Amplia Monthly Investment Letter

September erasing August losses

A month ago, equity investors had to grapple with multiple headwinds. US Fed had struck a less dovish tone in its July meeting; President Trump had announced new tariffs, Boris Johnson was at the height of his premiership and Italian government on the brink of collapse. Astonishingly, the situation has reversed less than a month. The trade war issues are on hold (with "gestures of goodwill" of tariff delays being offered by Mr. Trump), House of Commons has reined in Mr. Johnson, Italy has got a new government and the ECB has re-introduced its monetary policy easing. Considering these developments, it is no wonder that the markets have been rallying lately.

Draghi's legacy

Mario Draghi is set to hand over the leadership of the ECB to Christine Lagarde on 1st November 2019. Draghi's tenure at the helm of the central bank was characterised by his ardour and unprecedented willingness to break old rules in order to stabilise the ailing Eurozone economy. When he took over the ECB presidency in December 2011, the ECB's balance sheet stood at 2.43 trillion euros. Now it stands at 4.68 trillion: an increase of 93%. This bloated balance sheet competes with Japan's and China's central banks for the largest central bank asset base. In the ECB's case this uptick has mainly resulted from years of quantitative easing, which in plain English means absorbing fixed income assets from the market in order to press down interest rates throughout the maturity spectrum, and so reduce borrowing costs to stimulate economic growth.

Although the ECB asset purchases did fend off a complete financial meltdown in 2012, Draghi's tenure has been controversial, and so will his legacy be. Eurozone growth has been lagging that of other major economic areas since the Eurocrisis unfolded. Forecasts for growth have been revised down year after year. The ECB can hardly be held accountable for the malaise: it is rather the political inability to orchestrate concentrated demand growth in the entire Euro area, which with hindsight should have been possible with ever-lower borrowing costs, guaranteed by the ECB. The fact that the ECB now restarts the asset purchases (with no end in sight) signals that ECB senses the probability of a recession is growing, and the dismal flame of inflation dying out. If Europeans want to avoid the fate of Japan, now is the final moment for policymakers in Brussels and local governments to act.

Should the politicians fail to boost demand, the policy mix will sail farther into uncharted waters. The core issue is that monetary policy is losing its efficacy at a fast pace. Every new euro that goes into ECB's gigantic balance sheet does less to stimulate demand. The more negative the interest rates become, the more adverse are the side effects. With the current legislation on the allowable asset mix of pension funds, Euro area pension assets hardly are growing. European banks are bleeding, as their core activities of maturity transformation and deposit-taking are less and less profitable. Asset bubbles become increasingly likely, as the excess liquidity flows into financial assets such as real estate instead of real economy. The gravest of the issues is that the monetary policy will be out of action when the next recession comes.

When Mrs. Lagarde takes over the relay, we shall await Mr. Draghi's memoires, as they would shed light on the communication between the key policymakers and the interaction between Frankfurt and Brussels.

Our markets positioning

In our view, the "Trump card", i.e. Trump's tweeting activity, combined with central bank actions, will dominate other data flow over the coming months. We keep our equity allocation unchanged at 50%, as the market fundamentals are still supportive, primarily owing to the monetary policy easing and falling borrowing costs. On the technical side, the situation is improving, but caution is still warranted, with investors cutting exposure to stocks and sentiment remaining fragile.

Asset allocation - September 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%**

Following the increasing central bank support, we tweak our equity preferences to include listed real estate, on top of consumer discretionary and low beta health care. We keep materials and add communication technology to underweight.

On the fixed income side, the tailwinds resume, because benchmark interest rates keep drifting lower and credit spreads just reached lowest levels since March 2018. Hence, we see no reason to change anything in our fixed income strategy.

In USD terms, we favour low investment-grade issuers and high (BB+ to BBB-) high-yield notes with maturities between 5 – 12 years. Assuming adequate credit quality, extending the duration may be advisable, as we expect the rates to keep drifting lower from here. Issuance in developed markets has been abundant lately, so one should be looking at 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 space, Nordic, non-rated and variable debt with decent covenants and debt metrics remains our preference.

We close our recommendation for GBP after the steep rally in Sterling after the recent political events. Else, EUR/USD and EUR/SEK ought to remain rangebound in the next months.

In Zurich on 13th September 2019

Yours sincerely,
Juho Kivioja

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