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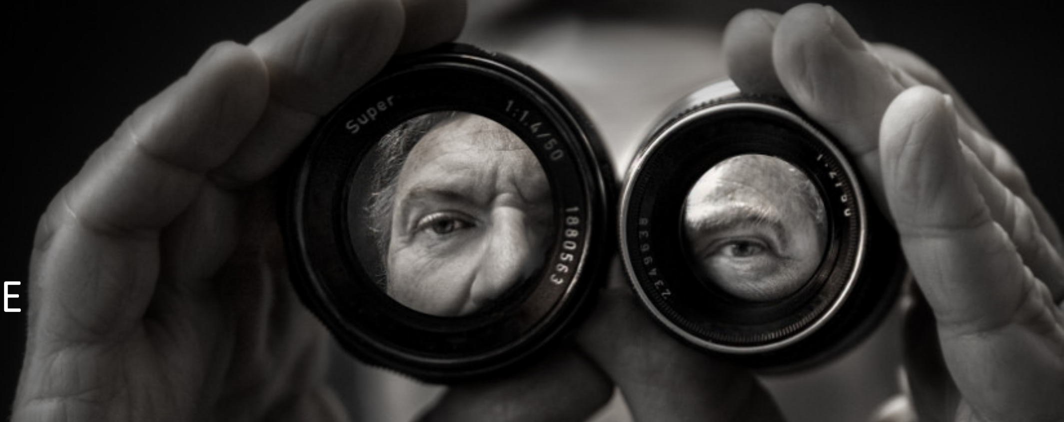
Portfolio Update

May 2019



- **Trade conflict is the baseline scenario**
- **Still ahead of peer groups in the year to date**
- **Standing on the sidelines**

Review

Trade conflict is the baseline scenario

The tone of the Sino-American trade conflict has rapidly soured. While hopes of an agreement being reached in the short term continued to send share prices climbing in April, the disappointing progress of the trade talks triggered a correction on the equity markets in May. Dashed hopes and the prospect of another round of tit-for-tat import tariff threats have clearly taken their toll on investor sentiment.

Tensions reached new heights when the US placed the Chinese IT group Huawei on its blacklist, prohibiting any commercial dealings with the company. It is clear that Trump will use any means possible to pursue his goals. This was further underlined when he threatened to impose import tariffs on Mexico of 5%, which would gradually be increased to 25%, in a bid to curb immigration. It remains to be clarified whether this is legally possible. However, China is probably also wondering – and rightly so – how binding an agreement with the US will be if it issues new threats shortly after the ratification of the USMCA agreement.

Accordingly, there are growing signs to suggest that the suppression of China's economic upswing will be of greater consequence than the optimisation on the US trade deficit. This may also imply that the conflicts between the world's two largest economies are unlikely to be resolved via trade agreements in the foreseeable future.

Analysts have made corresponding adjustments to their economic forecasts for this year in response to these concerns. A trade agreement is no longer priced into market valuations!

Equity indices 2019 (Total return)

Americas	May	2019
Dow Jones Industrial Average (US)	-6.3%	7.5%
S&P 500 (US)	-6.4%	10.7%
NASDAQ Composite (US)	-7.8%	12.9%
Brazil Ibovespa (BR)	0.7%	10.4%
Europe	**May**	**2019**
EURO STOXX 600 (EU)	-4.9%	11.5%
FTSE 100 (GB)	-2.9%	8.8%
CAC 40 (FR)	-5.3%	12.7%
DAX (DE)	-5.0%	11.1%
SMI (CH)	-1.8%	16.6%
Asia/Pacific & Emerging Markets	**May**	**2019**
Nikkei 225 (JP)	-7.4%	4.0%
Hang Seng (HK)	-8.4%	5.7%
MSCI Emerging Markets (EM) in USD	-7.2%	4.2%

Sources: Bloomberg, swisspartners

Safe-haven investments such as government bonds are not the only ones to benefit from the sell-off in equities, as the Swiss franc has attracted greater demand thanks to heightened risk aversion. The latter is also reflected by the relative strength of the Swiss equity market (see the table above).

Declining growth forecasts and consistently high demand for low-yielding bonds have continued to push down yields on safe fixed-income products. Based on the level of current share prices, market participants seem to be counting on a first rate cut by the US central bank as early as September.

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%
Apr 19	1.1%	2.2%	3.2%	1.5%	2.6%	3.8%	1.2%	2.5%	3.3%	1.2%	2.3%	3.2%
May 19	-1.3%	-3.0%	-4.7%	-1.7%	-3.3%	-5.1%	-1.1%	-3.0%	-4.6%	-0.8%	-2.4%	-4.0%
2019	**4.3%**	**7.6%**	**9.8%**	**4.3%**	**7.6%**	**9.5%**	**5.0%**	**8.0%**	**9.3%**	**4.6%**	**7.6%**	**9.4%**

The first setback has occurred after a successful start to the year and four positive monthly returns. Given the extremely negative underlying sentiment and sharp sell-off in risky assets, the declines for conservative and balanced profiles in May are tolerable. Only the dynamic profiles suffered a more pronounced loss of -4.5% on average. The performance levels for the year to date have been eroded accordingly, but remain clearly in positive territory thanks to the strong gains in the preceding months. At the same time, there is no change to the positive performance of our mandates relative to peer groups. While we have generated a slightly higher loss due to a more pro-cyclical bias in the current environment of heightened uncertainty, this is mitigated by the better results of previous months.

The result was largely shaped by the equity allocation, with IT names in particular posting a marked slump in share prices. It is precisely this sector that is the focus of the dispute between the US and China. Despite the challenging environment for bonds and underweighting of government bonds, we still achieved a positive performance contribution from bonds across the entire asset class in May.

There were no major portfolio reallocations last month.

POSITIONING

Liquidity Neutral	Where appropriate, the liquidity allocation is invested in money market assets to avoid the penalty interest rates applied by banks. However, negative yields are also unavoidable outside of the US-dollar investment universe. Dollar investors have the opportunity to make short-term investments in the money market via fiduciary investments, which carry an interest rate of more than 2%.
Bonds Underweight	Focus on global flexible strategies in combination with high-yield bonds, senior loans and floating-rate investment products with low interest rate sensitivity, while avoiding direct investments in government and European corporate bonds.
Equities Overweight	The equity allocation is being increased slightly to the detriment of bonds. In our baseline scenario, we expect a further slowdown, but consider fears of a recession to be exaggerated as we do not see economic growth moving into negative territory. In regional terms, we have moved closer to a neutral weighting, while adhering to our global strategy without a home bias.
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

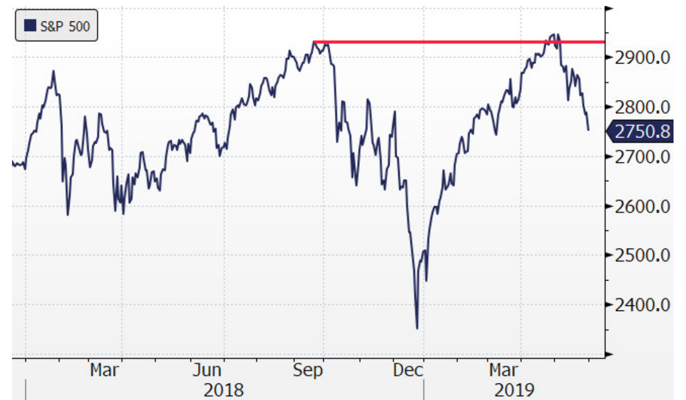
Standing on the sidelines

In our previous month's reporting, we mentioned the possibility of a temporary consolidation. Thirty days later, we can see that we are already in its midst. Few would dispute that the setbacks on the equity markets are directly connected to the escalating trade war. Indeed, the situation has deteriorated drastically. While hopes of a near-term agreement being reached remained the baseline scenario for many analysts in April, any sense of optimism seems to have vanished completely in May in the wake of the tariff increases and threats. It is unclear what the strategy of the self-proclaimed Tariff Man is if he intends to win over voters for 2020 as prices rise on imported goods.

However, the US president has probably already met one of his key targets elsewhere: namely interest rate policy, an instrument that cannot be overlooked as a driver of economic growth. As the implicit probability of a rate hike in the next two years now stands at 0%, Trump has succeeded in orchestrating a departure from restrictive monetary policy, something he previously failed to do by issuing direct threats to the central bank chairman. Perhaps this is the ulterior motive behind his trade policy, as a rate cut is likely to be followed by the dollar depreciation he desires?

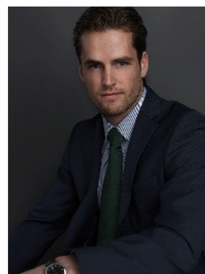
The fact is that comments on trade policy trigger very rapid and pronounced reactions on the equity markets. This is underlined by the performance of the US benchmark index, the S&P 500, which has seen sharp changes of direction and heightened volatility in the last 15 months.

S&P 500 index performance



Sources: Bloomberg, swisspartners

The unprecedented overdramatisation of economic journalism is fuelling the strength of these movements and making it difficult for professional investors to generate any added value via active strategies. In this environment, we therefore advise against aggressive shifts or excessive activity in the portfolio. History has taught us that trying to catch the right time for investing or selling via asset additions and disposals tends to have little success. In times such as these, investors will ultimately generate a better return if they focus on fundamental analyses of the companies they are investing in and on choosing the right fund managers.



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