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PORTFOLIO UPDATE

OCTOBER 2019

- EQUITY MARKETS DEFY NEGATIVE HEADLINES
- PREVIOUS MONTHS' LOSSES MADE GOOD
- NEW STOCK PRICE DRIVERS URGENTLY NEEDED

REVIEW

Equity markets defy negative headlines

Numerous events in September could have knocked the equity market off course in September. The amazing thing is how well it is holding up against the uncertainties in the current environment. On top of the daily back and forth in the trade war came a surprise downslide in the European Purchasing Managers' Indices. As well as the ongoing gloomy sentiment in manufacturing, this also reflected growth expectations in the services sector, which also took a sharp turn for the worse. Before that, Chinese leading indicators had already signalled a growth slowdown. The decline in the US Consumer Confidence Index also shows that the trade war is gradually having an impact. While confidence is still excellent for the time being, more and more Americans worry about the performance of their own economy going forward. Even a sudden 15% hike in the oil price sparked by drone strikes on Saudi Arabian oil infrastructure failed to cause lasting harm on the financial markets, despite concerns about heightened geopolitical risks. A temporary explosive surge in the US interbank funding rate to 10% caused a stir among financial experts but ultimately proved to have little bearing on the pricing of equities.

That there were no major share price losses despite these events was once again down to supporting action by the central banks. The Chinese were not the only ones to try and counter the now clearly visible impacts of the trade war with additional monetary and fiscal policy measures. Both the European Central Bank and the Federal Reserve eased the monetary policy reins despite growing discontent. It seemed that numerous banks' cries for help were being heard, at least in Europe. In any case, the ECB took action to cushion the damage caused by the negative interest rate policy. Following the Swiss example, it has allowed banks greater headroom before having to pay penalty rates – although experts are rightly debating whether the recent rate cut will indeed boost eurozone lending or in fact discourage it.

The brightest ray of hope and the main reason for the financial markets' resilience, however, continues to be optimism around a solution to the trade conflict. It is a fact that investors are most sensitive to news directly connected to the dispute. Nobody doubts that a resolution in the near future would dispel consumer insecurity and bolster business investment confidence, thus softening the sharp economic slowdown in many places. Concessions made by the Chinese government on planned pork and soya bean imports are promising in this regard. These came as a goodwill gesture for the resumption of trade talks on 10 October. Trump, too, could do with a success to chalk up given the launch of impeachment proceedings.

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%
Aug 19	0.0%	-0.2%	-0.9%	-0.2%	-0.4%	-1.3%	0.1%	-0.3%	-1.1%	0.0%	-0.3%	-1.1%
Sep 19	0.4%	0.7%	1.2%	0.3%	0.6%	1.0%	0.4%	0.6%	1.0%	0.1%	0.2%	0.5%
2019	**7.1%**	**12.3%**	**16.0%**	**6.4%**	**11.3%**	**14.1%**	**8.4%**	**12.9%**	**15.1%**	**7.8%**	**12.7%**	**15.4%**

The recovery was not long coming. Just a few days' trading were enough to make good the previous month's losses. Hopes that the trade talks could move forward put investors in a positive frame of mind. This also benefited our strategies, most of which showed substantial gains over the course of the month. It was only towards the month-end that investor sentiment began to crumble again. That was once more down to the American president, who contrived to upset spirits yet again with the possibility of a ban on US firms investing in China.

In the end, however, all that had little impact on the monthly result. Our mandates showed growth across all risk and currency strategies. The gains here are exclusively attributable to equity investments, which were the only asset class to generate a positive return. Neither bonds nor alternative investments managed to add value on a consolidated basis in September.

No changes were made during September in terms of portfolio positioning and orientation. It was only in individual equities that delivered substantial gains over the course of the year that we were able to bring in part of the income. In this connection, we reduced the weightings for Nestle, Faurecia, Zoetis and Western Digital to their initial levels.

Equities (neutral)	Given the deteriorating economic prospects and the Trump administration's unpredictable trade policy measures, the equity allocation was reduced in June to a neutral level. 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

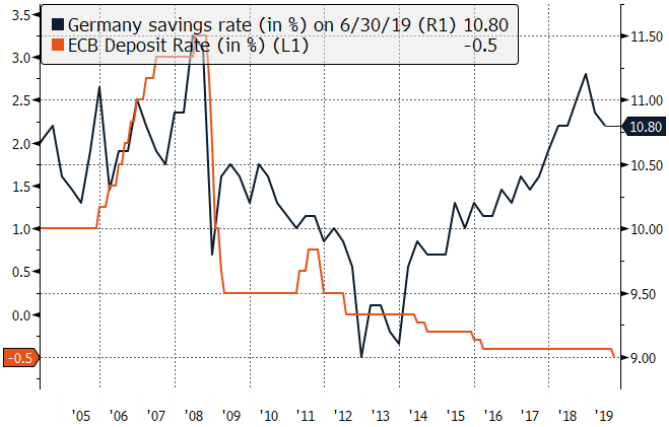
New stock price drivers urgently needed

Hardly anyone believes the trade dispute will be settled by the year-end. All the same, financial market players are increasingly taking the position that the deliberately induced trade war has a far more ambitious aim than merely improving the US trade deficit. That thought is not new, but economists seem to like the idea that the trade war is really about holding back China's economic ascent. In that scenario, neither an interim nor a lasting resolution would lead to the desired outcome, and such a resolution would scarcely be in the interest of the Americans. This points to a conclusion that the induced trade dispute will be with us for years yet, if not decades. Hopes of a resolution any time soon would be futile, thus pulling the justification out from under one of the financial markets' main current price drivers.

That leaves central banks' benevolence towards the financial markets. Yet here too, the success of their actions is increasingly questioned. There is hardly a company out there that blames a lack of investment on unfavourable financing conditions and calls for even lower borrowing terms. Even German consumers, with an eye to the uncertainties, seem to prefer a higher saving rate over hitting the shops (see chart on right). If there is no response to the central banks' efforts to stimulate the economy, yet another popular price driver will gradually lose its effect.

The stock market awaits the quarterly results published from mid-October onwards with corresponding anticipation. Anyone expecting anything momentous here might be disappointed. Some 73% of US companies that give profit guidance have thus forecast a decrease (source: Factset). In any case, it is feared that the third quarter will be the first time the trade dispute really makes a dent on income statements. Considering how analysts have dialled expectations right down, however, the opposite outcome is also possible. The yardstick is at any case at a level that leaves room for positive surprises.

Rising savings rate with falling borrowing rates (DE)



Sources: Bloomberg

In view of the mentioned uncertainties, the investment committee decided in September against changing the equity allocation. This had already been reduced to neutral in June in order to be less susceptible to any fluctuations on the financial markets. With the main price drivers to date potentially falling by the wayside and the economy continuing to sputter, we are currently forced to refrain from taking more risk back on board.

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