Amplia Monthly Investment Letter

Coronavirus – pandemia or not?

The Coronavirus has brought an abrupt end to the bullish beginning of the year. It is an ominous and ironic coincidence the outbreak coincides with the beginning of the Year of the Rat. Rat, the first of the 12 zodiac animals in Chinese astrology, is associated in China with wealth and prosperity. In the West however, it is associated with plague and disease. Perhaps the upcoming months will tell us which prediction has it right, and what the consequences for investors will be.

Decreased visibility, earnings in focus

Incoming economic data remain solid, or at least they lack clearly negative surprises. Once again, the US consumer is acting as the locomotive of the economic growth. The Consumer Confidence Index, and its Expectations sub-section, point to a continued growth. This is also manifested in the labour market, where the US economy created 225’000 jobs in January, thereby pressing the jobless rate to 3.6%, another fresh low. On the other side of the Atlantic, Eurozone PMIs seem to have bottomed and are in modest recovery. Also, changes in global trade policies are positive, for once. China announced a cut of tariffs on $75bn of American goods last week.

So far, we know that the Coronavirus will have a detrimental short-term impact on China’s and its trade partners’ GDP growth. We would however need to see an increased contagion and workplace shutdowns for the virus to have a longer-lasting effect on the growth trajectory.

We have previously emphasised companies’ earnings growth as a prerequisite for sustained asset price increases for valuations not to get too expensive. To this end, the full-year 2019 results have been adequate. The so-called aggregate earnings surprise tally of S&P 500 lies at 5.55%, meaning that the 320 companies that have so far posted their earnings have beat the street consensus with a healthy margin. Notably, the expectations for 2020 lie high, with the street predicting a 15.6% earnings growth for the full-year.

On the technical side, the Coronavirus has all but soured the investor mood. Volatility is increasing and every new piece of information results in considerable swings in the markets. Especially European luxury good manufacturers have taken flak recently. There is still latent and suppressed buyer interest waiting for an entry point to the markets. Combined with still low hedging demand and positive economic surprises, the aggregate technical signal stays moderately positive.

Our markets positioning

Despite the deteriorated technical market situation, we remain risk-on in equities thanks to the good earnings season and other factors described above. We cut our Emerging Asia exposure to zero at the end of January however, as we deemed the visibility too poor for us to justify an investment in the region for now.

Sector-wise, we prefer consumer discretionary, especially in Europe, after valuations have become more palatable. The same applies to financials. Healthcare and IT look also attractive although both may become vulnerable as we head into the US election. Rather than rotating between the sectors, we would advise to focus on large caps with a high market share and strong balance sheets. This would be important if the uncertainty and risks picked up from here.

Quantitative equity allocation - February 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%**

We still remain modestly positive on gold. Funding costs remain stable, US inflation is stubbornly around 2% and the upside for USD versus many of its trade partners is limited. The Chinese policy response of USD $170bn to counter the impacts of Coronavirus may also be positive for gold, should the sentiment suddenly deteriorate. In addition, many central banks are “de-dollarising” their currency reserves by replacing USD by gold.

With regards to fixed income, the equity market shatters resonate in the bond market. Credit spreads have widened, and interestingly there are days when all new issuance ceases, with underwriters and companies waiting for better days and lower coupons. The heightened spreads make corporate bonds, especially in USD terms, even more interesting, as one can lock in higher yields. Aiming for the low high-grade space with maturities of 5 – 12 years may also prove a decent hedge against equity market shocks because of the interest rate duration element.

With regards to currencies, we repeat our call for a gradually strengthening euro versus the US dollar. Monetary policy and trade flow development should result in slight strengthening of the EUR. For those who are positive on the markets, cyclical currencies such as the SEK and EUR should continue to climb higher. For hedging purposes, we recommend seeking shelter in USD or JPY rather than the CHF, as the latter has become expensive especially versus the EUR lately. Elsewhere, GBP is fairly valued in our view against both EUR and USD but we may expect wild swings to continue amid the trade negotiations with the EU.

In Zurich on 10th February 2020

Yours sincerely,
Juho Kivioja