Amplia Monthly Investment Letter

Old concerns re-emerging

The week from July to August saw old investor concerns re-kindle, sending stocks and bond yields down. First, US Federal Reserve delivered the long-awaited policy rate cut on 31st July but belittled it as an intermediary correction. As bond yields did not continue further down, President Trump fired his latest salvo in the trade dispute by threatening to introduce 10% tariffs on further $300bn worth of Chinese imports as of September 1. With little support coming from corporate earnings side, this news brought S&P 500 down by almost 6% from its July peak, before the slide finally reversed in the following week. Now, with the holiday season ending, the question is again, can monetary policy balance out the negative political development?

In anticipation of more news

Despite some weak spots from industrial production and economic sentiment surveys, especially from the Eurozone and Germany, the economic data is reasonably good. Purchasing manufacturing indices keep falling, but are still in expandatory zone, hinting at slowing, but still growing economies. Central banks keep demonstrating their ability to act when inflation does not meet their target levels. During the past three months, inflation and rate expectations have been overhauled and expectations now lie considerably lower. We would not be surprised if the ECB came out with unprecedented ways of stimulating the demand before 2019 draws to its end. Such measures could include a penalty to banks who do not pass on the negative rates to consumer deposits, ever-lower policy rates and new rounds of asset purchase programs.

Although most economic data are good, dark clouds are gathering on the technical side. In some ways, the current year draws parallels to 2018. The second half of last year was disastrous to markets, mostly because investors grew pessimistic about the prospects of a quick resolution to the trade dispute. Whilst our base case remains that China and the US will bury the hatchet before the US election cycle fully kicks off, risks to this view are growing fast. The lack of positive surprises to balance out the macro gloominess may keep dragging the markets lower in the near term. Recent weeks' sell-off has been broad-based, and investors have pulled out considerable amounts from risky assets. Similarly, economic surprises have mostly been negative than positive.

On the micro side, companies' Q2 results came in just ahead of lowered forecast estimates. The earnings of cyclical companies trended downwards. Europe came out much softer than the US, and number of profit warnings increased. On the other hand, most companies kept their full-year earnings guidance, and whether this holds further, depends on the macroeconomic development of the next five months.

Our markets positioning

We cut our equity market positioning to 50% of the individual maximum, as a result of the uncertainty of the technical factors. However, as we have witnessed so many times lately, the market sentiment could shift quickly if euphoric tweets surface. It would also be overly cautious to cut off exposure entirely, as the fundamentals vary from mixed to reasonably good.

Asset allocation - August 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%**

Of equity sectors, we favour health care, consumer discretionary and energy. Also, financials and industrials look attractive now, since their valuations have come down significantly. We dislike materials and information technology, the latter of which is heavily exposed to the turns in the trade dispute.

On fixed income side, the "goldilocks" combination of falling benchmark yields and credit spreads is coming to a halt, even though the rates keep falling further. The equity sell-off in recent weeks has sparked credit spreads higher, although they remain below the levels seen at the beginning of the year, or during the market turmoil in May.

Where does the sweet spot lie then? In USD terms, we favour low investment-grade issuers and high (BB+ to BBB-) high-yield notes with maturities between 5 – 12 years. If the credit quality is good, extending the duration may be warranted, as we expect the rates to drift lower from here. Issuance in developed markets has been abundant lately, so one should be looking for developed market issues in the first place. However, select emerging markets, such as Brazil, Russia and South Africa offer value in our view, as well.

In Euro terms, moving into Scandinavian, non-rated, usually variable-rate high-yield notes seems the only way to escape the negative interest rates. Hence, we see little reason to alter this.

With regards to currencies, our positioning remains also unchanged. GBP remains undervalued based on most metrics, but the risk of a hard-Brexit is weighing on its valuation. However, because Brexit is an "either-or" event, for those who believe in a sensible outcome, GBP remains attractive.

We keep our forecasts of EUR/USD (rangebound at 1.11 – 1.15) unchanged. We close our preference of Swiss franc over EUR, as the franc has climbed over 5.2% since its April highs, and we feel the franc's upside is limited from here on.

In Zurich on 13th August 2019

Yours sincerely,
Juho Kivioja

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