Amplia Monthly Investment Letter

Bullish beginning to new year

If 2019 was unprecedented in strength of the market advance, with for instance NASDAQ recording a gain of 37.91%, the start into 2020 has not been significantly different. In the first two weeks of trading, NASDAQ has clocked in gains of 3.11%. Whilst everyone knows that such gains are not sustainable in the long run, we feel it is not the time to start aggressively trimming equity exposure either. We rather advocate cautiousness and dynamic analysis of hedging strategies, should market conditions deteriorate.

Solid fundamentals, richer valuations

Underlying economic data of the past months have been solid. The composite PMIs in Europe and the US have not only bottomed out but have started to recover. The current absence of great political events and (temporary) clarity on Brexit are significantly contributing to the positive investor and corporate mood we experience. Monetary policy remains accommodative. The shape of the (USD) yield curve is sufficiently but not overly steep, and the absolute interest rate levels do not even match the US inflation, meaning that negative real interest rates apply. In such an environment, it is no wonder that consumers keep borrowing and corporates issuing bonds as well as buying back their shares.

The only drawback that arises from this lullaby atmosphere is the fact that valuations are becoming challenging. S&P 500 currently trades at a P/E ratio of 21.92, compared to the average of the past 10 years of 19.74. It is not alarming yet, but the room for further price rises is capped unless we see earnings growth in the next quarters. On the other hand, the fourth quarter 2019 earnings season has started well, although it is too early to estimate the trend from the first announcements. In terms of valuations, the super-tight bond credit spreads are a more worrying matter than the stock market valuations.

Looking at market technicals, the risk-on mode prevails. There is little investor nervousness. VIX, a measure of S&P 500 implied option volatility, is withing a striking distance from its multi-year lows. EUR/USD spot price volatility is at its lowest in 20 years. However, a few indicators, mostly related to the pace and steepness of the market's climb, are pointing to overbought levels. One such is the Bollinger bands that imply for instance NASDAQ to have risen too high, too fast.

One of the big contributors to last year's rally was the fading of political uncertainty. Whilst one has to work in scenarios here, our base case is that the Trump administration cannot afford any further deterioration in the US-China relationship because that could derail the stock market and decrease Mr Trump's chances of getting re-elected in November 2020. 2018 and 2019 provided ample evidence of situations where Trump backs down from an escalating conflict after the stock market has suffered *a priori*. In other words, Trump seems to consider the stock market the prime measure of his success, and we would expect him to use the stock market's climb as a weapon in his upcoming election campaign.

Our markets positioning

Quantitative equity allocation - January 2020	
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%**

Within equity space, our quantitative model favours consumer discretionary. Also IT and health care are well represented. We underweight energy, consumer staples and industrials. We would expect sectoral rotation ahead later in the year, depending on the development of the US Democratic primaries and polls in general. Health care and energy ought to be amongst the most affected sectors then.

We remain slightly positive on gold. Funding costs are stable or easing, US inflation is stubbornly around 2% and there is a chance of USD weakening versus EUR, CHF, JPY and GBP if the Fed were to lower rates further. In addition, many central banks are "de-dollarising" their currency reserves by replacing USD by gold. 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 as stated earlier. 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. US treasuries serve as a good hedging instrument and portfolio diversifier for USD-based investors but not others.

With regards to currencies, we repeat our call for a gradually strengthening EUR vs. USD. Monetary policy and trade flows development should result in slight strengthening of the euro. Elsewhere, GBP is fairly valued against both EUR and USD. SEK has had a tremendous run against the EUR, and we consider that finally fairly valued as well, at least for the immediate future.

In Zurich on 15th January 2020

Yours sincerely,
Juho Kivioja

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