Amplia Monthly Investment Letter

Markets rallying full steam ahead

With US – China trade discussions progressing, the upwards movement on stock markets that started at Christmas, defying last year's downturn, has kept going for two months now. Investor optimism has been most prevalent in the US where S&P500 and NASDAQ indices have climbed by 11.5% and 13.9%, respectively, since beginning of January. The key questions everybody is asking themselves are: will the rally still go on? Is it too late to hop on? Has something changed for the better in companies' outlook? We try to elaborate on these questions and give our view on them below.

What if there is no trade war?

US foreign policy has taken so many unanticipated turns lately that we abstain from making projections on whether there will be a trade war or not. If we *assumed* that messieurs Trump and Xi were able to strike a "deal" and bring the conflict to an end, it could ease the pain the supply chains globally are feeling now. Similar concessions made towards the Europeans, whose car industry has been one of the most vocal parties affected, together with creation of a "NAFTA 2", could further restore confidence in global trade. Ultimately, such trade pacts could reverse the trend of falling leading indicators of corporate outlook and consumer confidence.

The above described positive scenario, if materialised, would be a necessary condition in our view to sustain the current stock market rally. If it will be enough, largely depends on the investment and hiring decisions companies worldwide will make in the next 12 months, and how consumers see their near future financial situation developing. What we know already is that the globalisation will not be same as it was before. Trump's ostensive success in obtaining amendments from its trade partners has shifted the public mood in the US in a more protectionist direction, with new demands for "protecting" American workers winning bipartisan support in the Congress.

Secondly, the trade patterns may have suffered irrevocable damage with manufacturers opting for local, safer but more expensive procurement. A similar example are the UK-based banks that have spent billions in shifting operations from the UK to Continental European countries with inferior financial infrastructure compared to the British one, just to secure their operational continuity in anticipation of a disorderly Brexit.

A failure of the trade talks, on the other hand, would bring the markets to a fall, since the rally so far has greatly relied on progress in the talks.

Our markets positioning

Until there is clarity on trade and factual evidence on the impact of new agreements on globalisation, we see no reason to increase our equity exposure from the current levels. For the time being, the signals from the real economy remain contradictory. In a recent research paper of 19th February, WTO published a World Trade Outlook Indicator (WTOI) that had slipped below the baseline value of 100, triggering the organisation to issue a warning of a sharper slowdown should the trade tensions remain unresolved. Likewise, the data points we monitor still point to slowing trends in industry and consumption.

Balancing the negative development, corporate quarterly earnings were good especially in the US. Stock market valuations remain below levels last time seen in 2011 or 2012 in Europe and US, respectively. Thirdly, monetary policy has become much more accommodative in the past months, with central banks hinting at putting balance sheet trimming at pause for now, and companies enjoying good access to credit. Thus, we hope the macro economic picture to converge very soon.

As to market psychology, the technical backdrop has improved from previous weeks, favouring staying invested in equities. The rally has been broad-based, with considerable money flowing back to the markets, market risk indicators standing at benign levels. On the other hand, the demand for hedging remains high: open interest in put options, gold price and other safe haven assets have climbed recently. Combined however, our take on the technical indicators is also cautiously positive.

Asset allocation - March 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%**

We overweight emerging market equities and emerging market USD-denominated corporate debt.

In terms of sectors, we favour industrials, financials and information technology. We underweight materials and consumer staples.

In fixed income, USD investors should keep favouring long-term investment-grade corporate bonds. Previous weeks' statements from the Fed have got us only to increase this preference. In EUR space, although the pressures for policy tightening have receded, we would not go for long durations and thus keep our preference for small Nordic issues with variable coupons and small issuance sizes.

The trade negotiations overshadow the outlook on G10 countries' currencies, and hence we prefer not to issue exact forecasts. EUR/USD ought to stay rangebound between 1.12 – 1.16 and EUR/CHF between 1.12 – 1.15 in the next six months. We expect central banks to abstain from clear policy shifts before there is more clarity on the trade front, a fact which should curtail strong movements until then. We continue to regard SEK as heavily undervalued vs. EUR and USD at today's rates.

In Zurich on 26th February 2019

Yours sincerely,
Juho Kivioja

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