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FORUM FINANCE GROUP

1994

MONTHLY NEWSLETTER

September 2019

KEY ECONOMIC DATA PUBLISHED IN AUGUST

- China's July exports rose by 3.3% (YoY) compared to forecasts of - 1%; imports dropped by 5.6%, less than expectations of - 9%.
- China’s Caixin Manufacturing PMI was higher at 50.4 in August versus market expectations of 49.8.
- Economic sentiment in the Euro-zone dropped in August (ZEW survey at - 43.6 vs. - 20.3 in July). The PMI Composite number was higher at 51.9 (51.2 expected).
- In Germany, economic sentiment (ZEW survey) plunged in August (- 44.1 vs. - 24.5 in July). The IFO Business Climate Index declined to 94.3, below expectations of 95.1.
- US consumer confidence climbed to 135.1 in August, above forecasts.
- The Markit US Manufacturing PMI Index weakened in August to 49.9, below forecasts. The Services PMI was also lower at 50.9, well below market forecasts of 52.8.
- US payrolls in the private sector rose by 96K in August vs. forecasts of + 158K, with July numbers revised from 148K to 131K.

+ 18%: THE PERFORMANCE OF GOLD IN 2019

1.50%

THE END-AUGUST YIELD ON 10-YEAR U.S. TREASURIES

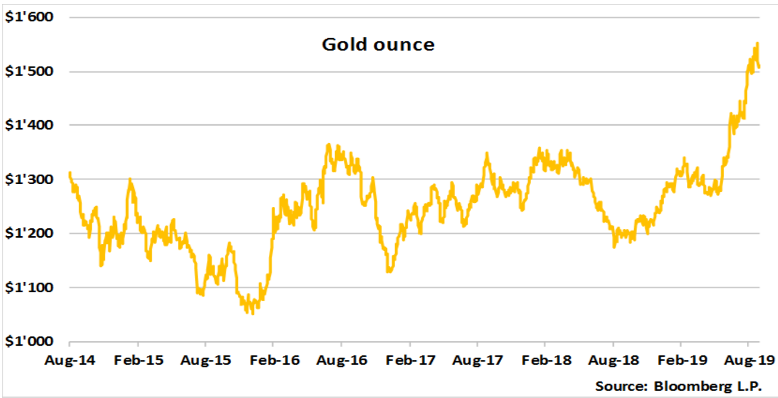
INVESTMENT PERSPECTIVE

The month of August proved to be much more volatile, largely thanks to Donald Trump’s Twitter activity going into overdrive; according to the New Yorker, Trump tweeted six hundred and eighty times during the month. Equity markets reacted to all kinds of headlines, at times violently, as trade tensions between the U.S. and China ratcheted up to another level and as political risks spiked across the world; markets were also weighed down by recession fears as the closely-observed 10-year/2-year Treasury yield curve briefly inversed. Global equities recorded four consecutive negative weekly returns before staging a rebound at the end of the month. The decline of high-quality sovereign debt yields accelerated, with that of the 10-year U.S. Treasury note dropping by 0.52% to 1.50%, its lowest level since July 2016, while the yield on 10-year Bunds reached a new all-time low of - 0.72%.

Once again, the tweeting activity of Donald Trump had a major impact on the capital markets; in early August, the U.S. President announced 10% tariffs on $300 billion worth of imports from China, up to then not subject to levies. This triggered a drop of the Chinese yuan in retaliation and the tensions between both countries continued to intensify. Trump was also very busy attacking the chairman of the Federal Reserve, Jerome Powell, whom he referred to as “clueless Jay Powell” and whom he accused of a “horrendous lack of vision”. As often in the past, when markets had been under pressure, Trump adopted a more conciliatory tone towards China later in the month, which contributed to equity markets regaining part of their August losses.

Another issue often mentioned during August was the possibility that fiscal stimulus could increase significantly, especially as the monetary policies of the main central banks appear to be reaching their limits. The fact that German officials openly talked about what kind of fiscal support they could introduce was very revealing of the impact that the downturn of the economy is having.

A STRONG MONTH FOR GOLD



Gold has been one of the main beneficiaries of tumbling bond yields. The chart shows that the price of gold has been rising strongly since the end of May as long-term Treasury yields have collapsed. With negative real interest rates prevailing across many economies, gold is no longer being penalized by its lack of income distribution; the rise of market volatility has also been a contributor to the commodity’s recent strong performance.

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INVESTMENT STRATEGY

During the summer, we maintained our disciplined approach as we stuck to our relatively defensive asset allocation and even added some equity protection. Over the recent period we have observed rising market volatility, another flare-up of political risks in Europe and higher trade tensions at a time when data has been showing economic weakness. Rather than betting on strong support from central banks and on a positive resolution to the U.S.-China trade conflict, we prefer to err on the side of caution and maintain our underweight equity allocation. This stance is also explained by our focus on active risk management in a context where year-to-date performances have exceeded most of our expectations.

The trend of bond markets has continued to reflect rising concerns over recession risks and anticipations of further rate cuts by the major central banks. While we agree that the weakening of economic data justifies part of the recent rally of bonds, we think that it has likely overshot and would expect a rebound of yields in the near term.

WE MAINTAIN OUR UNDERWEIGHT ALLOCATION TOWARDS EQUITIES

PORTFOLIO ACTIVITY/NEWS

In August the portfolios ended in negative territory but the late-month rebound of global equity markets meant that the monthly drawdown was limited. The best contributions were provided by fixed-income exposures as well as some hedge funds, in particular the trend-following strategy, thanks to its high exposure to rates. The steep decline of bond yields was the main driver for long duration fixed-income funds, with some reaching double-digit year-to-date performances, quite an achievement! Most of our equity funds outperformed their benchmarks and ended with positive monthly returns. Amongst the laggards, the U.S. value and Japanese growth positions fared the worst.

During the summer, we protected the portfolios by buying a put warrant on the S&P 500 Index. This was carried out at a time when volatility was cheap, enabling to limit the cost of this transaction. The main interest of this put warrant is that it has a "lookback" feature, meaning that its 95% strike will be fixed at the peak level of the index during the lifetime of the warrant. In the case of an equity rally followed by a correction, this solution would offer much better protection than a plain vanilla put where the strike is never ajusted.

	End 2018	July 2019	August 2019	MTD	2019
Equities					
S&P 500	2506.9	2980.4	2926.5	- 1.8%	+ 16.7%
Euro Stoxx 50	3001.4	3466.9	3426.8	- 1.2%	+ 14.2%
MSCI EM	965.7	1037.0	984.3	- 5.1%	+ 1.9%
Yields					
UST 10-year	2.68%	2.02%	1.50%	- 52bps	- 118bps
Bund 10-year	0.24%	- 0.44%	- 0.70%	- 26bps	- 94bps
BBB EU	1.89%	0.57%	0.40%	- 17bps	- 149bps
Currencies					
EUR/USD	1.147	1.108	1.098	- 0.9%	- 4.3%
USD/CHF	0.982	0.994	0.990	- 0.4%	+ 0.8%
EUR/CHF	1.126	1.101	1.089	- 1.1%	- 3.3%
GBP/USD	1.275	1.216	1.216	+ 0.0%	- 4.6%
Commodities					
CRB Index	169.8	178.5	170.4	- 4.6%	+ 0.4%
Oil (WTI)	USD 45.4	USD 58.6	USD 55.1	- 5.9%	+ 21.4%
Gold	USD 1282	USD 1414	USD 1520	+ 7.5%	+ 18.6%