Amplia Monthly Investment Letter

Stock markets taking a breather

As so many times before, March witnessed a series of events investors had been either hoping for or not counting with, only to find themselves flummoxed upon the materialization of the news, thinking what next.

First, the release of minutes of Fed's March meeting, signaling concerns of slowing growth in overseas economies. This cautious tone resulted in market participants raising the probabilities for a rate *cut* to 19.4% and rate *hike* to 0% *for* the central bank's June 2019 meeting, which is in sharp contrast to expectations from 26th December 2018, just three months ago (rate *cut* in June meeting: 3.0% vs. rate hike 25.5%). This cautious message, which markets normally would have cheered as dovish and supportive for equities, now triggered uncertainty and recessionary fears amongst the investor community. In other words, investors got what they had been hoping for, but once delivered, decided it was not a panacea for their ailing mood. The US yield curve inverted: a notorious warning sign of a recession 12 – 18 months ahead.

A secondary, but equally curious twist in the investor sentiment was delivered last weekend, as the verdict of the Mueller probe vindicated Mr. Trump and put an end to speculations of his impeachment. Wasn't a strong US presidency a key to pushing through reforms and concluding the trade negotiations? Barely had the news broken did the first market observers interpret Trump taking a harder stance against China now, again resulting in a seesaw market.

The above two events once again seem to confirm the wisdom that trying to observe factual data and cleansing them from the white noise of market commentators and politics is the best way forward when investors have difficulties in digesting new information.

Slowdown resumes

On the whole, economic data still points to a continuing cool-off of the world economy. Industry and service sectors are losing momentum, as is most notably manifested by downward pointing purchase managers' indices and industrial output in China, Europe and lately also the US. Household spending is gradually sagging, and the leading economic indicators in most Western economies on aggregate are sideways to negative. One of the few positive signals comes from the central banks whose repeated commitment to continuing stimuli we find supportive of risk assets, although this is dampened by tightening Chinese efforts to stem the growth of private credit.

In this environment, not many arguments speak for an extended market rally. One reason could be stock market valuations that, after the recent good earnings season, are still in line with long-term averages despite gains of the past three months. It could also be many investors are staying invested to reap dividends, as this year's dividend season is becoming very good.

As to market sentiment, demand for risk assets has been strong with money flow continuing to markets, and hedging demand ebbing. History has however proven that bond markets are better at forecasting economic cycles than stock markets. The current inversion of US Treasury yield curve suggests that either inflation or growth, or a combination of those two, will slow considerably in the next 6 – 24 months. Unless the long-term yields pick up soon again, the discrepancy between stock market (growth) and bond market expectations remains wide. Such conditions have in the past prognosticated a downward correction in the equity market. This warrants a cautious approach to equities now.

Our markets positioning

For the aforementioned reasons, we keep the equity exposure unchanged in our model portfolios. Of sectors we favour energy, consumer discretionary, health care and IT.

Asset allocation - April 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%**

When it comes to fixed income, the recent dovishness of the Fed and ECB have boosted prices of especially long-term USD bonds of investment grade and upper-end high yield. After the spread compression, we recommend taking profit and cutting the exposure to neutral. For USD-based investors opportunities continue to exist in emerging markets USD-denominated corporate bonds and, selectively, in domestic credit markets. Going for longer durations and better-quality credit profile in USD space is trump, in our view.

The recent weeks' drop in EUR-denominated yields did not make things easier for investors with reference currency euro. Although we see the risks of rising rates diminishing, locking in the ultra-low present rates does not make much sense either. Accordingly, the sweet spot remains in Nordic small issues with variable coupons, reasonably prudent credit metrics and solid corporate governance.

In FX markets, many main currency pairs have been trading in a surprisingly narrow range for a long while now. We would expect this to change at least for the Pound Sterling by summer, as the outcome of Brexit should pave way for a GBP/USD of 1.35 – 1.38, or in case of a hard Brexit, towards 1.25 – 1.29. Should equity markets start to correct, it could easily spill over to FX markets, resulting in a higher CHF, JPY and potentially USD. Barring this, EUR/USD and EUR/SEK ought to remain rangebound at the present levels.

In Zurich on 28th March 2019

Yours sincerely,
Juho Kivioja

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