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FORUM FINANCE GROUP

1994

MONTHLY NEWSLETTER

November 2018

KEY ECONOMIC DATA PUBLISHED IN OCTOBER

- China's September exports rose by 14.5% (YoY) compared to forecasts of + 8.4%; imports increased by 14.3%, below expectations of 15%.
- China's Caixin Manufacturing PMI edged up to 50.1 in October, compared to market expectations of 50.
- Economic sentiment in the Euro-Zone fell in October (ZEW survey at -19.4 vs. -7.2 in September). The PMI Composite number was also weaker in October at 52.7 (53.9 expected).
- In Germany, economic sentiment (ZEW survey) weakened in October (70.1 vs. 76 in September). The IFO Business Climate Index also dropped to 102.8, below expectations.
- US consumer confidence was 137.9 in October, above forecasts of 135.9.
- The Markit US Manufacturing PMI Index edged lower in October at 55.7, compared to forecasts of 55.4. The Services PMI rose from 52.9 in September to 54.7.
- US payrolls in the private sector rose by 246K in October, forecasts of + 195K.

THE WORST MONTH FOR THE S&P 500 SINCE SEPTEMBER 2011: -6.9%

10%

EXPECTED EPS GROWTH FOR THE S&P 500 IN 2019

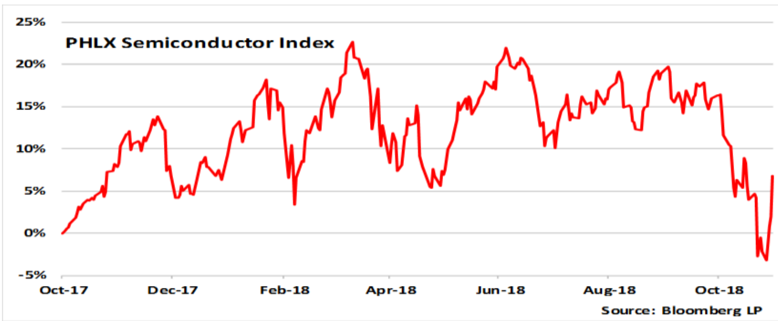
INVESTMENT PERSPECTIVE

October lived up to its reputation of being a volatile month for equity markets reflected by the 6.9% drop of the MSCI World Index, in local currency terms. The rout was widespread as stock markets across the world were hit by fears over slowing growth, trade wars and higher interest rates. For once, American equities failed to offer any additional resistance than the other markets and a number of technology favourites, such as Amazon and Netflix, suffered from heavy selling. The fall of the equity market showed a lot of similarity to the one that took place in late January/early February; equities suddenly dived following a period of fast rising Treasury yields whereas safe haven assets did not benefit that much from the sell off; 10-year Treasury yields ended the month 8bps higher and the price of gold appreciated by less than 2%.

The reporting of U.S. corporate earnings for the third quarter of 2018 can hardly be blamed for the equity market's poor behaviour even if there was some concern expressed over the forward guidance of certain companies. With more than 400 S&P 500 companies having reported, 82% have beaten profit estimates and 61% their revenue estimates; earnings growth is 27%, year-on-year, while revenue grew by nearly 9%. These results are outstanding but investors seem to have increasing doubts over next year's earnings which are expected to grow by some 10%. European companies have also been busy reporting their quarterly results, with solid growth rates of 12% for earnings and 6% for revenue.

The stress in equity markets was not helped by the ongoing sagas represented by the tensions over trade, the Brexit negotiations and the Italian budget. For the first time, the European Commission formally rejected a member's budget plans and yields on 10-year Italian bonds spiked to nearly 3.7% on the news, with the spread over Bunds climbing above 3.25%. In turn, the banking sector was under serious pressure with Italian banks being impacted the worst.

A TORRID MONTH FOR THE SEMICONDUCTOR SECTOR



The behaviour of equity markets during October was well illustrated by the highly volatile semiconductor sector. The PHLX Semiconductor Index plunged by 17% between the 3rd and 29th of October on concerns about forward guidance, valuations and U.S. relations with China. The reaction of investors following the publication of results was brutal at times and triggered waves of selling due to the breach of key technical levels. Along with the global equity markets, the sector has started to rebound from its end October low, with a 10% upside move at the time of writing.

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INVESTMENT STRATEGY

We consider the October selloff to have been more of a temporary setback than the beginning of a new bearish trend for equity markets. When we look at monetary and economic factors, market sentiment, valuations and earnings growth prospects, we do not feel it is the time to reduce our equity exposure. Investors may have become too accustomed to levels of volatility well below long-term averages and tend to overreact when markets correct. Valuations look attractive, with European equities trading back to 2013 levels (less than 13 times next twelve month earnings), and U.S. ones (15.7x NTM) dropping below the one standard deviation from their 5-year average. The contraction of these multiples this year has been significant and tends to indicate a good entry point. We expect the equity markets to benefit from the removal of a certain number of uncertainties in the near future and to end the year on a stronger note.

Our exposure towards the U.S. dollar has not changed as we continue to believe that a lot of positive news is already priced in. The market positioning is also quite long, hence the limited potential for further massive inflows. Once again, the resolution of certain issues in Europe should contribute to boost the value of the euro versus the dollar.

THE RECENT MARKET SELL OFF IS LIKELY TO BE A TEMPORARY SETBACK

PORTFOLIO ACTIVITY/NEWS

October was a stressful month for the portfolios with the equity sell off obviously being the main culprit for the monthly drawdown. All equity funds lost ground with Japanese, EM and U.S. equities faring the worst. To note that value and defensive stocks outperformed growth and cyclical ones, largely explaining a wide dispersion of our funds' returns. It was also somewhat reassuring to observe that frontier markets proved to be quite resilient as they registered less than half of the monthly loss of developed markets.

On a brighter note for the portfolios, the fixed-income and alternative exposures held up well, with the Global Macro, CTA and Risk Premia strategies even producing positive monthly contributions. It was quite revealing that major bond indices failed to record any gains during such a difficult period for risk assets; this highlights the challenge to build a truly diversified portfolio. Another positive contribution for non-USD portfolios was due to the stronger U.S. dollar which appreciated against the other major currencies.

	End 2017	September 2018	October 2018	MTD	2018
Equities					
S&P 500	2673.6	2914.0	2711.7	- 6.9%	+ 1.4%
Euro Stoxx 50	3504.0	3399.2	3197.5	- 5.9%	- 8.7%
MSCI EM	1158.5	1047.9	955.9	- 8.8%	- 17.5%
Yields					
UST 10-year	2.41%	3.06%	3.14%	+ 8bps	+ 73bps
Bund 10-year	0.43%	0.47%	0.38%	- 9bps	- 5bps
BBB EU	1.44%	1.83%	1.80%	- 3bps	+ 36bps
Currencies					
EUR/USD	1.201	1.160	1.131	- 2.5%	- 5.8%
USD/CHF	0.974	0.982	1.009	+ 2.7%	+ 3.6%
EUR/CHF	1.170	1.140	1.141	+ 0.1%	- 2.5%
GBP/USD	1.351	1.303	1.277	- 2.0%	- 5.5%
Commodities					
CRB Index	193.9	195.2	191.0	- 2.2%	- 1.5%
Oil (WTI)	USD 60.4	USD 73.3	USD 65.3	- 10.8%	+ 8.1%
Gold	USD 1303	USD 1191	USD 1215	+ 1.9%	- 6.8%