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Portfolio Update

August 2019

- Bad news is good news
- Performance: on target
- What data are relevant?

Review

Good news and bad news

As the old market adage goes, we should “sell in May and go away”. The original thinking behind this saying is that the financial markets tend to show a weaker performance in the summer months and react very sensitively to newsflow, as they usually do when market volumes are thin. Given the prevailing cocktail of risks, it may well be a good idea to withdraw from risky investments in the current environment. Having said that, few – if any – investors are likely to have gone on holiday and switched off from what is happening on the markets at the moment. Bellwether economic data, controversial central bank decisions and generally critical market levels made July one of the most interesting months we have experienced for some time.

Anything that initially appeared to be tantalising material for journalists was ultimately downplayed by the markets. The story continued in the same vein as it began this year. While data reports in the manufacturing sector have steadily weakened, the service sector has shown its more robust side. The highly regarded consumer polls have also held up relatively strongly and still bode well for an intact economic trend. However, the trade war between China and the US continues to loom over investors like the sword of Damocles. The second-quarter results already published by companies are certainly respectable, but this is probably largely thanks to the substantial downward revisions to earnings forecasts earlier in the year. At least some indicators signal that global trade is suffering from the current conditions.

Nonetheless, equities have climbed again. Bonds have also benefited from rising demand, although the supply of paper with positive yields is gradually becoming scarce, depending on the economic region. From the perspective of an equity investor, the uptrend may be understandable as valuations remain reasonable relative to the profit achieved. However, on the bond front, it looks as though we are moving into uncharted waters and will have to be content with the central banks’ monetary policy whether we like it or not. The paradox of “bad news is good news” is again reflected by investors’ expectations. It is a well-known fact that weak economic data increase the chances of looser monetary policy.

Equity indices 2019 total return

Americas	Juli	2019
Dow Jones Industrial Average (US)	1.1%	16.7%
S&P 500 (US)	1.4%	20.2%
NASDAQ Composite (US)	2.2%	24.0%
Brazil Ibovespa (BR)	0.8%	15.8%
Europe	**Juli**	**2019**
EURO STOXX 600 (EU)	0.3%	16.8%
FTSE 100 (GB)	2.2%	15.6%
CAC 40 (FR)	-0.3%	20.1%
DAX (DE)	-1.7%	15.4%
SMI (CH)	0.2%	21.5%
Asia/Pacific & Emerging Markets	**Juli**	**2019**
Nikkei 225 (JP)	1.2%	8.8%
Hang Seng (HK)	-2.3%	10.2%
MSCI Emerging Markets (EM) in USD	-1.2%	9.5%

Sources: Bloomberg, swisspartners

MANDATE RETURNS gross & POSITIONING

	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%
Jun 19	1.4%	2.7%	4.0%	1.3%	2.5%	3.8%	1.9%	3.4%	4.7%	1.7%	3.3%	4.6%
Jul 19	0.8%	1.2%	1.3%	0.7%	0.8%	0.8%	0.7%	0.8%	0.7%	1.2%	1.6%	1.5%
2019	**6.7%**	**11.9%**	**15.7%**	**6.3%**	**11.1%**	**14.5%**	**7.8%**	**12.6%**	**15.2%**	**7.7%**	**12.9%**	**16.1%**

As outlined above, we are looking back at an eventful – or at least very busy – month. In an environment of rising equity and bond markets, we again managed to improve on our positive performance in the year to date. The table above shows that positive returns were achieved in six out of seven months this year. May's negative performance was the only exception. As a result, investors who kept their cool after the brief but extensive sell-off in the fourth quarter of 2018 are likely to have recouped last year's losses thanks to the gains achieved this year to date.

Looking at the results in detail, we see that portfolios with a conservative bias rose again thanks to growing demand for global bonds. The equity allocation also delivered a positive contribution to returns. Equities are weighted more highly in balanced and dynamic portfolios for strategic reasons, which explains their excess returns. Alternative investments also served their purpose and generated a positive contribution to the return on a consolidated basis in the relevant reference currencies.

Our direct performance comparison with the strategy funds of reputable asset managers reveals that their portfolios currently have a similar structure to ours. While we generated an excess return in the first half-year, the most recent monthly performance virtually matched that of our peers on average. Accordingly, the higher return in relative terms remains intact on a year-to-date basis.

As the market environment has not changed, we are maintaining the same portfolio positioning.

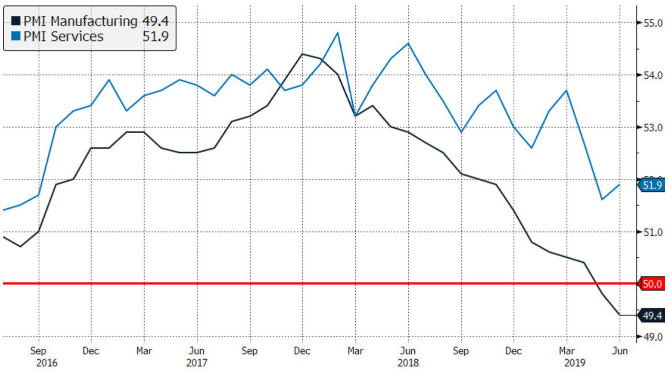
Equities (neutral)	Given the deteriorating economic prospects and the Trump administration's unpredictable trade policy measures, the equity allocation has been reduced to a neutral level in recent months. While we still anticipate positive economic growth, we feel we have adopted the right positioning with a neutral allocation given the existing risks. The liquid funds available can be quickly deployed for new investment opportunities in the event of a market correction.
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 underweighting direct investments in government and European corporate bonds that offer too little compensation for risk.
Alternative Investments (overweight)	Combination of insurance securitizations, market-neutral or option-based volatility strategies, which exhibit low correlations, unlike traditional asset classes.
Liquidity (overweight))	Outside of the US dollar investment universe, there are few opportunities to avoid the negative interest rates applied by the central banks. If necessary, we are parking excess liquidity in cash and accepting a negative return, which is partially passed on to customers, especially as there are no other risk-free alternatives. Trustee investments offer opportunities in US dollars.
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

Industrial data: increasingly irrelevant?

As I was preparing the outlook section for this month's report, it was not yet clear whether the US Federal Reserve was going to keep key rates on hold or cut them by 25 or even 50 basis points. This was probably due in part to Mario Draghi's somewhat equivocal comments at July's press conference on European monetary policy, in which he left some room for interpretation, in turn stoking fears that Fed chair Jerome Powell could "disappoint" the markets in a similar vein.

JPMorgan: global purchasing managers' indices



Sources: Bloomberg, swisspartners

We were still awaiting the decision of the US Federal Open Market Committee as this publication was going to press. But one question remains unclear: is a rate cut actually justified? More than a few economists, analysts and investors are asking this question while pointing to the solid performance of the US economy. Indeed, unemployment is at a record low, while US inflation readings are close to the desired targets and corporate surveys are raising doubts over whether looser monetary policy is actually necessary.

Admittedly, things look a little gloomier once economic data from the manufacturing (secondary) sector are included. The Eurozone, in which industry is evidently also struggling, faces the same problem. JP Morgan's global purchasing managers' indices provide a good illustration of this (see chart). The dark line reflects survey readings from industrial companies, while the lighter line replicates the services sector. A value above 50 (red line) implies economic growth, with values below this threshold pointing to contraction. However, those advocating the need for further monetary policy measures based on this data picture are ignoring – to some extent at least – one key aspect, which was addressed in detail in a recent article in *The Economist* – digitisation is prompting a shift in how the economy functions. As a result, the services sector is becoming increasingly important. Investments in plant and machinery have now been superseded by spending on research and development with a view to acquiring intellectual property. At the same time, the article argues that more intelligent supply chain management systems are reducing sensitivity to shifts in demand, thus removing the need for large-scale changes in inventories. In other words, data on the manufacturing sector are becoming less important.

At its current level of 51.9, while the purchasing managers' index for the services sector (light-blue line) is also lower than in the preceding months, it is certainly not flagging up any cause for concern. It therefore comes as no surprise that so many people are questioning the motives for additional liquidity injections. Although I find it difficult to see the positive consequences of this course of action over the long term, I am at least conscious of one welcome fact, which is that this economic cycle will not (yet) be brought to a halt by excessively high interest rates.

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