Amplia Monthly Investment Letter

Time for a breather

A month ago, we were hoping for a settlement of the consistent political topics and more focus on economic fundamentals. Our wishes came true to a great extent, and October was all in all a good month for various asset classes. Stock markets rose (S&P 500 by 2.04%, Euro Stoxx 50 by 0.97%) and credit spreads fell (US high yield by 12 bps and its European counterpart by 15 bps, respectively). Pound Sterling recovered from its August lows, as the shadow of a hard Brexit was dispelled by the announcement of a new general election on December 12, with the rivalling parties' agendas ranging from an orderly Brexit, signed off by the EU and the Parliament, to no Brexit at all. In a way, it seems as if the political worries were receding.

Hence, we feel a bit more relaxed about the world around us. This break in political turmoil gives us all the reasons to draw our attention to the fading 3rd quarter earnings season and other, more factual trends in economy.

Money pours into the markets

Bank of America Merrill Lynch's renowned fund manager survey from 12th November showed that fund managers saw their cash levels declining the most since Donald Trump's election in November 2016. This flow of money to the stock market is explained by investors suddenly growing worried about losing out on the market rally, and thereby forgetting their old recession worries. BofA also noted that fund manager global growth optimism saw its highest surge in the survey's 20-year history to a fresh 18-month high, in a sign of better expectations for earnings growth.

Looking at various economic data, it is easy to agree with the fund managers. Economic surprises have been mostly to the upside lately, with for instance Germany's exports rising unexpectedly by 4.6 per cent in September, helping the country to avoid a technical recession in the 3rd quarter 2019. Consumption figures are good, as evidenced by University of Michigan's Consumer Confidence Sentiment that has continued the rebound from its August lows. Stock valuations have become slightly richer, but are still supportive, partly owing to the lowered discount yields. The biggest support comes again from the monetary environment, thanks to the central banks' continuous efforts to stimulate money supply.

The only contradicting messages come from the industry and service sectors, where various surveys point to muted expectations for the near future. On micro level, the 3rd quarter earnings season is soon coming to an end, and it seems that many large caps, especially in the US, would see their net earnings shrink moderately from a year ago, with S&P 500's earnings pointing 3.75 per cent downwards from Q3 2018. This has not spooked the investor community though, as the expectations were so low due to the seasonal effect of Trump's tax cuts in 2018. In fact, 78.7% of the companies having reported so far have beaten their consensus earnings forecasts.

So where are the risks then? We would argue they lie in abrupt political swings that could de-rail and jeopardise the *entente cordiale* recently established between the large economic blocks (mostly China and the US). It has also become increasingly obvious that many economies depend on the abundant money supply and the central banks. Barring any deterioration in these, we feel comfortable with our risk-on positioning.

Our markets positioning

Quantitative equity allocation - November 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)	**100%**

In equity sectors, we add a cyclical tilt. Industrials and financials are overweighed, at the expense of communication services and utilities.

How about gold? With our expectation of key interest rates (US Treasuries, EUR and USD swap rates as well as China 1-year Lending Rate) staying rangebound or slipping lower, the alternative costs of holding gold are kept in check. Given that gold serves as a haven in times of turmoil, we are mildly positive about the precious metal. Spot prices below $1450/oz. should be seen as entry levels, and spikes over $1530 as selling points. Our favoured way to gain exposure is via gold miner ETFs or bonds, as they provide with at least some income, should the prices stay where they are.

On the fixed income side, not much has changed. Credit spreads remain at low levels. There is practically no upward pressure in benchmark rates in any developed markets' currencies. We continue to favour low investment grade issuers and high (BB to BBB-) high yield notes, with maturity of 5 – 12 years in USD. We add subordinated bank debt to our USD fixed income preferences. For euro investors, Nordic, non-rated and variable-rate debt with adequate covenants and debt metrics is still our preference.

With regards to currencies, we continue to favour EUR over USD at the current levels around 1.10. Monetary policy and trade flows development should result in slight strengthening of the euro. GBP is fairly valued against both EUR and USD. We still consider the SEK attractive vs. EUR, and remain SEK buyers, with target levels at 10.60.

In Zurich on 14th November 2019

Yours sincerely,
Juho Kivioja