Amplia Monthly Investment Letter

Harvest time

Considering the uncertainties and risks investors have had to grapple with in the past months, we face a rare moment of tranquillity and placidness in the markets. Against the backdrop of reasonably favourable flow of geopolitical news and economic data, it is time for us to gradually wrap up the year and look into 2020. We are grateful for the asset price gains that have materialised right on time for Christmas, enabling us to end the year on a very positive tone.

What was 2019 made of?

To simplify complex matters a bit, 2019 was a year when old data patterns stopped working and one could say this time it was different. If 2018 had been a terrible year for most asset classes, 2019 was truly the opposite of it. Equity markets broke new records at a time when the gold price rose sharply, and interest rates fell throughout the curve. Most conventional and well-tried cross-asset correlation patterns did not work, as almost all asset classes moved in the same direction, without granting the diversifying element so often aspired by portfolio managers of this world. Even many of the "new alternative assets", such as Bitcoin, rose sharply. Bitcoin is up year-to-date 92.7% by the time of writing this. Luckily there was little need for diversification, as the direction was upwards.

The gains achieved so far this year did not always come easy, though. For instance, an investor who became convinced of a détente in the trade dispute between the US and China and climbed in equities in late July, had to wait long into October to recuperate his losses. The reason behind this is that only two factors accounted for most of the market swings: monetary policy (especially the central banks of the US, Eurozone and China) and the tweeting activity of President Trump. Given that the latter in particular more resembles a random walk than anything else, timing the market became increasingly difficult. Hence, the proven concept of sticking to quality assets with sound fundamentals was well-rewarded. On the other hand, any technical trends that emerged usually lasted for a while, making the year of many CTA hedge funds successful.

Our market positioning for 2020

Given the recent favourable progress in Brexit and US-China trade negotiations, a lot of the macro risks that have dominated the discussion in 2018 and 2019 seem to have receded. However, because risks are by definition something that usually cannot be projected, it would be foolish to be carried away by the ongoing good investor atmosphere.

With ever tighter credit-spreads, lower price volatility in various asset classes (from equities to FX) as well as historically low bond yields and high equity prices, valuations may become a problem soon. Valuations are still in line with historical averages but given the constantly rising asset prices, the headroom is getting smaller. Overall, if we had to name the top risks for investment returns for 2020, those would be the re-emergence of trade disputes and technical sell-offs, usually resulting from long bouts of continuously rising asset prices.

We are moderately optimistic about equity markets but would be (positively) surprised if we saw net returns higher than high single digits. The main supporting factors ought to be the lack of alternatives and moderate (mid- to high single-digit) growth in corporate net earnings (EPS). Within equities, sectoral rotation can be expected, especially between cyclicals and defensives, if global growth forecasts are revised during the year amid developments in trade and announcements of fiscal stimuli. Some individual sectors, most notably automobiles and healthcare, will be heavily dependent on political outcomes (healthcare due to the upcoming US presidential election and automobiles due to its dependence on global trade agreements and logistics).

In 2019, we saw the US Federal Reserve lower its policy rate thrice. Somehow the implemented changes and the tone of the Fed communication have led to the USD market interest rates enjoying a "goldilocks" environment, at least in our view. There is not much pressure either up- or downwards, and the rate curve is sufficiently upwards-sloping to prevent doomsayers from interpreting recessionary signs out of it, whilst not being overly steep to stifle economic expansion. In Europe, Ms. Lagarde at the helm of ECB seems to tiptoe on the path beaten by her processor, Mr. Draghi. In Europe, the monetary policy has however played its part, and now the expectations are loaded for politicians to announce public investment packages to take the growth further from here. Hence, unless inflation expectations rise from the present, investors should not expect wild swings in Euro area market rates either.

Meanwhile, credit spreads are now so low, especially in the Eurozone, that we barely see any room for further tightening. Thus, together with the market rates staying where they are, an investor should be asking themselves if they regard the current bond yields as a sufficient compensation for the risks. If not, they should be looking elsewhere for investments. High yield is a poor diversification element in an (equity) portfolio context.

2019 was characterised by low currency volatility. For instance, EUR/USD stayed in a historically tight range of 1.0899 – 1.1543. Lower currency price fluctuations are good for globalisation. They also encourage investors to diversify their holdings more globally. However, we would be surprised if the FX volatility stayed so low in 2020. The present calmness should be used to review one's FX positions, the need for currency hedging and rethink the FX risk budgets.

Of alternative asset classes and return sources, we would abstain from general recommendations and opportunistically look at individual sub-sectors instead. For instance, real estate prices have climbed swiftly in many developed markets in the recent years, especially in the US. This does not prevent us from finding value in UK REITs, especially those with a commercial RE focus. Similarly, we would not advise to selling equity market volatility in the current market lull, but should a market sell-off occur, selling equity volatility via options and structured products could provide a low-beta boost to portfolio's income generating ability.

Gold may continue its gradual climb upwards although this is conditional on the ongoing de-dollarisation efforts of other economic blocks as well as interest rates staying low.

In Zurich on 17th December 2019

Wishing you a peaceful Christmas time and much success in the New Year,

Juho Kivioja