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FORUM FINANCE GROUP

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MONTHLY NEWSLETTER

October 2019

KEY ECONOMIC DATA PUBLISHED IN SEPTEMBER

- China's August exports dropped by 1% (YoY) compared to forecasts of + 2.2%; imports dropped by 5.6%, less than expectations of - 6.4%.
- China's Caixin Manufacturing PMI was higher at 51.4 in September versus market expectations of 50.2.
- Economic sentiment in the Euro-zone improved in September (ZEW survey at - 22.4 vs. - 43.6 in August). The PMI Composite number was lower at 50.4 (52 expected).
- In Germany, economic sentiment (ZEW survey) jumped in September (- 22.5 vs. - 44.1 in August). The IFO Business Climate Index was stable at 94.6, in-line with expectations.
- US consumer confidence plunged to 125.1 in September, below forecasts of 133.
- The Markit US Manufacturing PMI Index improved in September to 51.1, above forecasts. The Services PMI was also higher at 50.9, but below market forecasts of 51.4.
- US payrolls in the private sector rose by 114K in September vs. forecasts of + 130K, with August numbers revised from 96K to 122K.

THE GLOBAL STOCK OF NEGATIVE-YIELDING DEBT REACHES $17 TRILLION

10%

THE OVERNIGHT REPO LENDING RATE SPIKES

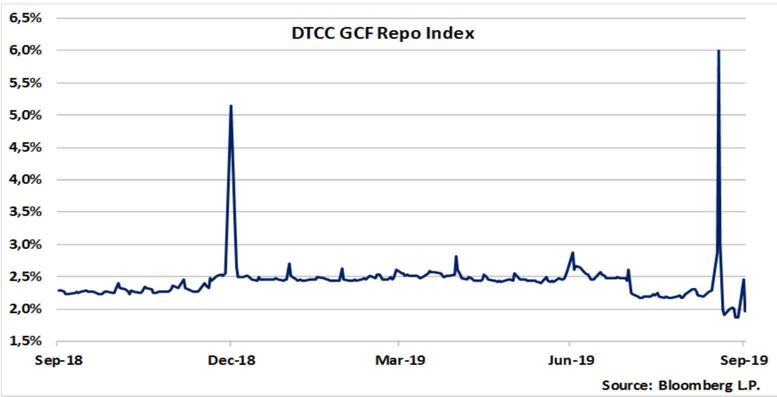
INVESTMENT PERSPECTIVE

Risky assets fared well during September as trade tensions eased somewhat. The MSCI World, in local currencies, appreciated by 2.2%, with Japanese and European equities outperforming, whereas government bonds pared back some of their strong year-to-date gains. Gold was also in consolidation mode as a result of higher yields and of a firmer U.S. dollar. The past month was marked by a major attack on Saudi Arabia's oil infrastructure which triggered a spike of oil prices; this proved to be only temporary however as the release of strategic reserves and a faster-than-expected recovery of production then pushed prices below their end-August levels. Politics continued to be a key driver for markets; the formation of a new coalition government in Italy and a series of defeats for Boris Johnson's U.K. government, deemed as reducing the chances of a no-deal Brexit, were taken positively by investors.

The September meetings of the European Central Bank and the U.S. Federal Reserve were highly awaited by the markets. The ECB decided to cut rates by 0.1% to - 0.5%, to restart QE (€20 billion per month) and to introduce "tiering" for banks in order to limit the impact of negative rates on their profitability. The ECB will also offer banks new TLTROs (targeted long-term financing) with favourable terms. On its side, the Fed cut rates by 0.25% to a range of 1.75% to 2% but said that it didn't expect further rate cuts this year. Members of the Federal Open Market Committee (FOMC) were much divided on the bank's next move, with seven members wanting at least one more reduction in 2019.

The global stock of negative-yielding debt surpassed $17 trillion at the onset of September. According to Bloomberg, thirty percent of all investment-grade securities are trading with sub-zero yields, including corporate bonds. With global economic growth slowing and central banks back in easing mode, this stock of negative-yielding debt could well keep on expanding.

THE LIQUIDITY CRISIS IN THE REPO MARKET



Source: Bloomberg L.P.

The market for repurchase agreements, or repos, has recently been under stress temporarily, exposing some fundamental weaknesses as a number of structural changes have drained up too much cash from the financial system. In September, a mix of big Treasury auctions, corporate tax payments, and the need for financial firms to manage their capital requirements prior to the end of the quarter resulted in a shortage of cash, with the overnight lending rate briefly spiking to 10%.

The Forum Finance Group SA
6, rue de la Croix d'Or – P.O. Box 3649 – CH-1211 Geneva 3 – T +4122 311 84 00 – FFGG.COM

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INVESTMENT STRATEGY

Since the beginning of the year, the consensus of the market anticipated an improvement of the global economy in the second half of the year. This optimistic scenario has been increasingly put into doubt as macroeconomic data has failed to show signs of a rebound. We have been quite surprised that markets have brushed these concerns aside so easily and placed so much faith in the ability of central banks to offer sufficient additional support to extend the economic cycle. Indications that the so-far resilient consumer sector is also starting to show some weakness would likely only amplify the current growth concerns. The upcoming reporting of third-quarter corporate earnings is likely to focus on the impact of the economic environment on capital investment and on the outlook for future earnings. These factors largely explain why we are sticking to a more cautious portfolio positioning as we look to protect strong year-to-date gains.

As we had expected, bond yields rebounded from their year-lows as investors took some profits and the bond rally had clearly been overbought. However a big rise of bond yields is not our main scenario, in a context of softening economic activity and of easier monetary policies.

ECONOMIC WEAKNESS LIKELY TO WEIGH MORE ON MARKETS

PORTFOLIO ACTIVITY/NEWS

The portfolios ended September higher thanks to the positive performances of equity positions. The rebound of bond yields meant that the overall contribution of the fixed-income asset class was close to neutral. The past month's best contribution was provided by our U.S. value fund which benefited from the rotation out of momentum and growth stocks into deep value ones. It is still too early to know whether this shift will prove just to be a temporary trend or a more sustainable one, but what is certain is that value stocks are trading at a record discount compared to growth stocks. Our allocation into Japanese equity funds was another strong contributor in view of the monthly outperformance of Japanese equities. The much discussed trend-following strategy was the biggest detractor in the portfolios as it suffered from the impact of rising bond yields, but still stands around + 20% YTD.

We added a defensive global equity fund to the portfolios in September. The fund has a value approach and its current defensive positioning is reflected by a significant exposure to cash and to gold. At a time when certain market factors appear to be running out of steam, the fund could benefit from renewed demand for value stocks and from a normalisation of bond yields.

	End 2018	August 2019	September 2019	MTD	2019
Equities					
S&P 500	2506.9	2926.5	2976.7	+ 1.7%	+ 18.7%
Euro Stoxx 50	3001.4	3426.8	3569.5	+ 4.2%	+ 18.9%
MSCI EM	965.7	984.3	1001.0	+ 1.7%	+ 3.7%
Yields					
UST 10-year	2.68%	1.50%	1.67%	+ 17bps	- 101bps
Bund 10-year	0.24%	- 0.70%	- 0.57%	+ 13bps	- 81bps
BBB EU	1.89%	0.40%	0.59%	+ 19bps	- 130bps
Currencies					
EUR/USD	1.147	1.098	1.090	- 0.7%	- 5.0%
USD/CHF	0.982	0.990	0.998	+ 0.8%	+ 1.6%
EUR/CHF	1.126	1.089	1.088	- 0.1%	- 3.4%
GBP/USD	1.275	1.216	1.229	+ 1.1%	- 3.6%
Commodities					
CRB Index	169.8	170.4	173.9	+ 2.1%	+ 2.4%
Oil (WTI)	USD 45.4	USD 55.1	USD 54.1	- 2.0%	+ 19.2%
Gold	USD 1282	USD 1520	USD 1472	- 3.1%	+ 14.8%