CITYWIRE / TOP 50
INDEPENDENT ASSET MANAGER

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MONTHLY PULSE TUESDAY, 06 AUGUST 2019

ECONOMIC OUTLOOK

The FED cuts interest rates for the first time since December 2008 by 25 basis points. Markets expected more of a dovish stance in terms of the Forward Guidance though and took Powell's statement as somewhat hawkish. The question will however remain: was this an insurance cut or rather a beginning of an easing cycle?

Looking at the big picture, we stick to our view that trade disputes and geopolitical tensions remain the key drivers for the global economy and markets. Trade tension have already caused global growth to slow and we expect further fallout that may weaken domestic spending. These days central banks have been quick to pivot to more dovish stances. This indicates they are ready to provide more stimulus to reduce downside risks, even though it is not clear that monetary policy stimulus can effectively offset the US protectionism.

Meanwhile the US economy is still resilient, and it does not look that a US recession is around the corner. However, market sentiments could change quickly which would weigh on global growth. Even if monetary policy and fiscal policy support helps extend the life of the cycle, we could still face the prospect of slower growth and higher inflation. Increasing macro uncertainty could also herald a shift to a new regime of more frequent risk asset sell-offs and higher market volatility. Therefore, we believe that building portfolio resilience is critical as this cycle continues to age.

In Europe, the economy is still struggling with lacking inflation. Hence, the ECB will provide additional stimulus in form of a shift in forward guidance, lower rates or restarting of QE – all these ahead of the end of President Draghi's term. Our main scenario is a deposit rate cut by 10 bp in September and a resumption of some sort of asset purchases. However, it is still doubtful if such measures are enough to spur the inflation, credit lending and ultimately growth in the Eurozone. Unfortunately, we have seen several times in the past that the ECB is not making any headway here.

Fixed income yields have lately fallen, driven by the decline in government bond yields and tightening yield spreads. However, if you look at easing measures by the central banks, the further downside potential for yields seems limited at mid to long end maturities – capping the return potential as well. We remain neutral and prefer short duration credit risk and exposure to capital structure with a tilt to EM debt.

Equity markets are attractive from the momentum point of view. European stocks look modestly overpriced versus the macro backdrop. However, the dovish shift by the ECB should provide an offset to a certain extent. However, we are still cautious and remain slightly underweight on global equities even despite of the prospect of an extended cycle. The geopolitical risks and trade tensions can shift quickly with increasing volatility and eventually stronger market slumps.

With the ECB becoming dovish again and the EZ economy continuing to be sluggish, the EUR/USD tends to stay under pressure. Additionally, the carry trade is still in favour of the USD with stronger labour data in the US. Gold has broken major resistances on the back of lower USD yields and softer USD. We continue to keep gold as a good portfolio diversifier but would dissuade from chasing the rally tactically as the trade looks crowed and particularly sensitive to FED policies. Oil bounced back lately as supply risks increased amid rising tensions in the Middle East. Analysts however consider a fair price of mid-60s for coming months.

TACTICAL ASSET ALLOCATION*

Liquidity	Neutral
Bonds	Neutral
Equities	Slight underweight
Alternative Investments	Neutral

EQUITY INDICATORS

Valuation	Underweight
Momentum	Attractive
Seasonality	Underweight
Macro	Underweight

*no changes to previous month

Should you require further information or advise, please do not hesitate to contact your Clarus Capital relationship manager.

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MARKET OVERVIEW AS OF TUESDAY, 06 AUGUST 2019, 4:03 PM

FIXED INCOME

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	2.35	-0.02	-0.03	-0.03
USD 1y Swap	1.96	-0.06	-0.60	-0.80
USD 3y Swap	1.65	-0.09	-0.75	-0.95
USD 5y Swap	1.62	-0.13	-0.78	-0.96
USD 10y Swap	1.75	-0.18	-0.79	-0.97
EUR Overnight	-0.36	0.00	0.00	0.00
EUR 1y Swap	-0.43	-0.05	-0.20	-0.20
EUR 3y Swap	-0.45	-0.07	-0.33	-0.38
EUR 5y Swap	-0.37	-0.11	-0.41	-0.57
EUR 10y Swap	-0.05	-0.20	-0.57	-0.86
CDX Xover 5y	3.33%	0.14%	0.03%	-1.16%
iTraxx Xover 5y	2.63%	0.18%	0.07%	-0.89%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.2%	0.5%	0.9%	0.9%
USD Aggregate 1-3y	0.3%	1.7%	2.7%	3.0%
USD Aggregate 3-5y	0.5%	2.9%	4.4%	5.0%
USD Aggregate 5-7y	0.7%	3.5%	5.3%	6.1%
USD Aggregate 7-10y	0.9%	5.2%	7.3%	8.1%
EUR Overnight	0.0%	-0.1%	-0.2%	-0.2%
EUR Aggregate 1-3y	0.1%	0.4%	0.7%	0.7%
EUR Aggregate 3-5y	0.4%	1.5%	2.5%	2.8%
EUR Aggregate 5-7y	0.8%	2.9%	4.9%	5.7%
EUR Aggregate 7-10y	1.3%	4.9%	7.6%	8.9%
US Corp. HY	0.3%	1.6%	5.6%	10.5%
EUR HY	0.4%	1.3%	5.0%	7.3%

EQUITY

	Price	P/E	D. Yield	FCF yield
MSCI World	6,321	16.4	2.5%	4.6%
S&P 500	2,954	17.8	2.0%	4.5%
NASDAQ	7,801	21.6	1.1%	4.4%
Euro Stoxx 50	3,407	14.0	3.7%	5.6%
SMI	9,807	16.6	3.4%	4.3%
FTSE 100	7,452	12.8	4.8%	5.2%
DAX	11,964	13.9	3.4%	0.7%
MSCI Asia Pacific	158	13.6	2.9%	5.6%
FTSE China A50	13,305	10.1	3.2%	18.3%
MSCI Emerging Market	1,025	12.7	3.0%	6.8%
PH Semiconductor	1,512	17.4	1.8%	5.5%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	-1.1%	1.1%	8.3%	16.8%
S&P 500	-0.7%	1.2%	9.1%	17.8%
NASDAQ	0.0%	1.0%	13.5%	23.2%
Euro Stoxx 50	-2.9%	-2.3%	7.4%	13.5%
SMI	-1.6%	0.4%	9.0%	16.3%
FTSE 100	-1.4%	1.4%	6.1%	10.8%
DAX	-4.5%	-3.1%	7.0%	13.3%
MSCI Asia Pacific	-2.8%	-3.0%	1.0%	7.5%
FTSE China A50	-4.8%	-2.6%	15.7%	28.1%
MSCI Emerging Market	-3.7%	-5.0%	-2.4%	6.1%
PH Semiconductor	2.4%	-3.1%	17.4%	30.9%

COMMODITY

	Price	FCST 19	FCST 20	Δ Future
Gold	1,439	1340	1,385	-3.0%
Silver	16.19	15.5	16	-1.8%
Platinum	851	860	900	1.3%
Palladium	1,427	1425	1,309	-1.2%
Crude Oil	54.86	60.3	61	5.6%
Brent Oil	61.72	67.7	68	6.6%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	2.2%	13.1%	9.3%	12.3%
Silver	6.2%	10.1%	-0.2%	2.5%
Platinum	2.1%	-1.0%	1.7%	4.9%
Palladium	-8.1%	6.5%	10.9%	22.4%
Crude Oil	-2.6%	-11.4%	-3.4%	14.7%
Brent Oil	-0.7%	-10.4%	-1.4%	12.3%

FOREIGN EXCHANGE

	Price	FCST 19	FCST 20	Δ Spot
EUR/USD	1.1101	1.1500	1.1800	6.1%
GBP/USD	1.2131	1.2800	1.3500	10.7%
USD/CHF	0.9863	0.9800	0.9800	-0.6%
USD/JPY	106.90	107.00	105	-1.8%
EUR/CHF	1.0949	1.1200	1.1500	4.9%
USD/RUB	64.68	64.25	63.50	-1.8%
EUR/RUB	71.79	74.66	75.45	5.0%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	-1.8%	-0.7%	-2.9%	-3.1%
GBP/USD	-3.8%	-6.9%	-7.0%	-4.8%
USD/CHF	-0.1%	3.3%	1.2%	-0.4%
USD/JPY	0.9%	4.3%	2.8%	2.6%
EUR/CHF	1.7%	4.0%	4.2%	2.8%
USD/RUB	-2.1%	1.2%	1.4%	7.8%
EUR/RUB	-0.4%	1.9%	4.5%	10.6%

Source: Clarus Capital Group, Bloomberg

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SPECIAL TOPIC: FACTOR INVESTING

HOW CAN AN INVESTOR PROFIT FROM FACTOR INVESTING?

Factor-based investment strategies are grounded on selection, weighting, rebalancing of portfolios etc., favouring stocks that have specific characteristics of improving returns over time. The key question is how to define factors? The most famous ones are size, value, momentum, quality and low risk.

The size factor captures excess returns of smaller firms relative to larger counterparts. Fama and French (1993) found the existence of premium from investing in smaller-cap stocks. This is explained by higher extent of risk of smaller companies due to such aspects as volatility, risk of bankruptcy etc., which in turn require compensation to investor expressed in higher premium. Research based evidence does confirm that in the long-term small-cap stocks outperform large-cap counterparts.

The value factor captures the fact that investors tend to be excessively optimistic about the performance of expensive stocks, defined by high Price to Earnings ratio, unlike such of their cheaper counterparts, with low Price to Earnings ratio that are in turn attributed a serious extent of pessimism. In case cheap stocks indicate surprisingly higher than expected earnings they will outperform as a result of market's overall improved confidence in them. Fama and French (1993) found that stocks with low price-to-book ratios outperformed those with higher values.

Momentum investing is about examining price trends to forecast future returns. The first evidence for the momentum anomaly was published by Jegadeesh and Titman (1993), demonstrating that stocks that outperformed in the medium term would continue to perform well and vice versa. The argument for why momentum works comes from the fact that investors tend to underreact to company trends, making past winners winning further. This cycle continues until there occurs a cause for it to stop (e.g. an overvaluation). Measuring 12 months price returns has proven to be an effective strategy to outperform the market.

There is still no consensus upon the definition of quality. Some academics evidence that companies with higher earnings quality have outperformed over time. Other agree that things like lack of excessive leverage and stable income are indicators of good companies.

The low volatility approach assumes owning stocks with lower return volatility. These have shown to outperform broader market over time. One of the empirical evidences of such is by Robert Haugen and James Heins (1972), who found portfolios with less variance produce higher returns. Many however argue that the outperformance is attributable to size anomalies, yet not the volatility characteristics. The volatility approach is best utilised when volatility is high and markets decline rapidly, as lower volatility stocks in this case will have better chance of remaining at the level of higher returns.

Factor-based strategies can be used in different ways: an investor can for example depict the style of an actively managed fund. If for example a portfolio manager sells his fund thanks to his exquisite skills to choose the cheapest equities (value approach), but shows momentum like returns, one should investigate his investment approach further. Another approach is to select one's equity exposure following the factors. Equity factors such as low risk or quality tend to outperform in negative market environment whereas valuation and momentum do better in a positive environment. Not only is the concept but also the implementation of the concept relevant. There are different measures of risk such as volatility, correlation or the measured period of risk. This could lead to a return deviation of the initial investment expectations.

The recent study by G. Baltussen, L. Swinkels and P.V.Vliet (2019) finds that momentum, value, seasonal and carry premiums are significant in four asset classes as well as collaborating very well with others as means of portfolio diversification. The main argument of the paper comes down to multi asset factor strategies being efficient by delivering Sharpe Ratios (ratios of return reward in excess of the risk-free rate to the measure of risk) in the range between 0.5 to 1.2 on every 10-year period from the 200 years financial data period. Overall, factor premiums are robust throughout various economic conditions, such as either bull or bear markets, recessions, periods of economic growth and so on.

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IMPRESSUM

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