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Portfolio Update
March 2019

- Best quarter for seven years
- Successful first quarter of 2019
- Inverse yield curve – are we heading for a recession?

Review

Best quarter for seven years

Thanks to optimism of an agreement being reached in the Sino-US trade war in the near future, the US equity index S&P 500 has recorded its best yearly start for seven years. Besides glimmers of hope in geopolitical matters, the central banks' restraint is also likely to have played a major role in fuelling global demand for risky investments. The announcement from the US central bank chairman that the Federal Reserve will not hike rates at all in 2019 probably took many investors by surprise. Some investors have taken a negative view of this move, claiming it is unnecessary and poses the risk that, later in the year, the Fed chairman will have to signal another change of policy in favour of rate increases. On the other hand, the loose monetary policy means that the economy will remain supplied with cheap money, which should benefit risky asset classes in particular. Equity market weakness on the back of the Fed meeting was correspondingly short-lived. Even the downwards revision to US economic forecasts failed to dampen risk appetite, leading the majority of global equity indices to post double-digit growth rates in the first quarter.

Equity indices in March & Q1 2019 (total return)

Americas	March	Chg QTD
Dow Jones Industrial Average (US)	0.2%	11.8%
S&P 500 (US)	1.9%	13.6%
NASDAQ Composite (US)	2.7%	16.8%
S&P/Toronto Stock Exchange Composite (CA)	1.0%	13.3%
Mexican IPC (MX)	1.2%	4.2%
Brazil Ibovespa (BR)	-0.2%	8.6%
Europe	**March**	**Chg QTD**
EURO STOXX 600 (EU)	2.1%	13.0%
FTSE 100 (GB)	3.3%	9.5%
CAC 40 (FR)	2.3%	13.4%
DAX (DE)	0.1%	9.2%
IBEX 35 (ES)	-0.3%	8.9%
FTSE MIB (IT)	3.0%	16.7%
AEX (NL)	1.7%	13.1%
OMX Stockholm 30 (SE)	0.5%	12.2%
SMI (CH)	2.1%	13.8%
Asia/Pacific & Emerging Markets	**March**	**Chg QTD**
Nikkei 225 (JP)	-0.1%	6.8%
Hang Seng (HK)	1.6%	12.8%
S&P/ASX 200 (AU)	0.9%	11.4%
MSCI Emerging Markets (EM) in USD	0.8%	9.9%

Source: Bloomberg

Bonds have exhibited an interesting trend, with yields continuing to head downwards due to the absence of rate moves combined with modest economic growth. While the US yield curve has actually inverted (see Outlook for more details), the yield on 10-year European government bonds has dropped below 0% once again. Hopes of an agreement being reached in the trade war in tandem with a cooling economy have led to the unusual situation of equities posting gains in line with safe-haven government bonds. The rise in expectations that a deal will soon be struck in the trade dispute has therefore largely been fuelled by the continued lack of improvement in leading economic indicators.

MANDATE RETURNS GROSS

	Euro			Swiss Franc			US Dollar			British Pound		
	CONS	BAL	DYN	CONS	BAL	DYN	CONS	BAL	DYN	CONS	BAL	DYN
2012	**6.6%**	**7.4%**	**10.5%**	**4.3%**	**6.5%**	**10.9%**	**5.9%**	**8.4%**	**11.8%**			
2013	**1.5%**	**6.5%**	**13.5%**	**1.9%**	**8.3%**	**16.7%**	**2.8%**	**9.4%**	**18.5%**			
2014	**6.1%**	**8.0%**	**10.2%**	**4.9%**	**6.5%**	**9.2%**	**1.6%**	**2.2%**	**3.1%**			
2015	**2.7%**	**6.3%**	**9.9%**	**-0.8%**	**0.0%**	**1.8%**	**-0.3%**	**0.0%**	**1.0%**			
2016	**2.3%**	**5.3%**	**7.1%**	**1.3%**	**3.9%**	**5.7%**	**2.8%**	**6.2%**	**7.2%**	**4.6%**	**9.5%**	**12.1%**
2017	**3.5%**	**7.3%**	**10.8%**	**4.3%**	**8.9%**	**15.0%**	**7.1%**	**12.7%**	**18.1%**	**4.7%**	**8.7%**	**14.2%**
2018	**-4.3%**	**-9.0%**	**-10.5%**	**-5.6%**	**-10.1%**	**-12.1%**	**-2.5%**	**-7.9%**	**-9.8%**	**-3.3%**	**-8.6%**	**-10.4%**
Jan 19	2.4%	4.4%	6.0%	2.6%	4.7%	6.3%	2.6%	4.8%	6.1%	2.1%	4.0%	5.4%
Feb 19	1.4%	2.5%	3.3%	1.4%	2.4%	3.1%	1.4%	2.6%	3.0%	1.2%	2.3%	2.8%
Mar 19	0.7%	1.3%	1.9%	0.6%	1.1%	1.5%	0.8%	1.1%	1.5%	0.9%	1.3%	1.9%
2019	**4.5%**	**8.5%**	**11.6%**	**4.6%**	**8.4%**	**11.1%**	**4.9%**	**8.6%**	**10.9%**	**4.2%**	**7.8%**	**10.3%**

Our strategies posted further growth in March, backed by a favourable trend on the equity markets and gains on bond prices. As a result, last year's losses should now be largely recouped. In particular, portfolios with a higher equity allocation benefited from the remarkable gains on the global equity markets in March, while their focus on technology and cyclical consumer stocks enhanced the performance even further. Our relative performance analysis, which involves measuring our strategies against internal and external benchmarks, shows minimal differences in performance. While our conservative profiles lagged behind slightly owing to a lower equity allocation, the dynamic strategies achieved a corresponding excess return.

In our review of the quarter, we can see that the strategic overweighting of equities to the detriment of the bond allocation was vitally important to the excess return. However, our equity selection probably delivered the most significant contribution to performance. With gains of 40.4%, 33% and 31.4%, individual stocks such as Airbus, Alibaba and Western Digital had a major influence on the result. Bonds also generated an excess return, with priority given to corporate bonds over sovereign paper. Thanks to these results, we can look back at a successful start to the year. Nothing changed in terms of the portfolio bias in March.

POSITIONING

Liquidity Neutral	Liquidity is allocated to money market investments where necessary to avoid punitive interest rates at banks.
Bonds Underweight	Focus on globally flexible strategies in combination with high-yield bonds, senior loans and floating-rate investment products as well as inflation-protected bond funds while gradually reducing interest rate sensitivity and avoiding direct investments in sovereign and European corporate bonds.
Equities Overweight	The equity allocation is being increased to the detriment of bonds. We still expect the global economic growth trend to remain intact. In our view the concerns over an economic recession are overdone. Although our baseline scenario assumes a further slowdown, we do not believe there will be negative growth. The trade war continues to weigh on valuations. If an agreement is reached – which we expect – share prices will make further gains. In regional terms, we have moved closer to a neutral weighting in recent months and reduced our overweighting of Europe as a result.
Alternative Investments Overweight	Combination of insurance securitisations, market-neutral or option-based volatility strategies, which exhibit low correlations, unlike traditional asset classes.
Foreign currencies Underweight	The foreign currency allocation is reduced in the portfolio by deploying foreign exchange futures transactions. A higher share in the reference currency is favoured at present on the basis of risk considerations.

OUTLOOK

Inverse yield curve – are we now heading for an economic downswing?

The US yield curve has been attracting media attention for months due to the shrinking yield differential between short and long-dated US government bonds. For a long while, investors had wondered when the curve would invert, which is one of the most reliable predictors of a recession. The much-anticipated inversion finally materialised in March. For the first time since 2007, short-term US government bonds for three months (annualised) carried a higher yield than their long-dated counterparts with a maturity of ten years. It is therefore reasonable to wonder whether we will be facing an economic recession in the foreseeable future. From a historical perspective at least, inversion of the yield curve seems to have been a reliable indicator of past recessions. Analyst firm NDR Research has summarised the events of the last 70 years in the adjacent table, which leads us to draw the following conclusions. Effectively, previous recessions have always been preceded by an inverted yield curve, although an inversion has not always led to an economic crisis. It is also interesting to note the wide variation in the length of time from the date of yield curve inversion to an economic downswing (second column from the right). While a median of 12.4 months can be calculated from the statistics, this can hardly serve as a basis for a trading recommendation. In any case, the length of time between inversion and the beginning of a bear market is more interesting for investors. A median of -0.5 would imply that the equity markets tend to weaken around half a month in advance. However, this figure is also of little significance given the substantial discrepancies in the underlying values. Another aspect to note is that the curve was not fully inverted in March as the two-year yield, for example, remained below that of its ten-year counterpart (see chart). This casts further doubt over the reliability of the inversion as an indicator.

Historical analysis: yield curve inversion

LEAD/LAG TIMES FROM YIELD CURVE INVERSIONS, BEAR MARKETS, AND RECESSIONS

			----------Months----------		
Yield Curve Inversion (YCI) Date	Bear Start Date	Recession Start Date	YCI to Bear	YCI to Recession	Bear to Recession
1/11/66	2/9/66	N/A	1.0	N/A	N/A
12/19/68	12/3/68	12/31/69	-0.5	12.4	12.9
6/1/73	1/11/73	11/30/73	-4.6	6.0	10.6
11/1/78	9/8/78	1/31/80	-1.8	15.0	16.8
10/29/80	4/27/81	7/31/81	5.9	9.0	3.1
3/27/89	7/16/90	7/31/90	15.6	16.1	0.5
9/10/98	7/17/98	N/A	-1.8	N/A	N/A
9/8/00	1/14/00	3/31/01	-7.8	6.7	14.5
1/17/06	10/9/07	12/31/07	20.7	23.4	2.7
3/22/19	??	??	??	??	??
Median			**-0.5**	**12.4**	**10.6**

Yield curve = 10-year Treasury yield minus three-month Treasury yield. First inversion in two years. NDR-defined cyclical bear market criteria in T_202. Recessions as defined by the National Bureau of Economic Research.

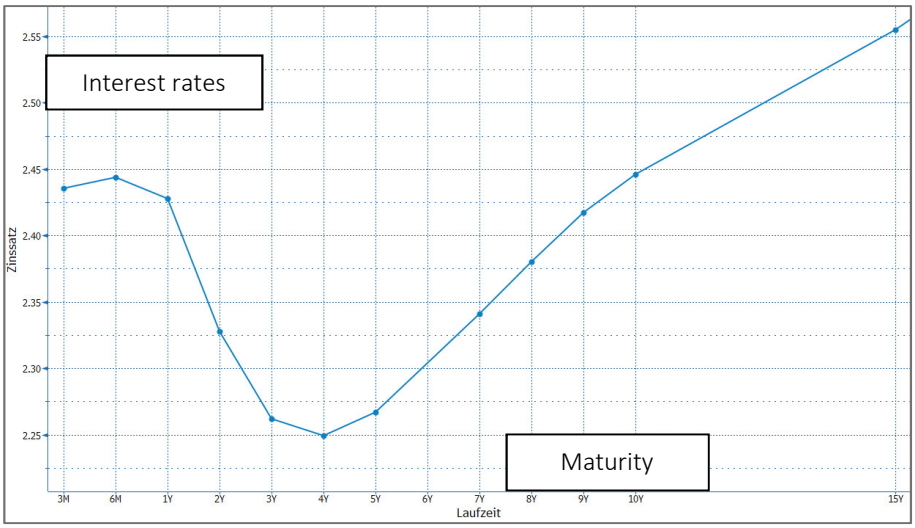
Ned Davis Research, Inc. *T_SSF19_06.1*

Source: Ned Davis Research, Inc.

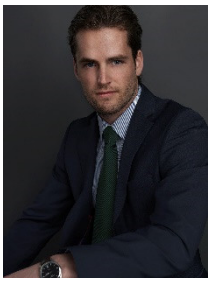
Thus, we attach greater importance to other factors for our market outlook. The Federal Reserve Bank's change of policy confirms the view we held at the beginning of the year that accommodative money supply would continue for a prolonged period. The agreement we expect to be reached in the US-China trade dispute should lend additional support to riskier investments. Encouraging signals are also coming from overseas, with leading indicators pointing to a pick-up in China's economic output.

However, after the strong market trend of recent months, temporary market turmoil cannot be ruled out, with revenues expected to come in lower and earnings growth set to be negative for the first quarter of 2019. With this in mind, we have taken profits by selling individual stocks in recent months and have increased the liquidity allocations in the portfolios. In the event of any market corrections, we would be less exposed to losses and could make purchases at lower levels when opportunities arise.

US yield curve



Source: Bloomberg



This portfolio update was written by:

Nick M. Jenni, Partner
Head Investment Management & Solutions (CH)