Short OUTLOOK 2019

January 2019

Partner of AWAP

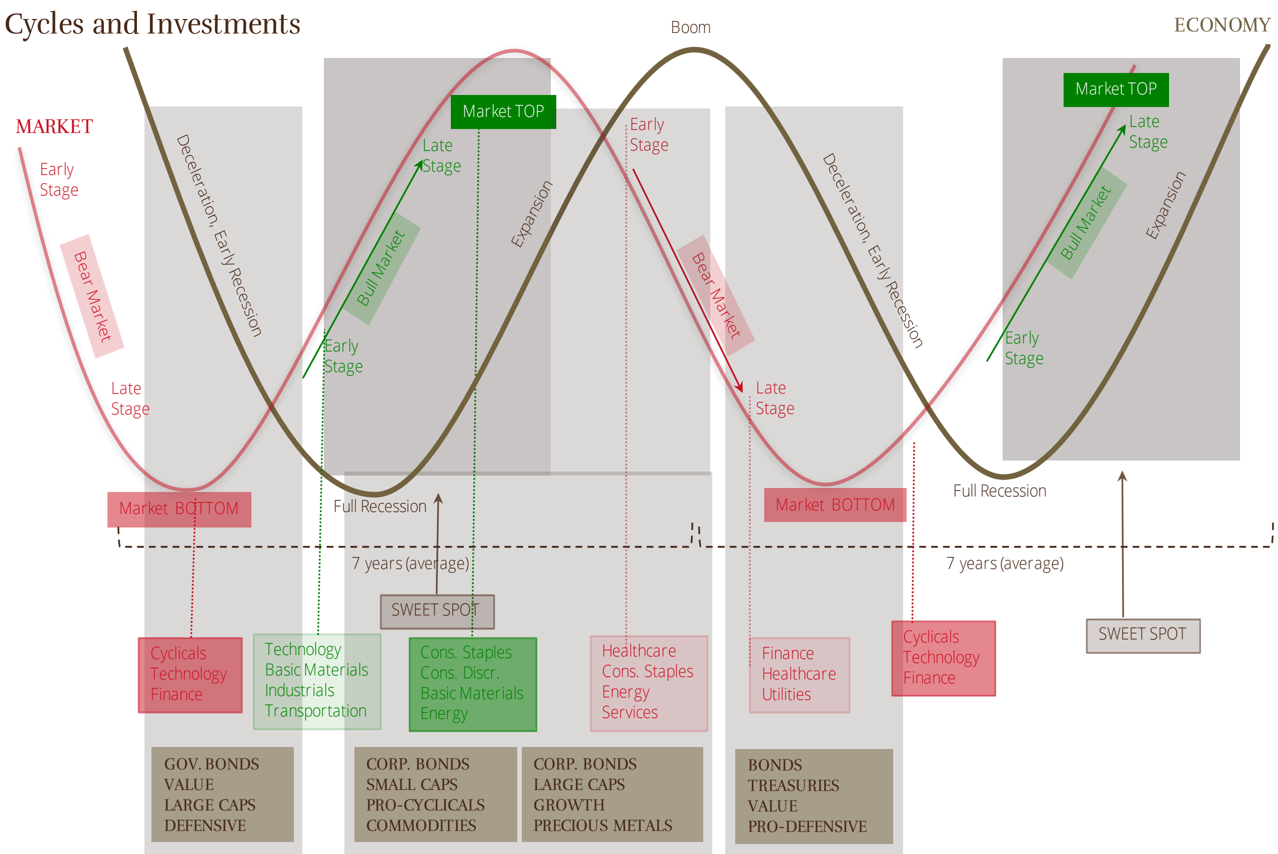
THE END OF THE CYCLE: THE RUPTURE ?

Being rational did not help during some periods of the past bull market. We mention on purpose "past" as we believe the end of cycle almost over and a downturn could be effective during the last part of the year

The "economic populism" will bring some disturbing factors like the increase of prices, augmentations of public deficits combined with an upward inflation. The latter should be contained but with growth waning, some sectors should be favored in order to anticipate a change in market segment trends (rotation). As in the attached economic cycle, the rupture would trigger a risk-off mode and we would argue to more conservative investments combined with long term growth segments in equity related investments.

We will probably see during the year, a reconnection between markets and fundamentals that would be carefully monitored. Even if the broad picture remains somewhat healthy, growth has moderated in many developed countries. We do not anticipate recessions in the next quarters but could withstand the premises of it by the end of the year (or earlier if the trade disputes intensify). We now have several clouds on investments (related in our "weather pictures" of asset classes). On the "Vision ahead" part of this presentation, you will find a road map of the current situation and current status of the cycle.

Globally, we are moderately optimistic for 2019 but with a special note called "cautiousness".



Gradual move from [A] to [B] blocks

THE RUPTURE ?

Market anticipations are a common principle of economics. Today's environment would still be supportive for equities but volatility will prevail and the change of market patterns will occur mostly at the end of the year. We should expect any bear market trend to resume probably in the second half of 2019 (or 1Q2020) and will adapt portfolios progressively to a low growth, challenging environment and market disruptive conditions

MOUNT INVEST

LIQUIDITY & SIMILAR

After 10 years of QE, now it's time to “cash-in”. Tighter monetary policies will continue to develop. Still, we did not notice high volatility on currencies but expect this to be short lived. Political challenges are key factors to watch. Inflation is picking up and real rates will adjust. Growth is waning. The USD near its peak. Consider hedges versus the greenback. The EUR will suffer more political turmoil's, but rate differentials will abate and the currency should appreciate. The EUR end of negatives rates is for the 2S19. GBP and the Brexit = drop followed by recovery. CHF stronger and MXN weaker. Maintain above-average cash holdings

The rate normalization should materialize in all major economies, but the recession scenarios even if they are mounting should not materialized until late 2019 or even 2020. Any signs of an inverted yield curve (already in some segments and markets) should be a sign to look at as it usually precedes a turn in markets (6-12 months on average).

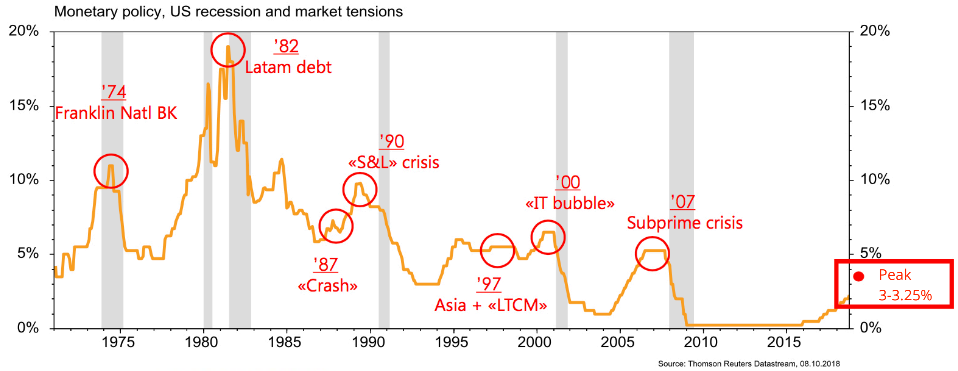
The FED main risk: putting the economy into recession. Today's comments on a more flexible approach are positive signs. Even, the FED will stay on course. We foresee 2 rates hikes (max 3) during the year, pushing the target rate to levels around 3-3.25% max (see attached chart).

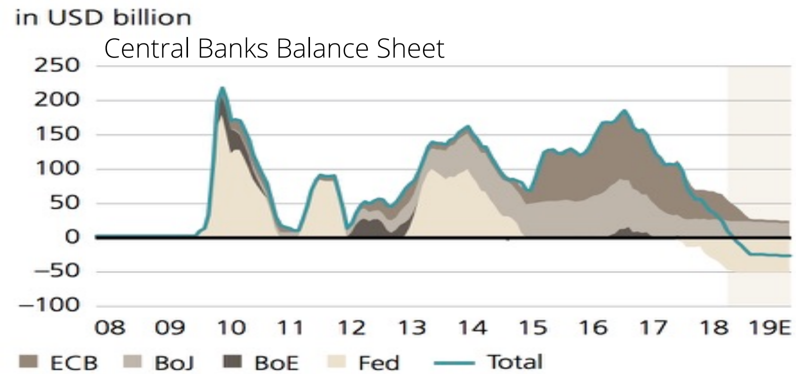
The ECB will normalize its monetary policy gradually. The end of the negative rates will be seen (4Q probably) and the interest rate differential with the USD and other developed economies will abate. We thus see a recovery of the EUR currency.

A "no-deal" on the BREXIT front is mounting but our scenario is for a consensus of a "light-Brexit". Procrastination will be the only temporary solution. Since more than a year, we unwounded any exposure to the British Pound and warned that the hard BREXIT should materialize. We argue that there is a chance of a positive light deal (under the current proposed-options-deal) and invested in UK Treasuries time ago, hedging also any GBP exposure. We would return to the currency at more favorable levels than today's quotes. The BoE would probably maintain rates at a low level and pursue an accommodative stance to counterbalance any negative Brexit effect.

CHF will act as safe haven again, like the JPY should. The Mexican peso rallied but we do not believe it will sustain its path and look for further weakness on the currency.

Globally, hedging strategies should be pursued (vs the USD relatives).





USD PEAK

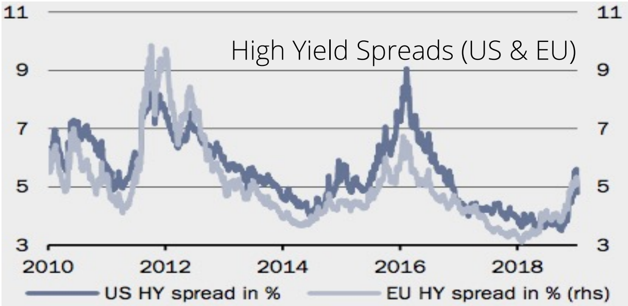
The USD has reached its peak (2016) over the last 10Y period. Rate differential in developed economies will abate and we thus recommend foreign investors to hedge any exposure to it

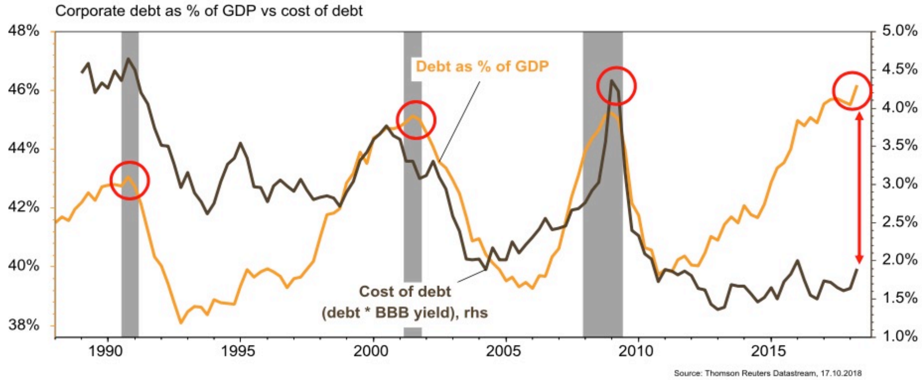
MOUNT INVEST

FIXED INCOME & SIMILAR

Long term rates still capped and short term real rates still low. The FED should still tighten 50 to 75 bps in 2019 but the "peak" will be reached after. The end of tightening is frequently followed by a market drop and recession. An inverse yield curve should be seen during the year and this is also a warning signal for markets. This gradual tightening will also challenge debt serviceability and the need to reduce High Yield exposure becomes urgent. The ECB should turn more hawkish, exit the negative rates and monetary normalization should follow the same path as its US counterpart. The tightening should not be seen before 2020 or at the earliest on late 4Q19. Global public deficits still too high. Avoid exposure to countries with negative current account deficits. We expect a corporate debt credit crisis in 2019 and would prepare for it. During the year, slowly increase durations on portfolios and add inflation linked securities

The FED should raise rates till the 3% threshold. 2019 should see +50 to 75bps increases, depending on general growth trends.
Corporate valuations are at historical highs due to central banks unprecedented support for bonds. This environment is no more supportive, and challenges will arise as US rising yields would not be easy to digest for many indebted governments or corporations. As mentioned, we expect to see further restraints in liquidity (thus an extend of the spread widening, see attached chart) and would recommend taking steps to protect the portfolios against the expected credit-crunch or liquidity crises, particularly on High Yields (high-beta) bonds.
Charts: above, HY spreads on the rise; below, debt vs BBB yield – the gap will be closed = higher yields!
From 2019 to 2022, a wall of junk bond maturities will arise: USD 1 trillion on total! It is urgent to decrease exposures to low rated bonds. Durations in USD should be raised step-by-step.
The ECB monetary normalization should materialize this year and we prefer to invest in short dated and quality Investment Grade names. We do not foresee any rate increases before 2020 (perhaps at the end of 4Q19 if growth resumes but political risks still a drag). Rate re-conversion between the US and Europe will be seen, providing support for portfolios switches but corporate valuations are now tight on high yielding securities. We thus recommend to avoid excessive corporate credit risks.
The inflation has globally surprised to the downside (worldwide). It should increase slightly unless a commodity shock is seen (not our main scenario) and we can continue to add inflation-linked securities.





HIGH YIELD RISK

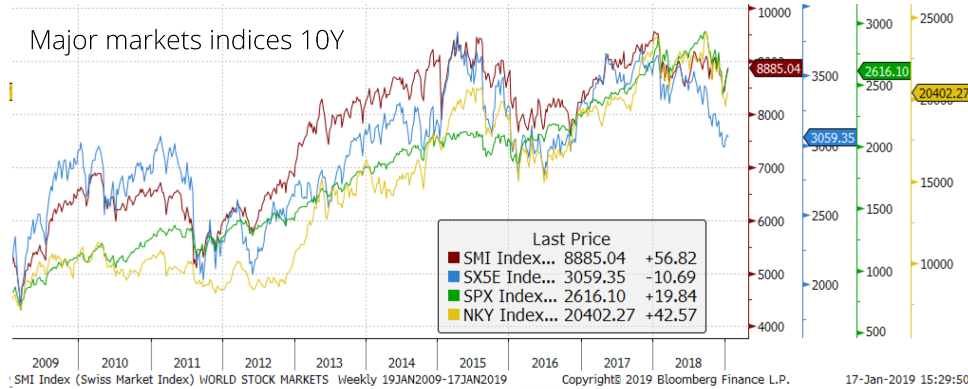
We reduce our exposure to HY bonds and will look the Investment Grade high quality segments to diversify. Durations to extend only in USD for now, combined with exposures to inflation related securities

MOUNT INVEST

EQUITIES & SIMILAR

Can the markets sustain a normal path? – Protectionism is gaining strength and global trade war is a risk. 2019 will see "rebound-trends" on markets. The US-China trade talks should resume and find an equilibrium point thus providing support for equities over the next 6 months, but clouds are mounting and weaker overall earnings growth will have impacts on valuations. Centrifugal trends in Europe are troubles that should be monitored. The Swiss market still attractive on valuations standards and its defensive stance vs other developed markets could add support. An Emerging Market equity recovery should be seen as valuations are now more compelling but expect some swings. This includes some Asian markets as well. Fundamentally, we are slightly positive on equities with the gauge of increased volatility.

4Q18: markets have slumped with political and global risks that intensified (Brexit, commercial wars and growth concerns).
The effects of US fiscal stimulus likely to wane just as the headwinds facing European economies drop, growth levels on either side of the Atlantic should start to converge by the end of next year.
In Europe particularly, the markets dropped between 10 to 20% in 2018.
The US has limited the downside with "only" -7% (S&P500). Even with global removals of liquidity currently seen, the monetary accommodation is still present and should favor the equities segment. 2019 will see an evolution of stock prices more in line with profit growth, with the later dependent on global economic developments.
A dynamic approach to investments and sectors will be necessary. Country-specific shocks and tightening global financial conditions have pressured Emerging Markets but policy easing measures and past currency depreciation will provide some macro stability, both domestically and across the emerging markets more broadly.
The backdrop of Emerging Market equities is improving fast. We see some opportunities within selected countries with sound fiscal surpluses and would place strategic allocations to these markets.
We gradually move from cyclicals to defensives and look into recession proof sectors like healthcare, utilities (etc.) within companies with sound short-term liquidity and long-term solvency. On an opportunistic level, we look at our usual suspects, i.e. digital, cybersecurity, water, etc. We started to integrate sustainability concepts in our research strategies and will continue to do so in our focus for investment themes.



UPTREND WITH PROTECTIONS

With volatility to stay in 2019, strategies able to reduce equity exposures without loosing market upsides will be proposed = Booster certificates and Call strategies

MOUNT INVEST

ALTERNATIVE INV. & SIMILAR

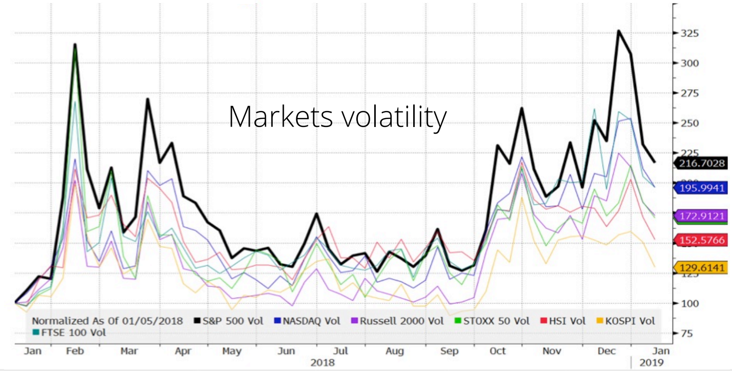
A commodity shock should not be expected but we anticipate an oil rebound. Some industrial metals should revert paths (on the upside this time) as Chinese demand should first stabilize followed by an increase. The Gold suffered a USD appreciation combined with a risk-on sentiment (before the end of the 4Q18). Now its trend will be positive. Add on weakness. The Real Estate segment (in a bubble-risk zone) should suffer due to the rising cost of capital. We will reduce our allocation to the segment. Volatility is here to stay in 2019. On the Crypto front, it is time to reconsider the segment as our entry points targets are now on focus

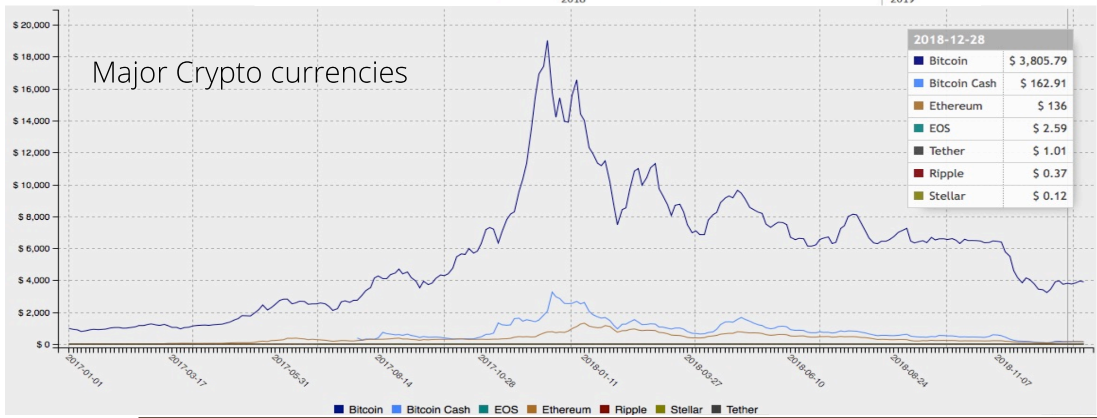
The Oil contango is back (future prices higher than spot prices). After a drop since October 2018 of more than 40%, the oil should gather some support and could probably return to the US$ 65.-/80.- levels on the WTI as the OPEC is aggressive again on production cuts.

The Gold suffered the USD appreciation combined with rate hikes but recent concerns about inflation and market uncertainties makes a case scenario for the precious metal. We still recommend the asset class and should see levels around 1350.- an ounce on a 12-month target. Idem on some other industrial metals.

The Real Estate segment should have more troubles ahead because of the increasing cost of capital. We will decrease our exposition to the related investments.

After reaching almost USD 20k, the Bitcoin has reached our expected consolidation levels, i.e. USD 3500.-, with more than 80% drop from its peak and -73% in 2018! Even if we do not have traditional methods to evaluate the value of the cryptocurrencies, today's alternative valuations tools provide indicative levels of good confidence to enter into the segment. The Bitcoin should turn progressively into an "exchanged currency type" with more regulations and interest form the investors (out of the pure speculators). The "blockchain" and similar technologies are gathering strength and interest. We continue to follow these trends, particularly those in crypto's tied to tangible assets like diamonds, oil or gold.





A BET IN 2019 ?

We think the crypto currencies will be favored as this "decentralized" segment and its related applications would be authorized/regulated via government initiatives and investments

MOUNT INVEST

THE RUPTURE ?

Not yet globally but cautiousness is key. We consider today's situation like the ones of 2000 and 2007 (dashed squares on below chart). Even if the economic cycle is more closed to the end than its beginning, it would probably be prolonged during 2019 (green circles)

INVESTMENTS FOCUS

Liquidity & Sim.: Overweight Cash; hedge USD exposures

Fixed Income & Sim.: Reduce HY; improve quality; add inflation related notes

Equities & Sim.: Buy "values"; adjust betas (lower); buy calls & puts

Alternative Investments: Add Gold; reduce Real Estate segment; add volatility strategies & hedges on portfolios

2019: a balanced and cautious portfolio approach highly advisable

2019 FORECASTS

2018 Accurate view		Storm	Rain	Partly cloudy	Mostly sunny	Sunny
1 USD	✔✔			●		
2 GBP	✖		●	●		
3 EUR	✖✖			●	●	
4 JPY	✔✔✔			●	●	
5 EM Currencies	✖✖		●			
6 US Equities	✔✔✔		●			
7 EU Equities	✖✖✖		●	●		
8 UK Equities	✔✔✔		●			
9 EM Equities	✖✖		●			
10 Japan Equities	✖✖		●			
11 US Gov Bonds	✔✔		●	●		
12 EU Gov Bonds	✔✔		●			
13 Corp Bonds	✔		●	●		
14 Corp EM. Markets	✖		●	●		
15 Corp High Yield	✔✔✔	●	●			
16 Metal Commodities	✖✖			●		
17 Agriculture Commo.	✖✖		●	●		
18 Precious Metals	✖✖				●	
19 Oil	✖✖			●		
20 Volatility	✔✔					●

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Sources: UBS, BlackRock, Lombard Odier, USGS/BMI, Bloomberg, World Wide Web, etc.

APPENDIX

ASSET CLASSES & ALLOCATIONS – 1Q 2019

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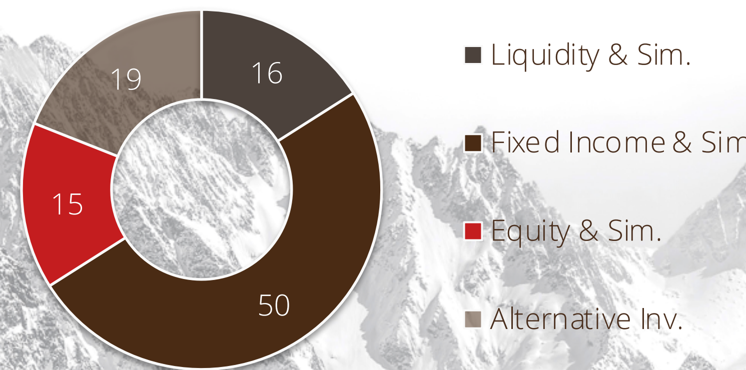
"Special USD Balanced"



% ALLOCATIONS

ASSET CLASSES		CURRENCIES	
Liquidity & Sim.	16	USD	75
Fixed Income & Sim.	50	EUR	20
Equity & Sim.	15	GBP	0
Alternative Inv.	19	DIVS.	5
	100		100

*Example of a "Special Balanced" portfolio USD based. Not recommended for all investors.
** % opportunistic allocations included in each category (for details, contact your advisor)