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FORUM FINANCE GROUP

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MONTHLY NEWSLETTER

September 2018

KEY ECONOMIC DATA PUBLISHED IN AUGUST

- China's July exports rose by 12.2% (YoY) compared to expectations of + 10%; imports increased by 27.3%, more than forecasts of 16.5%.
- China’s Caixin Manufacturing PMI declined to 50.6 in August, in-line with market expectations.
- Economic sentiment in the Euro-Zone rose in August (ZEW survey at - 11.1 vs. -18.7 in July). The PMI Composite number was stable at 54.4 in August, as expected.
- In Germany, economic sentiment (ZEW survey) was stable in August (72.6 vs. 72.4 in July). The IFO Business Climate Index was higher at 103.8, above expectations.
- US consumer confidence was 133.4 in August, above forecasts of 126.6.
- The US ISM Manufacturing Index was lower at 54.5 in August compared to forecasts of 55.
- US Q2 GDP growth was revised up to 4.2%, above forecasts of 4%.
- US payrolls in the private sector rose by 204K in August, above forecasts of + 194K.

THE TURKISH LIRA AND THE ARGENTINE PESO DEPRECIATED BY 25% VS. THE USD IN AUGUST

60%

ARGENTINA’S LEVEL OF INTEREST RATES

INVESTMENT PERSPECTIVE

August was a mixed month for global equity markets as the MSCI World Local Currency Index’s 1.1% gain was only the result of higher U.S. equity prices; in contrast, the Euro Stoxx 50 Index lost 3.8%, the Topix 1% and the MSCI EM Index 2.9%, in dollar terms, due to concerns about the ongoing trade dispute and the stress in emerging markets. This higher aversion to risk was also reflected by the significant strength of the Swiss franc, which appreciated by 2.9% against the euro, and by lower yields on U.S. Treasuries and Bunds. Emerging market bonds were badly impacted by EM currency weakness, with the J.P. Morgan EMBI Global Spread Index widening by 46bps to 400bps.

U.S. equities have continued to outperform and appear to be living in a world of their own. They are so far proving to be largely immune from the threat of a commercial war between the United States and its main trading partners and are benefiting from the acceleration of the domestic economy’s growth. The reporting of the second quarter’s corporate earnings has been outstanding, with revenue and earnings growing significantly and above analysts’ expectations. Growth stocks remain the drivers of U.S. equity performance with the technology sector and small caps leading the rally.

Turkey and Argentina continue to make negative headlines as they try to regain the confidence of financial markets. Despite their differences, both countries have seen inflation spiral out of control and investors question the independence of their central banks. Argentina has attempted to support its currency by dipping into its reserves, by seeking financial help from the IMF and by raising interest rates up to 60%, but to no avail so far. Turkey has taken a different route by not raising rates and by blaming external forces for their current plight, obviously not a response likely to reassure investors.

THE WEAKNESS OF EM CURRENCIES

Source: Bloomberg LP

The chart shows that the ongoing depreciation of emerging market currencies accelerated during August with the J.P. Morgan EM Currency Index dropping by more than 6%. Since its mid-February peak, the index has lost over 16%, led by the collapse of the Turkish lira and the Argentine peso. Since the end of 2017, the peso has depreciated by 50% vs. the U.S. dollar and the lira by 42%. Other currencies hurt by heavy losses include the Brazilian real (-18%), the South African rand (-16%) and the Russian ruble (- 15%). While all emerging markets assets have seen their values drop, the currencies have suffered the most due to the unwinding of an early-year overweight positioning.

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INVESTMENT STRATEGY

The ongoing turbulence in emerging markets is weighing on market sentiment, especially as the risks of contagion are increasingly mentioned, even if not justified. Tensions over trade persist, despite the recent agreement between the U.S. and Mexico, and there has been no progress between the United States and China or Europe. This means that the tug-of-war between a strong economic and corporate framework and negative headline news is back. We are sticking to our positioning and are keeping a modest overweight allocation into equities as we believe that the supportive fundamentals will prevail, helping markets that have underperformed to make up some lost ground.

2018 is proving to be a very challenging year for portfolios, with rising U.S. yields, wider credit spreads and weak equity markets outside of the U.S. It is therefore reassuring to note that our active fund managers have fared very well relative to their benchmarks. The debate over active and passive management is ongoing, and far from concluded, but we are convinced that the selection of good active managers truly adds a lot of value to the portfolios.

PORTFOLIO ACTIVITY/NEWS

August was a positive month for the portfolios. The best contributions by far were provided by U.S. equity funds, while convertible bonds and the CTA strategy contributed more modestly. Our recent recommendation to invest into a U.S. small cap growth fund has proved to be very timely as the fund produced a very strong return during the past month. Emerging and frontier markets were the worst detractors along with a Global Macro fund. For portfolios denominated in euros, the appreciation of the dollar also boosted their performance.

In August, our main investment decision was to reduce our exposure to the dollar following its steep appreciation early in the month. We believe that a lot of good news has already been priced into the greenback and observed that market positioning had become extended. We also added a new Japanese fund focused on companies with high growth potential as well as a European fund currently positioned in a defensive manner and exposed to out of favour sectors.

THE DOLLAR EXPOSURE HAS BEEN REDUCED

	End 2017	July 2018	August 2018	MTD	2018
Equities					
S&P 500	2673.6	2816.3	2901.5	+ 3.0%	+ 8.5%
Euro Stoxx 50	3504.0	3525.5	3392.9	- 3.8%	- 3.2%
MSCI EM	1158.5	1087.5	1056.0	- 2.9%	- 8.8%
Yields					
UST 10-year	2.41%	2.96%	2.86%	- 10bps	+ 45bps
Bund 10-year	0.43%	0.44%	0.33%	- 11bps	- 10bps
BBB EU	1.44%	1.72%	1.66%	- 6bps	+ 22bps
Currencies					
EUR/USD	1.201	1.169	1.160	- 0.8%	- 3.4%
USD/CHF	0.974	0.990	0.969	- 2.2%	- 0.5%
EUR/CHF	1.170	1.158	1.124	- 2.9%	- 3.9%
GBP/USD	1.351	1.312	1.296	- 1.2%	- 4.1%
Commodities					
CRB Index	193.9	194.5	193.0	- 0.8%	- 0.5%
Oil (WTI)	USD 60.4	USD 68.8	USD 69.8	+ 1.5 %	+ 15.6%
Gold	USD 1303	USD 1224	USD 1201	- 1.7%	- 7.8%