MOUNT INVEST

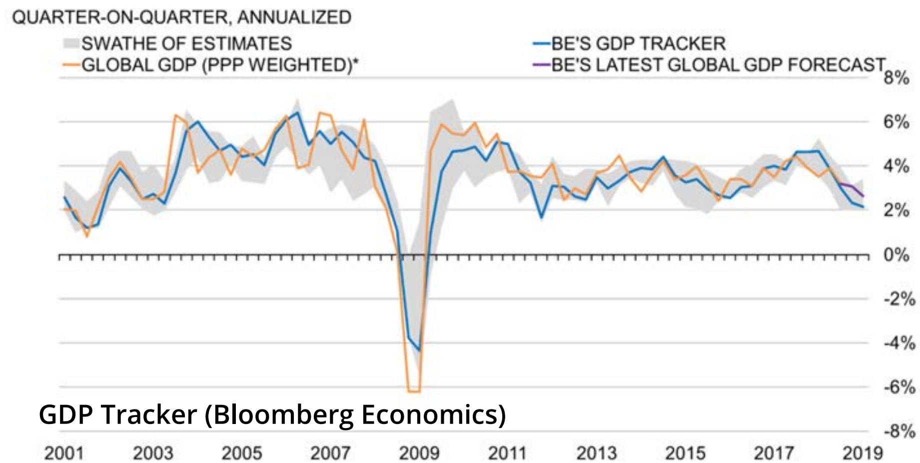
OUTLOOK 2Q2019

April 2019

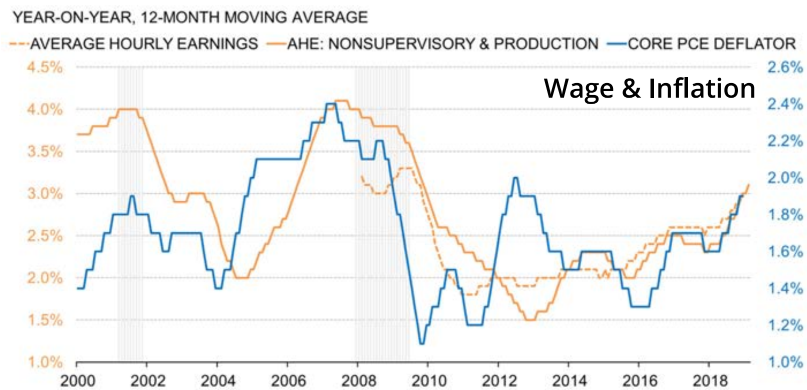
Partner of AWAP

HOW TO PILOT A SOFT LANDING ?

Downward revisions of growth and corporate earnings underway. An economic upswing could be seen but we rather think it could stall going forward as government spending, tax cuts and monetary incentives are fading. The central banks of developed markets will now face the challenge to have their economies landing in a soft manner. How to land a 747 on a small road ? Challenging...



The US economy is already in a bear market... Can we validate such sentence? We do believe there is room for this assertion as some macro-economic numbers pointed to weak trends and slump in growth. But the data collection in today's world is not as accurate as before (can't trust the numbers...). If we believe the inversion curves predictions, a recession could come within 12 months (on average looking at previous cycles). As mentioned in our Short Outlook 2019, the "rupture" like the ones seen in previous market cycles comes after a prolonged market upswing characterized by market volatility.



As of today, markets have rebound significantly, and we do expect some consolidation after new highs. Be also aware that markets anticipate economic cycles and we may see a downtrend following the final and so much expected trade deal between the US-China, the EU elections as well as the Brexit saga ending... (or never ending?).
The IMF cut its global growth outlook to the lowest level since the financial crisis.

Volatility will return and we would like to avoid being caught in the downtrend while trying to get some of the possible further appreciation of the risky assets.

THE ROAD AHEAD

Investors should curb short-term expectations as fundamental and structural challenges remain high. Bond markets pricing these factors, while equities within historical highs. Which one is right? Market uncertainties induced by politics will drag on equities. They should underperform the global economics data.

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LIQUIDITY & SIMILAR

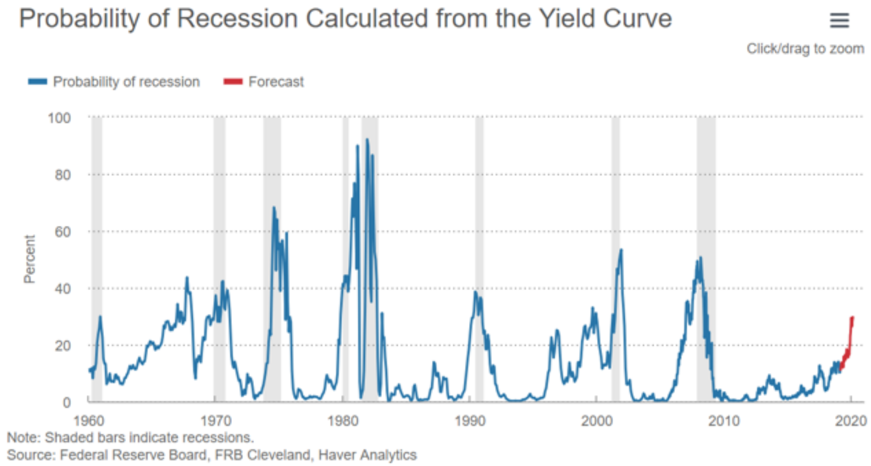
Mixed signals in terms of global activity. The FED moved to a very dovish stance. Mild inflation pressures and a downgraded economic forecast are part of the current views. Some developed economies with no engine to run further growth. UK-EU relations near a cliff edge that has been delayed = procrastination is the new trend... The total cumulated debt worldwide stands at USD 180'000 billions! Yet the burden of the debt is manageable but for how long? Central Banks could face the lack of ammunition for the next recession fight = policy tools in a short supply!

The EU leaders gave another 6 months to the UK to avoid a no-deal Brexit. As of today, discussions for a delayed extension needs further UK commitments and/or approval. But to postpone a problem is not to solve it! We still believe the hard Brexit should materialized as hardliners should not commit to the 3 times presented deal that the EU wants to see. Avoid exposure to GBP and related equities till the end of the saga (Season 3 episode 55...). Procrastination is the new trend...

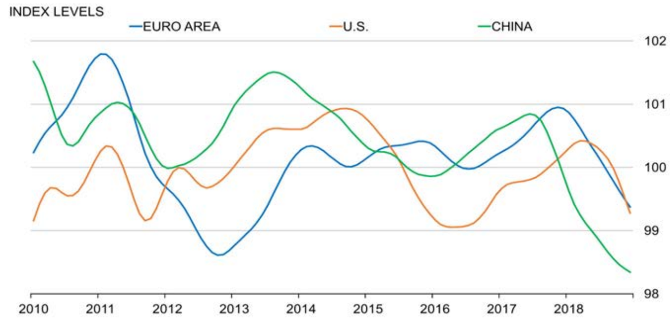
The ECB pointed to potential further easing. It already reduced its QE and should monitor the period of slowing growth for any rates or non-conventional monetary directions. As of today, the negative interest rates are still effective and the yield on some "AAA" governments are near the 0 level. Any economic data revisions (happening in mostly developed economies) on the upside should materialize with further money tightening by the ECB. We believe the EUR has room to strengthen but we need to see a "better Europe" instead of a the traditional "more Europe". USDEUR target to 1.15 maintained.

A US rate cut soon? Probably not but the Fed Funds Futures are pricing one by January 2020. This raise the question of a serious slowdown. We still see further tightening within the year (+50bps max).

The MXN overnight rate was kept unchanged at 8.50%. The Peso weakened and we continue to advise to sell the currency vs USD at the lower range of 19.00 (or under) and to wait for levels above 19.65 to close positions as we believe the uncertainty surrounding the control of public accounts will create problems on budgets and medium-term growth.



Momentum is easing across the world's major economies (Source: OECD)



LIQUIDITY PEAK ?

When you run negative interest rates for a long time, you undercut the ability of the financial sector to provide credit. This influences the rate of growth and money supply needed to pursue any expansion...

High Yield Spreads (US & EU)

FIXED INCOME & SIMILAR

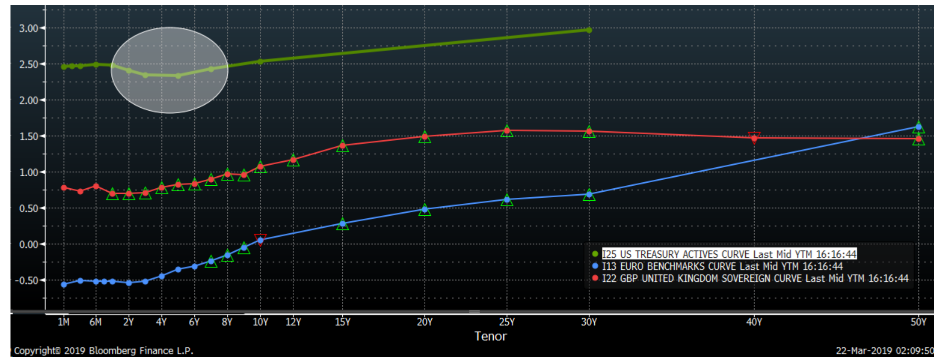
The FED has turn pessimistic and passive. Still expect eased financial conditions but with a limited policy space, i.e. no much room to move. High yield spreads signal no danger (yet...) but current spread levels could burst and the segment be the "canary in the coal mine". Fears of recession are starting to go higher and curve inversions seen as a pre-downturn (with a 1Y lag on average...). We do not foresee such in the next quarters but probably in 2020 (earlier if trade war does not settle). As volatility is expected to rise, we would argue for a "barbell" strategy

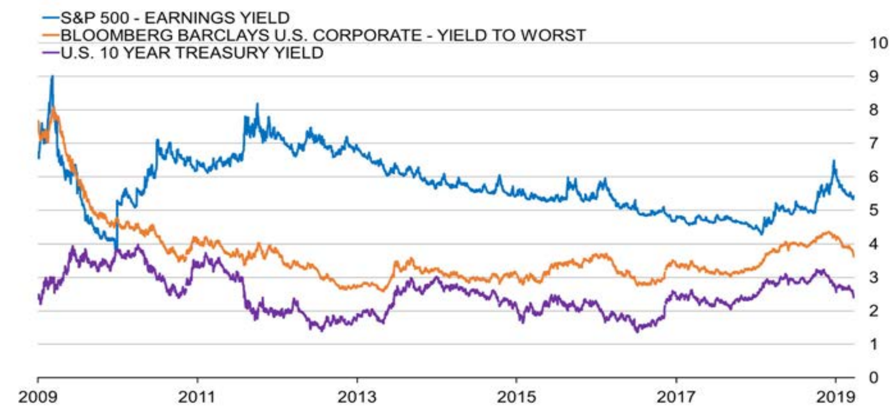
The rates on hold for a prolonged time. This is the resume of the latest FOMC meeting. The Treasuries have reacted, and medium-long term yields have fallen (the 8-10Y segment). We are still on an inverted curve in the 2Y-5Y spread and soon could see the 2Y-10Y spread inversion!
Yield curve inversion are predictors of recessions, but it's not immediate. Actually, the FED holds a larger share of Treasuries compared to previous periods. This diminishes the impact of the inverted curve signals. Some additional economic numbers are key. As of today, the FED has tightened monetary conditions by +525bps considering +225bps of rate hikes and +300bps of QE inversion (Quantitative Easing). The consequence: a pause of the tightening cycle and assessment were to land the current cycle. We still believe at least one more hike rate will be seen in 2019. A yield curve steepening is not expected at the moment but we will see it sooner than later. The FED move may influence the rate at which other central banks tighten monetary policy.

The ECB kept its benchmark rate unmoved and Governments bonds trade near the 0% yield levels ! Italy is underperforming and we will look to lock-in gains on our 5Y treasuries (with more than 4% returns on a few months).

Globally, central banks may face the lack of “ammunition” for fighting the next recession as rates are still well below previous hiking cycle tops.

Credit spreads lower and near the peak. Difficult to find value within the High Grade segments. For US Corporates, we still favor high-quality segments and remain cautions on high-yield (for which exposures have been reduced). We may look to "floored-floaters" structures to provide a minimum coupon per annum and upside potential in case rates rise.





FIXED INCOME POSITIONNING

The FED dot plot revision should help a curve steepening. We still favor High Grade corporates and invest in the short and long end of the risk spectrum

EQUITIES & SIMILAR

Risk appetite is waning. US and global economies are somewhat struggling. Downside scenarios are higher than previous quarters and cautiousness will prevail. As some economists are saying: "the world economy is not running on all cylinders". Take profits and rebalance towards quality. We reduce our direct risk-on exposure on portfolios and will switch to options for exposures. Avoid the equity "value trap"*. Hedge portfolios as current volatility is still low

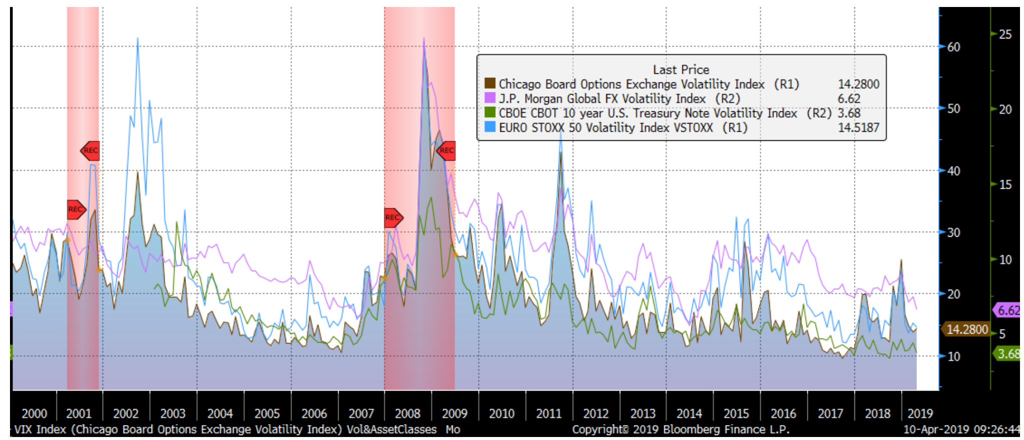
After comments early 4Q18 (Chart point A) from the US FED Chairman about rates being a "long way from neutral" (i.e. more hikes to come) the markets started a downtrend followed by a dive in December after some comments (B) on a "balance sheet run-off on automatic pilot and the rate policy as the active tool of monetary policy". Early January (C), the same Chairman commented the fact that the FED "wouldn't hesitate to change it (the automatic pilot) and that produced a shift in risk-mode perception for investors, thus leading to the current rally year-to-date. On the latest FOMC meeting (21.03.19, D), as expected no rates hike. Also the vision of rates on hold for a prolonged time. This buys time for the market to get a bit more suction to new highs...

Asian markets have performed well and should continue to do so but we would recommend to look at countries specific exposures to find value.

Earnings growth should suffer. Year over year we saw them dropping because of weak global growth and declining operating margins. Spending cuts and a weaker dollar should materialize if we want to see a sustained market rallies in the next few quarters.

Look for recession proof sectors: healthcare, utility, consumer staples. Also invest in companies with sound short-term liquidity and long-term solvency. As such, we recommend to slowly switch to value investments and take profits of new market highs to unload some equity exposures. Expect a more volatile period for stocks in the short term.

*value trap explained in the "Vision Ahead" page



REDUCED RISK-ON MODE

In today's environment, any opportunity is a high-risk bet. We think the "euphoria" rally could materialized but to invest now to get this potential "final rally" is a bet we won't recommend at the moment. Better play it safe with option exposures or wait better entry points, for rebounds play

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ALTERNATIVE INV. & SIMILAR

Gold rush followed by soft patch. The precious metal is gaining traction with volatility. Keep or add exposure. Real Estate assets still favored but look at segments to be on the right place. Oil trend is up: targets soon reached, and protections needed soon. Commodities should continue to perform in this late economic cycle. Keep an eye at the Crypto currencies (on a positive run lately). Volatility still lags but should resume in this quarter (during the "sell in May and go away"?). We add options strategies to take part of any spike in the segment

Strong inflows into gold-backed ETFs and similars underway. Monetary policy and USD dollar trend will be key drivers for the precious metal. We keep an exposure and look to have a positive trend in the quarter. Expect the Gold within the 1350-1400 range in a few months.

In parallel, Silver and Platinum have lagged and are now good candidates for a "normalization" towards the Palladium and Gold actual levels (since 1987, historically the Platinum has traded (mostly) above the Gold prices. Since 2015 a divergence has been noted that should revert to its mean, i.e. have spreads of -129 vs 410 today! Idem for Silver, with data from 1950 showing a mean divergence of 389 points vs today 1290!) = buy!

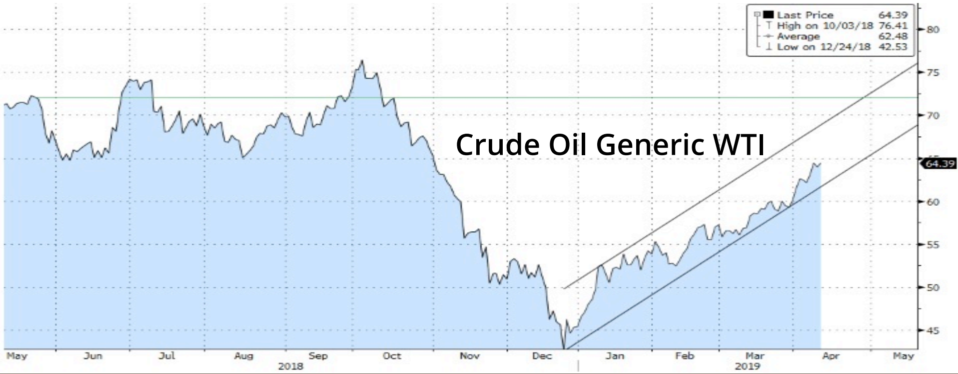
The commodities strong returns seen during the 1Q19 should continue and rally further on demand growth combined with fiscal stimulus and market deficits within the sector (good for metals).

The oil demand is improving on seasonal demand and production tightening (combined with geopolitical troubles in some major exporting countries). The oil market should tighten further and our scenario of a WTI at US$ 65 per barrel is almost reached. Later, a trend towards the 75 levels is expected (see chart channel).

Real Estate valuation still appropriate, even more in Switzerland where current dividend yield of 2.70% exceeds Fixed Income yields by far. But slowly reduce exposure and take profits.

Since our "Short Outlook 2019" the crypto currencies have performed well: +35.44% on Bitcoin, +33.84% on Ethereum, etc. The segment should continue its growth but expect some profit taking (aprox -15%) before entering (if you do not hold positions).

We recommend to hedge portfolios using puts on indices!



A BET IN THIS QUARTER

Looking at Platinum and Silver spreads vs Gold, we strongly believe a catch up valuation of the two metals would occur and advise to invest in both via ETFs (for risk oriented investors only)

INVESTMENTS FOCUS

2019 is shaping up to be a slower and bumpier year for the world economy. As stated by the IMF: “The global economy is highly vulnerable to a debt crisis as dangerous levels of business and government borrowings could crush growth and exacerbate any slump”. Shocks can be amplified if nothing is set to curb the latter. As of today, we do not see any improvement on both matters

Liquidity & Sim.: Overweight Cash and place in USD call 48h; Sell MXN vs USD under 19.00 (currently)

Fixed Income & Sim.: In USD, buy the short end and long end of the risk curve. Favor corporates within the High Investment Grade spectrum

Equities & Sim.: ***Value trap:** equities with earnings growth deceleration combined with downward analyst revisions. Some stocks appear appealing but are currently not worth the risk

Buy worldwide technology, consumer-discretionary and health-care stocks for exposure to growth but start to consider in the same portfolio recession proof sectors like the same health-care, utility, consumer staples. Globally, consider companies with sound short-term liquidity and long-term solvency versus peers

For conservative investors, you could sell the equity exposures, lock-in profits and buy Reverse Convertible notes on the same underlying's, with cushions and a fixed coupon (in this case, you forget the upside potential but locks-in the gain and get an additional coupon with the ”risk” to buy the underlying (same stock you sold) at a cheaper price *

Alternative Investments: Buy Silver and Platinum. Gradually take profits on Real Estate funds

Buy Put options to protect portfolios: if you maintain the equity exposure, the portfolio continues to benefit from the equity market upside but has some downside protection in case of a market drop

Sell Equities and buy Call options as an alternative: With this strategy, you lock-in your gains and could participate in the upswing of the selected stock or indices/markets. Your risk is the loss of the premium paid for the call *

* For details on strategies and costs, please refer to your advisor

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