

Amplia Monthly Investment Letter

2019 – the year of the pig

Of the twelve Chinese zodiac animals, pig is the last one. According to a myth, the Jade Emperor said the order and rank of the animals would be decided by the order in which they arrive at the Heavenly Gate (or his party). The pig was the last one because he overslept, or – as another myth puts it – because the wolf destroyed his house and he had to rebuild it first. Whichever narrative holds true, investors have so far been more agile than the swine in their quest for fortune: January has witnessed sizeable money flow into risky assets, and stock markets have recorded mid-single digit gains across the globe since the start of the year.

Sino-American trade talks dominate headlines

Of the political investor concerns of late 2018, Brexit and the US-China trade war are the only ones that remain unsolved, with the rest having practically been postponed or cleared. Whilst Brexit barely progresses, the trade talks are ongoing, and the pieces of information that drip out of them are promising. This progress has materialised in the prices of especially cyclical, exporting companies, many of whose share prices have gained more than 10%.

On the negative, global economic growth has begun to stall. To what extent this is due to the trade tariff uncertainty that discouraged companies from investing, and what derives from deleveraging especially in China, is debatable. At any rate, our fears from last year are slowly materialising: enough spat in the media is not good for the business environment.

In terms of economic fundamentals, monetary policy tightening by the leading central banks has taken a breather, with for instance the Fed signalling they would be more attentive to data (and market sentiment) going forward. It is still easy for companies to access credit in developed countries. China has embarked on a massive new stimulus, and Chinese money supply is increasing at a pace that is supportive for growth. Accordingly, monetary conditions have improved over the past month in a fashion that speaks for a risk-on sentiment. Similarly, the depth of the recent market slump made many stock markets less expensive, something that also speaks for being fully invested.

This being said, a significant cooling-off is evident in data from industry and private consumption. For instance, the US Empire State Manufacturing general business conditions survey has clearly deteriorated over the past two months, as has the Bavarian ZEW survey, measuring Eurozone general business conditions. There are numerous indicators that echo these, and both consumption and industry are deteriorating fast albeit from strong levels. Combined, fundamentals are still speaking for a cautious approach to risky assets.

With regards to market psychology, last week (ending 18th January) was the first time when the aggregate market risk sentiment started speaking for a sustainable market rally. Although the hedging demand is high and surprises drip in weak, corporate earnings remain good and the Q4 2018 earnings season has started off well. On top of that, the market rally of previous weeks was supported by broad-based buying and optimism. Accordingly, the risk sentiment is supportive for being invested in equities.

Our markets positioning

We increase our equity weighting from 25% to 50% of the investor-specific maximum level as a result of more balanced market valuations and risk sentiment. Simultaneously, we would expect to see further improvement in the economic backdrop before selling all our hedging positions.

In terms of sectors, we favour energy (especially oil & gas), consumer discretionary and healthcare. We underweight financials, consumer staples and industrials.

Asset allocation - February 2019	
Industry	↘
Consumption	↘
Monetary environment	↗
Market valuation	↗
Fundamentals total	↘
Hedging demand	↘
Economic surprises	↘
Market risk	↗
Market breadth	↗
Money flow into risky assets	↗
Risk sentiment total	↗

Equity exposure (of maximum): 50%

In fixed income, in USD space we keep our preference for long-term investment-grade corporate bonds. This has been a benign positioning since a while, given that long-term interest rates have fallen constantly, resulting in higher bond prices. As to the Euro, the picture remains as challenging as ever, and our favoured issues remain small Nordic issues with variable coupons and small issuance sizes.

Although overvalued compared to its fair value, the US dollar ought to stay strong amid Fed balance sheet reduction and likelihood of one to two further rate hikes this year. This contrasts with many other economies, especially the Eurozone. We doubt the ECB will be able to raise their policy rate above zero before the next recession comes, as the recently fallen business optimism, disinflation and ongoing issues with public finances of some southern member states effectively reduce the room for manoeuvre of the ECB. Therefore, we forecast EUR/USD to stay rangebound to 1.1250 – 1.1600 over the next 12 months.

EUR/SEK should fall towards 10 from the current 10.28 level as the Swedish economy sees its housing market rebalancing and the export industry gearing up if an agreement for (waiving of) the tariffs is reached with the US. As the Swedish inflation (KPIF) is stubbornly staying over the 2 per cent mark, Riksbank will have more arguments to proceed with another ¼ percent hike later this year.

In Zurich on 25th January 2019

Yours sincerely,
Juho Kivioja

