Amplia Monthly Investment Letter

Twists between euphoria and despair

Markets were caught off guard in late May by Mr. Trump's tweets in which he announced the American withdrawal from the trade negotiations with the Chinese and introduction of further punitive import customs on Chinese goods. This 180-degree turn was sufficient to cause S&P 500 to drop by 6.2% in May, making it the worst May month in the history of the index since the 1960's. The intermezzo also sent a shock to investors who had been surprisingly optimistic in the first months of the year, enabling many to take profits and giving everyone a reminder of the impact and existence of political risk.

Central banks – the white knights

On the face of it, not much has changed since the previous month. The fundamental data is still supportive for risky assets on aggregate, led once again by the central banks that sounded a cautious, dovish note as the prospect of the looming trade escalation threatened to sour the mood amongst investors and companies.

This fall in interest rates has not only been a boon for bond markets but also provided a sole plate for equity markets who reversed in June some of their losses from May. Whilst we do not outright expect the Fed to lower interest rates yet this year – barring an escalation in the trade conflict and drop in global trade – the very readiness of the central banks to act will help equity markets in the months ahead.

Else, the consumer segment has rebounded although industry and services activity still point downwards. Valuations have become more attractive after the recent sell-off. Investor psychology is still positive despite the turmoil of the previous weeks, which is evidenced by below average volatility and minor hedging demand, to name but a few.

Our markets positioning

We remain risk on and are comfortable with our present market positioning. In an environment where one single tweet can cause reverberations that swing the equity markets heavily up and down, it is practically impossible to time the market. One must rely on fundaments and work by scenarios.

At the moment our base case is that an escalation of the trade war will be avoided, and the Americans and the Chinese are able to reach a deal before the uncertainty again hits the economy, something which already partially happened last year. In our view, the stock market is a factor that is very closely watched in the Oval Office, and the direction of New York stock exchange one of the (few) things Mr. Trump truly respects. An escalation of the trade conflict would send the US markets lower, turn investor and corporate mood sour, lower employment and press down US house prices. The impact from all this would be a poorer and discontent electorate that would not grant Mr. Trump a second term in the office.

The risks to this view are admittedly considerable and mounting, but we rely on the view and the currently still positively developing fundamentals as well as investor psychology in terms of the equity allocation.

Asset allocation - June 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%**

Of equity sectors, the steep drop in oil and natural gas prices within just a few months has led us to increase the weigh in the energy sector. Other favoured sectors are consumer discretionary and health care. We underweight consumer staples and utilities.

As to bond markets, the ongoing fall in benchmark yields in both euro and dollar terms has provided new fuel to the bond market rally. Especially the prices of USD denominated debt have once again risen, damping the effect of stock market gyrations. In addition, the stock market sell-off in May drove the credit spreads on average 20-30 bps higher across the globe. This has made not only US but also European high yield bonds attractive. So far, we have disliked the European investment grade and high yield space, apart from Scandinavian smaller issues, however the recent spike in credit spreads makes the European high yield attractive for the first time in two years.

On the currency front, not much has happened lately. The only real event was the steep drop in Pound Sterling's value versus the USD, EUR and CHF, as markets raised the prospect of a hard Brexit. For those who can stomach the impact of moody British politics and can imagine staying in Pounds for potentially 2 – 3 years, building exposure in Sterling via forwards, put options or structured forwards provides great value in our view for now. We continue to forecast EUR/USD to remain range-bound around 1.11 – 1.15 levels for the next 6 months. For those who are concerned about the political stalemate of Italy, buying CHF and CHF-denominated assets at these levels could prove a good hedge.

In Zurich on 6th June 2019

Yours sincerely,
Juho Kivioja

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