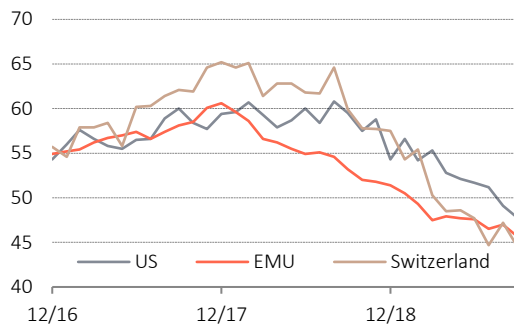


Fig. 2: PMIs

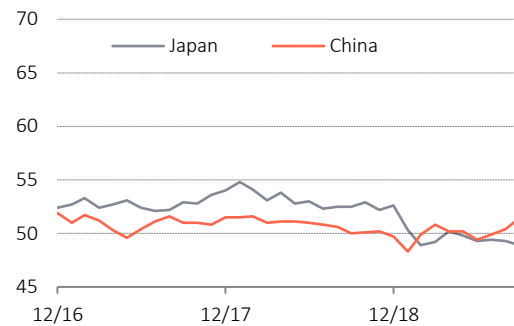


Fig 3: Consumer price inflation, in % YoY

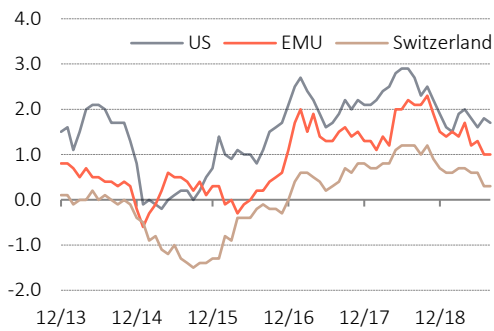


Fig. 4: Consumer price inflation, in % YoY

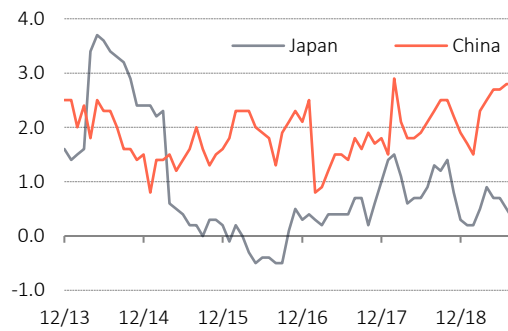


Fig 5: Unemployment rates, in %

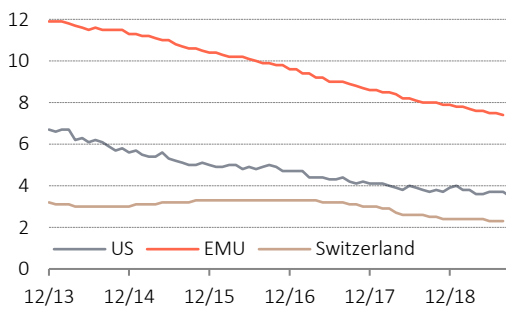
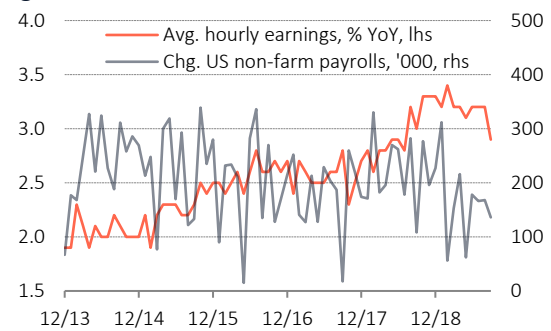


Fig 6: US labor market



FIXED INCOME

Bond yields remained at ultra-low levels, despite yields climbing by about 10-15 basis points in September. Also, break-even inflation rates, a measure for inflation expectations, remained very low. US inflation is expected to stay at 1.5% on average for the

next 10 years, and European inflation at below 1%. Credit spreads continued to tighten in September, but widened somewhat during the last week of the month.

Fig.7: 2Y government bond yields

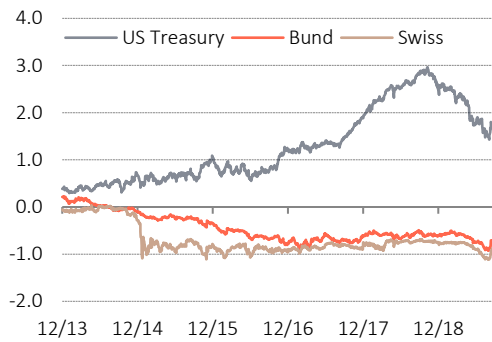


Fig. 8: 10Y government bond yields

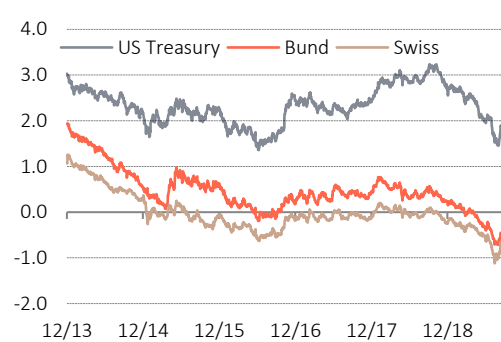


Fig 9: 10Y break-even inflation

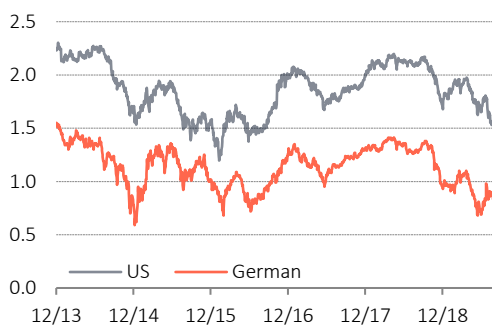


Fig. 10: Credit spreads, 5Y credit default swaps

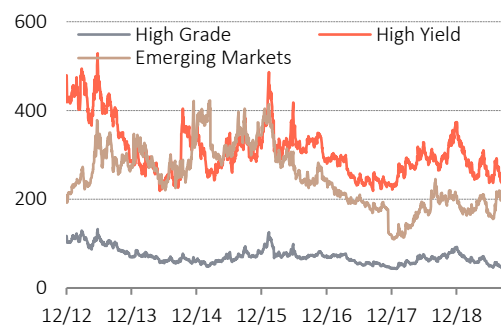


Fig 11: Money market spreads (3M-2Y)

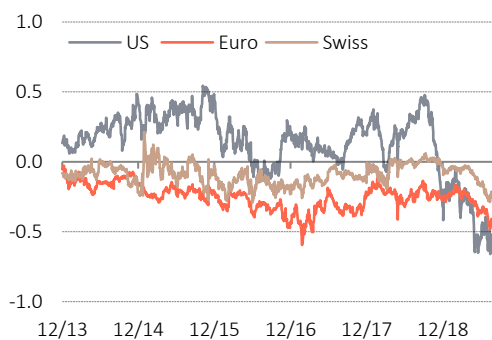
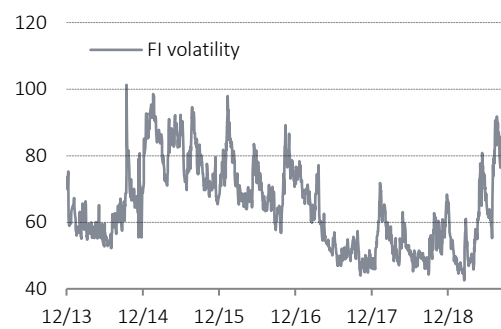


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

In September equity markets recovered from August's losses. Developed markets equities rose 1.9%, emerging markets 1.7%. The Nikkei 225 index outperformed, rising 5.1%, followed by the DAX index, up by

4.1%, and the S&P500, up by 1.7%. Among emerging markets, China clearly underperformed, with the CSI 300 rising merely 0.4%, while the Brazilian Bovespa index rose 3.6% and the Indian Nifty 4.1%.

Fig. 13: MSCI equity indices – major regions

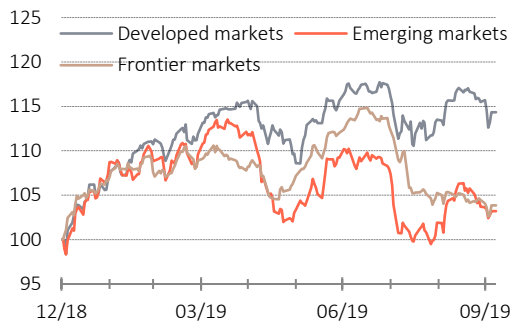


Fig.14: Equity indices – major developed markets

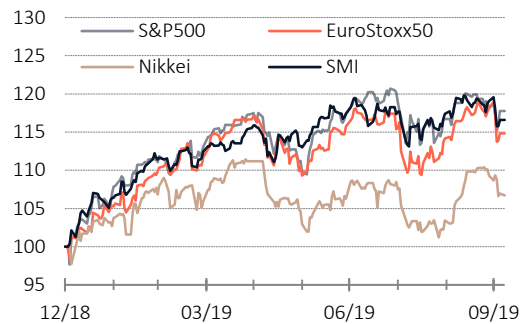


Fig 15: Equity indices – major emerging markets

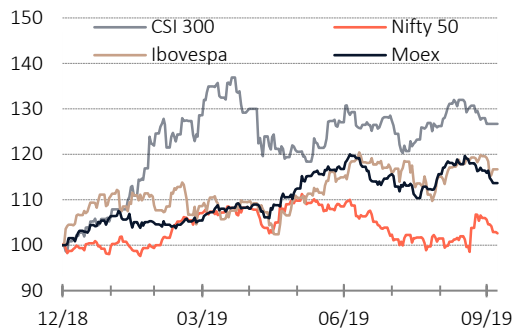


Fig. 16: Sector performance, MSCI Europe, 2018

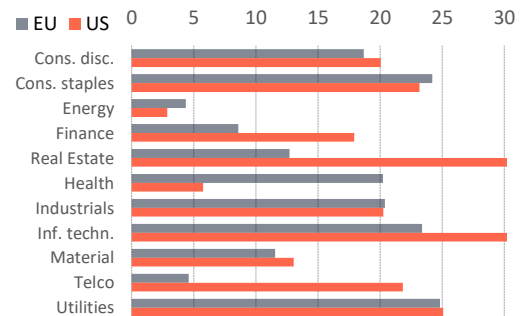


Fig 17: Price-earnings ratios

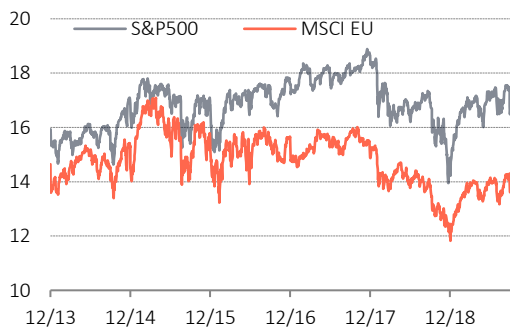
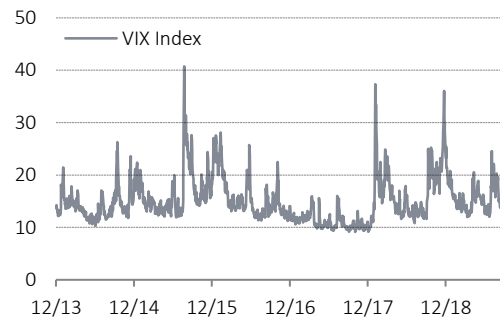


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

After gold rallied strongly reaching USD/oz 1,550 in early September, the gold price declined and stabilized around USD/oz 1,500. Oil prices rose by 20% after the drone-attack on Saudi crude facilities, but fell

back to pre-attack levels thereafter. REITS continued to perform strongly, both in August and September, making it the best performing asset class of our portfolios.

Fig. 19: Gold price, USD/oz



Fig.20: Brent oil price, USD/bl



Fig 21: Bloomberg commodity indices

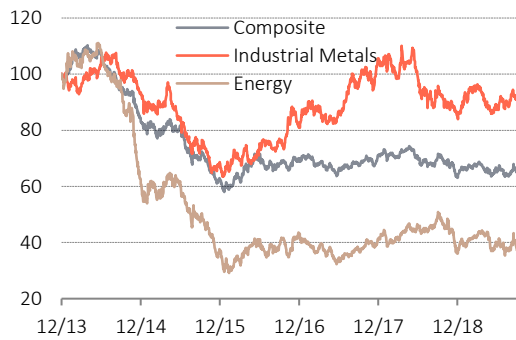


Fig. 22: HFRU hedge fund indices

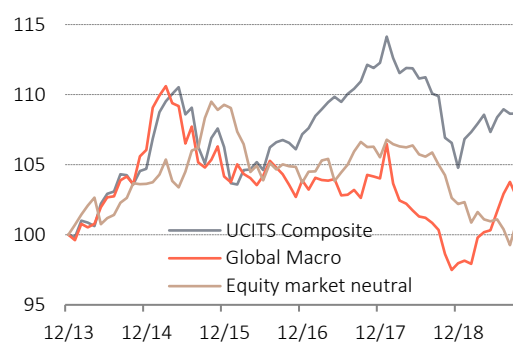
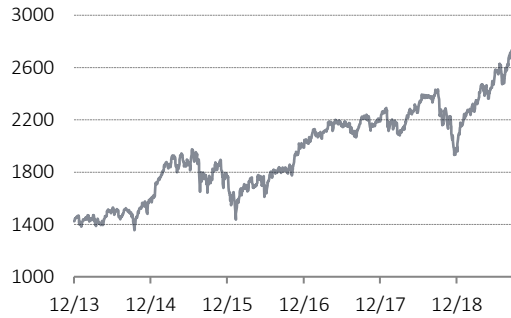


Fig 23: FTSE EPRA/NAREIT global REITS index



Fig 24: LPX global listed private equity



CURRENCIES

The EUR weakened, driven by further easing of the ECB and falling export demand. Three-month implied volatility of the EUR stands at 5.5% and, thus at the lower end of the spectrum, suggesting that the market is not expecting sharp EUR movements either upwards or downwards. Despite recent political ups and

downs the GBP remained relatively stable. Nevertheless, three-month implied volatility stands at above 12%, suggesting that the market is factoring in the possibility of sharp GBP movements.

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

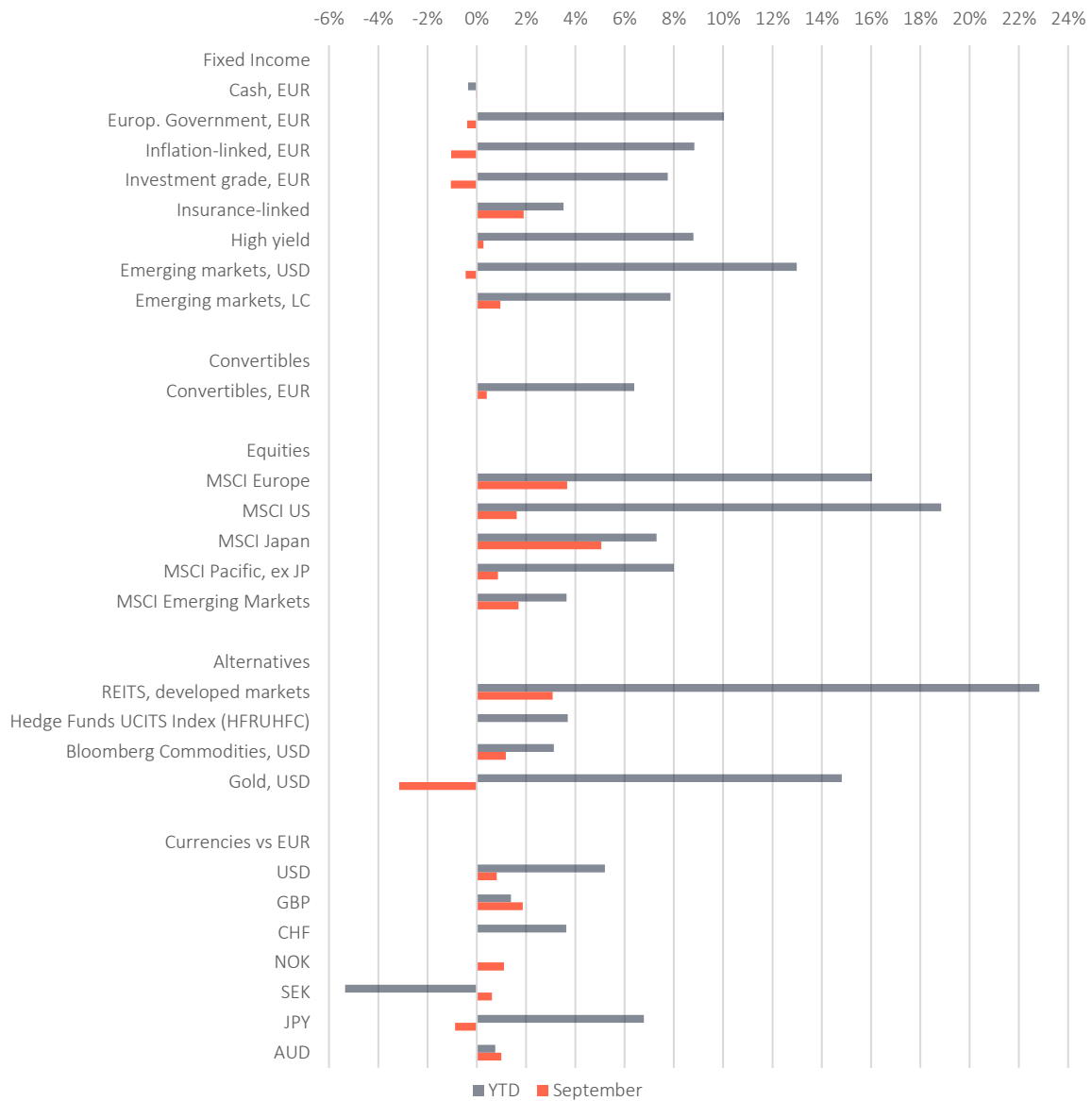


ASSET ALLOCATION

In September most asset classes performed well; risky assets especially had a good month. At the same time, safe-haven assets, like government and investment grade bonds as well as gold, retreated.

The best performers were Japanese equities, followed by European equities and REITS: REITS have been the best performing asset class this year, with a very strong increase of 22.8%. Most major currencies appreciated vis-à-vis the EUR this year.

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



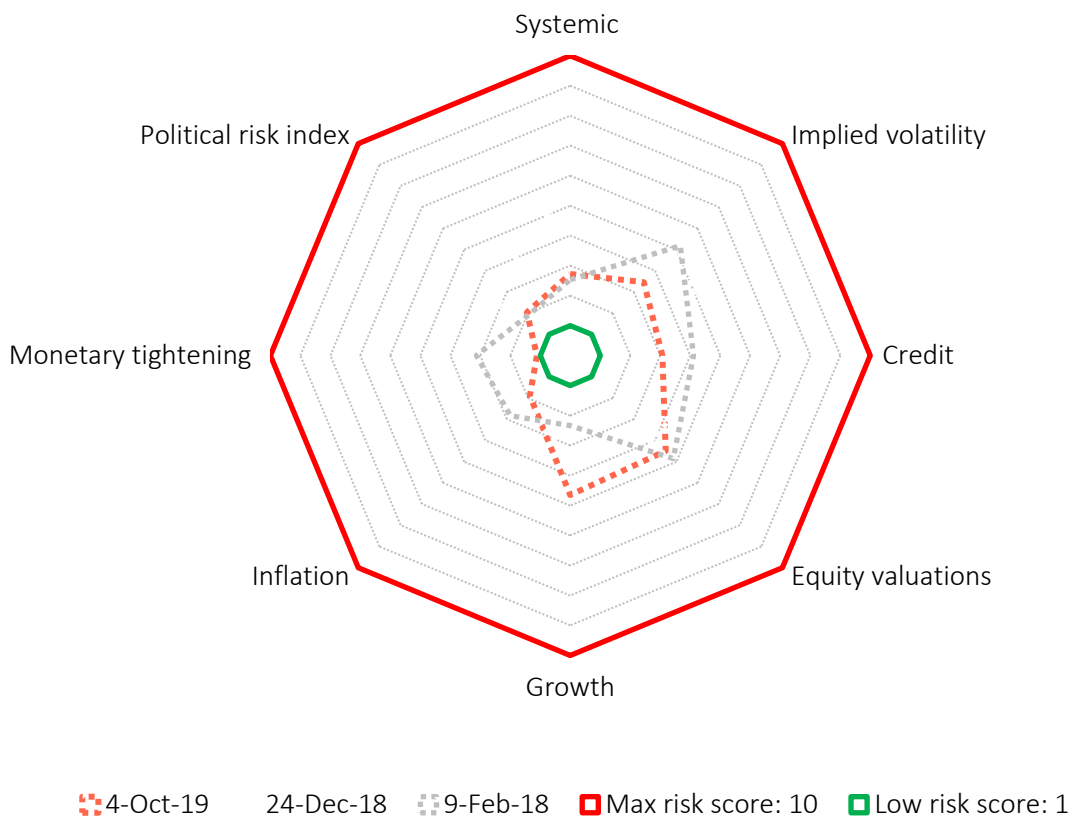
RISK MONITOR

Despite geopolitical uncertainties, especially in relation to the US-Sino relationship, and tensions surrounding Iran, our risk indicators remain relatively calm. There is no concern about monetary tightening for the near future; inflation remains in check

and credit spreads remain tight. Our market indicators show the biggest concerns are the growth outlook and relatively high equity valuations.

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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Source for all graphs: Bloomberg, IMT Asset Management AG.