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Weekly Investment Focus

June 24, 2019

Headlines

- For central bankers, *"an ounce of prevention is worth more than a pound of care"*
- Financial markets have benefited significantly from the accommodative statements of central bankers
- Because yields have reached negative levels, the fixed income asset allocation needs to be very selective
- Short duration in dollars, investment grade and emerging market corporate bonds are sources of interest

Chart of the Week

"How to invest in the midst of all these negative yield bonds?"

	2 Year	3 Year	5 Year	7 Year	10 Year	15 Year	30 Year
China	2.80	2.91	3.03	3.26	3.24		3.86
Brazil (USD)	2.27			3.41	4.56	4.98	5.16
Mexico (USD)	2.36	2.56	2.82	3.28	3.62	4.29	4.39
United States	1.76	1.72	1.78	1.90	2.04		2.57
South Korea	1.44		1.44		1.56		
Canada	1.43	1.39	1.36	1.42	1.48		1.72
New Zealand	1.11		1.20	1.36	1.51	1.70	
Greece		0.90	1.15	1.49	2.35	2.74	
Australia	0.91	0.90	0.95	1.12	1.29	1.52	
Italy	0.21	0.82	1.35	1.56	2.09	2.56	3.10
United Kingdom	0.56	0.53	0.59	0.65	0.81	1.14	1.42
Portugal	-0.40	-0.26	-0.11	0.15	0.55	0.91	1.46
Spain	-0.43	-0.38	-0.14	0.08	0.41	0.91	1.39
France	-0.68	-0.66	-0.48	-0.28	0.03	0.38	0.97
Sweden	-0.66		-0.56		0.00	0.17	
Japan	-0.24	-0.25	-0.27	-0.26	-0.16	0.04	0.34
Netherlands	-0.70	-0.72	-0.62	-0.39	-0.13	0.01	0.30
Germany	-0.75	-0.75	-0.64	-0.55	-0.30	-0.11	0.27
Switzerland	-0.97	-0.94	-0.88	-0.77	-0.53	-0.29	-0.02

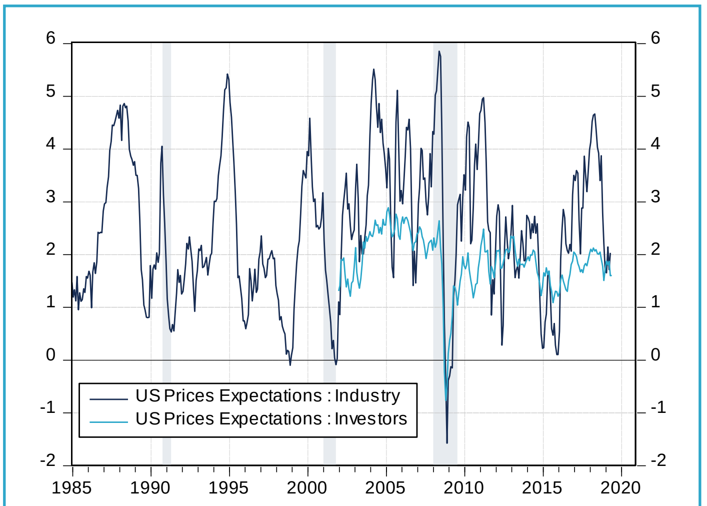
Source: Bloomberg, Atlantic Financial Group

Bond Market Analysis

"Don't fight the Fed... nor the flow"

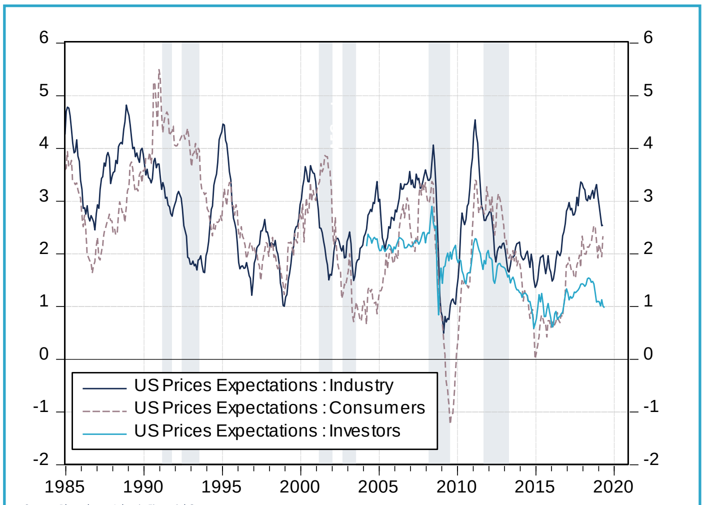
A month ago, we concluded our analysis with this sentence: *"Without a recession, the Fed has no convincing reason to reduce its key rates"*. **We were wrong.** While the U.S. economy will not fall into recession, **the Fed, like other major central banks, has chosen to be much more proactive than in the past to address the current economic downturn.** A statement pronounced by Jerome Powell during his last question-and-answer session summarises the strategy of modern-day central bankers: *"An ounce of prevention is worth more than a pound of care"*. Central banks were already prepared to ease their monetary policies to take account of the cyclical weakening of activity, but the escalation in trade war and geopolitical tensions (in Iran) prompted them to act even more quickly and decisively. Last but not least, **low inflation expectations are a real headache for the monetary policy's transmission to the real economy.** Bear in mind that inflation expectations are more important than inflation itself, because they influence the purchasing behaviour of companies, households and investors. However, they have been in very sharp contraction for several months, both on the financial markets and in surveys conducted among economic agents (see charts 2 & 3). The inflation puzzle, which is certainly a bit technical, provides a good understanding of why central banks are keeping the door open for a series of rate cuts in the second half of the year.

Chart 2 – United States Inflation Expectations



Source: Bloomberg, Atlantic Financial Group

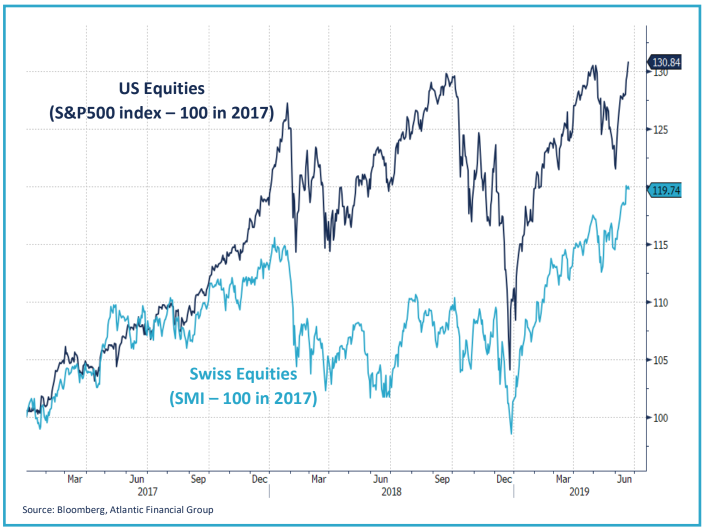
Chart 3 – Euro Area Inflation Expectations



Source: Bloomberg, Atlantic Financial Group

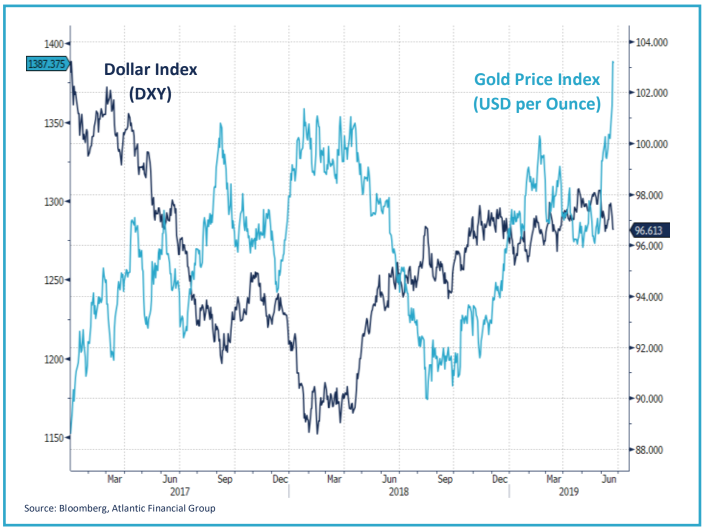
Investors have benefited significantly from the statements of central bankers. Equity markets are reaching new records (see chart 4), gold has just broken important elements of resistance and the dollar is weakening against major currencies (see chart 5). All these topics are in the headlines, **but we would like to take the time to analyse the bond market.**

Chart 4 – Equity Market



Source: Bloomberg, Atlantic Financial Group

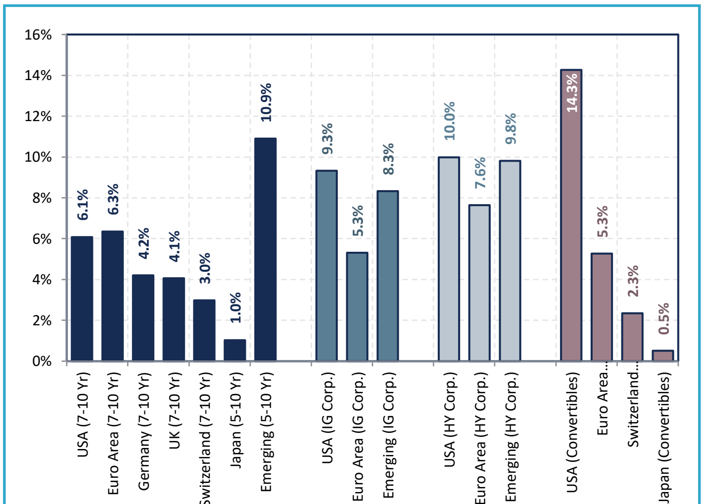
Chart 5 – US Dollar & Gold



Source: Bloomberg, Atlantic Financial Group

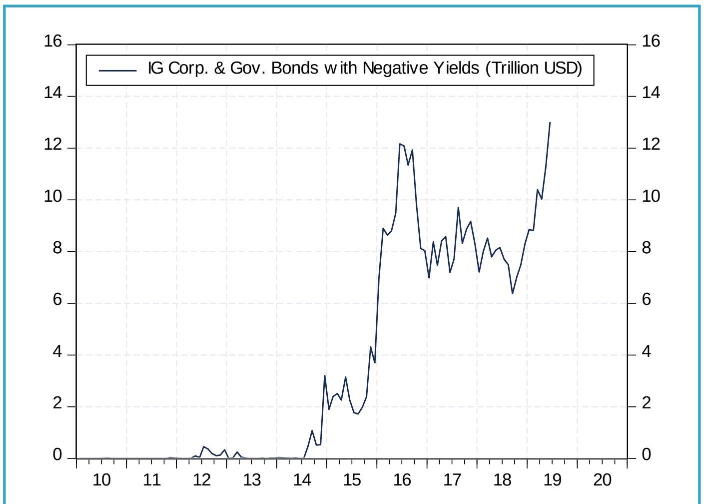
Fixed-income asset performances have been at stellar levels since the beginning of the year, ranging from 0.5% to 14.3% (see chart 6). Regardless of their positioning, investors made their money grow in 2019. However, remember, the bet was not won in advance on January 1st. The second half of the year will be of a different nature and will be much more difficult to manage. **Rates have fallen so sharply that the stock of global bonds with negative yields has reached record highs** (see chart 7): $13 trillion, far from the October 2017 trough of $5.7 trillion, and very close to the June 2016 absolute high of $14 trillion (intra-month).

Chart 6 – Fixed Income Performances, Year to Date



Source: Bloomberg, Atlantic Financial Group

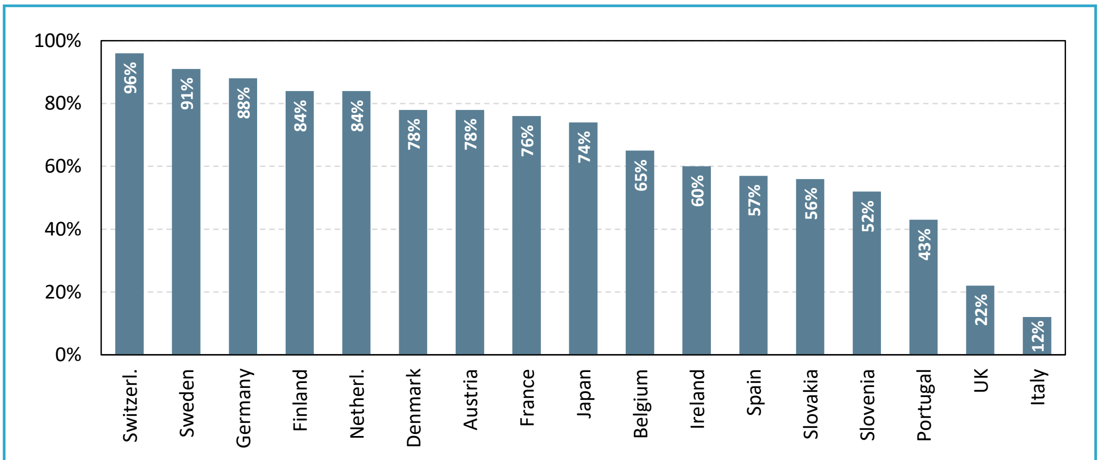
Chart 7 – Global Pile of Bonds with Negative Yields



Source: Bloomberg, Atlantic Financial Group

A country like Switzerland no longer offers any positive coupon on the entire yield curve, from 3 months to 30 years (see Chart of the Week & chart 8). Ironically, Spain or Portugal, which had difficulty raising capital during the European debt crisis eight years ago, are now financing themselves at negative rates up to 5 years. Investors are so much in the hunt for returns that they are also rushing on Italian papers whose spreads are being compressed, ignoring the risk that the current government will be careless with the country's unhealthy over-indebtedness.

Chart 8 – Share of Government Debt with Negative Yields, as of June 18, 2019



Source: Tradeweb, Atlantic Financial Group

This decline in returns leaves investors who hunt them with no choice but to go with the flow and add more duration or take excessive risks on high yield, whether sovereign or corporate. To the contrary, we believe that it is preferable to look at the first half of the curve (from 3-month to 3-year) and/or the steepening of the sovereign curve, particularly in dollars. We also prefer to focus on credit spreads, through corporate investment grade bonds (see chart 9). These can also be emerging (in hard currency) because the fundamentals have improved massively in recent years and a possible weakness of the dollar would make them even more competitive.

Chart 9 – US Corporate Spread vs Equity Volatility Index

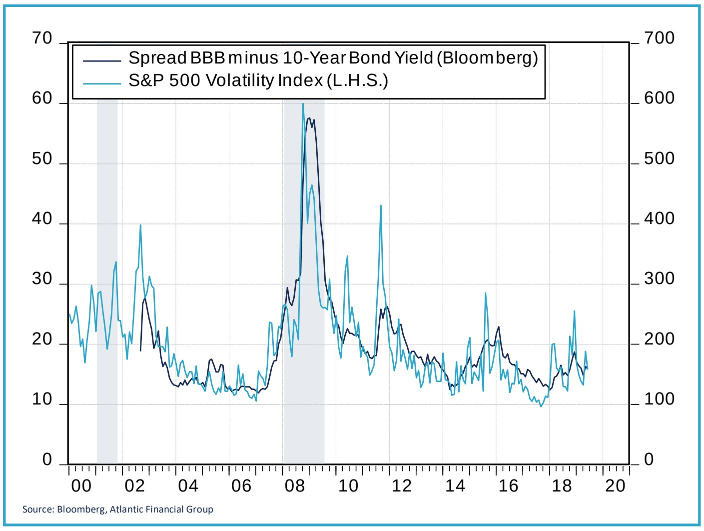
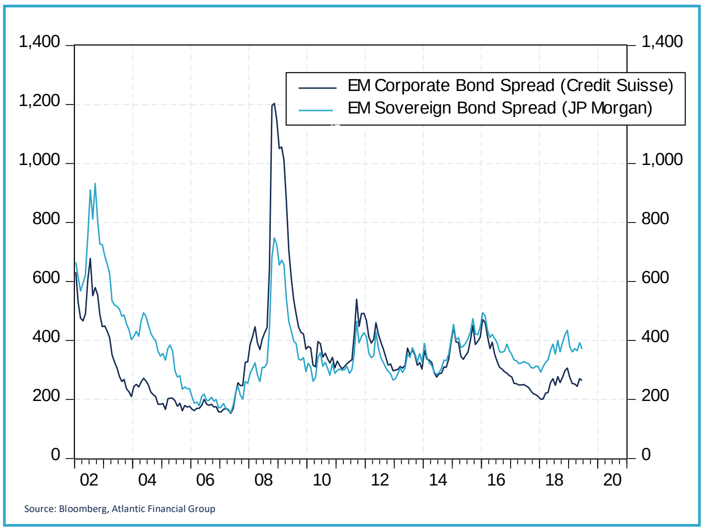
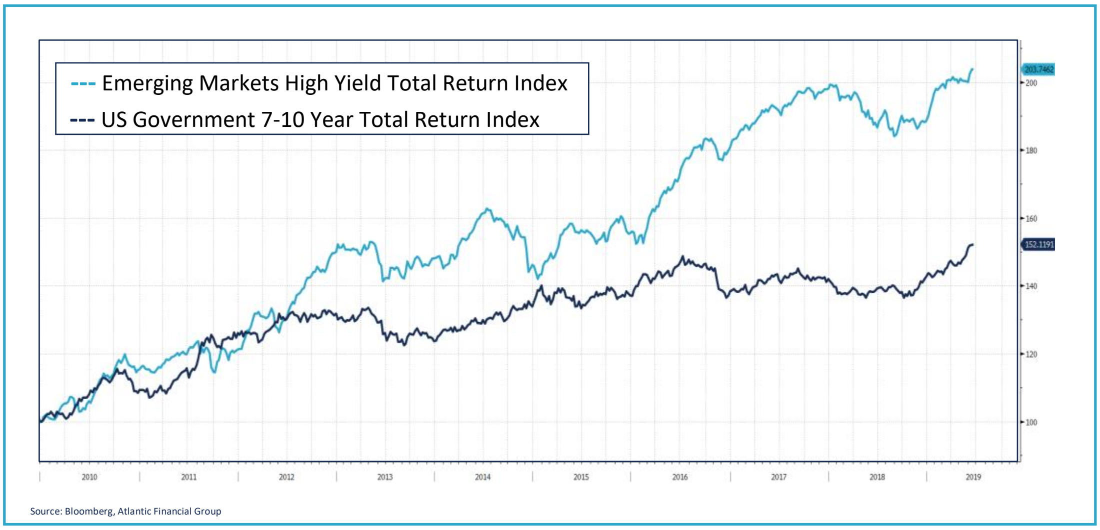


Chart 10 – Emerging Bond Market: Sovereign vs Corporate



Emerging Countries now account for almost 60% of global Gross Domestic Product (GDP) and have a strong growth profile, better than developed economies. They enjoy a firm domestic demand, growing populations and rising living standards. They are constantly improving fundamentals and are key players in commodity markets, on both the supply and demand side. **If we are looking at market trends, the emerging debt is one of the fastest growing asset classes** (see chart 11).

Chart 11 – Emerging vs US Sovereign Bond Market



Investors shouldn't ignore it. That is true for sovereign bonds and also for corporates. For several years, the corporate sector has been engaged in a powerful deleveraging process, reducing its vulnerability to external shocks. During the last 18 months, spreads have increased slightly and provide an interesting return on the underlying risk (see chart 10). it should be taken into consideration, as a relevant diversification bucket among a fixed income allocation.

Conclusion:

Uncertainties about global growth and expectations of continued low inflation have raised hopes of rate cuts. High-Yield and Inflation-linked bonds should be avoided. This decline in returns leaves investors with no choice but to go with the flow and add more duration. To the contrary, we prefer to go to the short end and/or play the steepening of the sovereign curve. Investors should also continue to add spread risk, via investment grade or emerging market corporate bonds.

For any bespoke investment solutions, feel free to contact your personal portfolio or relationship manager.

Returns on Financial Assets

Total return performance by asset class

Markets Performances (local currencies)	Last Price	1-Week (%)	1-Month (%)	2019 Year-to-Date (%)	2018	2017
Equities						
World (MSCI)	523.3	2.4%	3.4%	16.5%	-8.9%	24.7%
USA (S&P 500)	2 950	2.2%	3.2%	18.9%	-4.4%	21.8%
USA (Dow Jones)	26 719	2.4%	3.5%	15.9%	-3.5%	28.1%
USA (Nasdaq)	8 032	3.0%	3.3%	21.7%	-2.8%	29.7%
Euro Area (DJ EuroStoxx)	375.3	2.2%	2.1%	17.5%	-12.1%	13.4%
UK (FTSE 100)	7 415	0.9%	1.4%	12.7%	-8.8%	12.0%
Switzerland (SMI)	9 951	0.8%	3.1%	21.5%	-7.0%	17.9%
Japan (Nikkei)	21 286	0.7%	-0.1%	7.3%	-10.3%	21.3%
Emerging (MSCI)	1 053	3.8%	6.0%	10.3%	-14.3%	37.8%
Bonds (FTSE)						
USA (7-10 Yr)	2.04%	0.2%	2.9%	5.6%	0.8%	2.9%
Euro Area (7-10 Yr)	0.26%	0.4%	2.4%	6.0%	1.4%	1.2%
Germany (7-10 Yr)	-0.30%	0.2%	1.8%	3.9%	2.4%	-1.4%
UK (7-10 Yr)	0.81%	0.0%	1.9%	3.7%	1.5%	1.8%
Switzerland (7-10 Yr)	-0.49%	0.0%	0.9%	2.7%	n.a.	n.a.
Japan (5-10 Yr)	-0.15%	0.3%	0.8%	1.0%	0.7%	0.2%
Emerging (5-10 Yr)	5.46%	1.5%	3.8%	10.4%	-4.2%	9.3%
USA (IG Corp.)	3.23%	0.9%	2.7%	9.1%	-2.5%	6.4%
Euro Area (IG Corp.)	0.57%	0.7%	1.6%	5.2%	-1.3%	2.4%
Emerging (IG Corp.)	5.07%	0.7%	1.8%	8.2%	-1.9%	8.0%
USA (HY Corp.)	5.75%	1.0%	1.8%	10.0%	-2.1%	7.5%
Euro Area (HY Corp.)	3.62%	1.2%	1.8%	7.6%	-3.8%	6.9%
Emerging (HY Corp.)	7.29%	1.4%	3.1%	9.5%	-4.7%	9.5%
World (Convertibles)	290.9	1.5%	2.1%	10.6%	-4.0%	16.5%
USA (Convertibles)	345.8	1.6%	2.0%	14.0%	-1.8%	17.3%
Euro Area (Convertibles)	3 797	0.7%	0.5%	5.3%	-5.2%	7.0%
Switzerland (Convertibles)	185.6	0.2%	0.2%	2.2%	-0.3%	0.6%
Japan (Convertibles)	184.7	0.0%	-0.1%	0.3%	-5.0%	6.1%
Hedge Funds (Crédit Suisse)						
Hedge Funds Indus.	602.6	n.a.	-1.0%	4.3%	-3.2%	7.1%
Distressed	838.8	n.a.	-1.6%	2.7%	-1.6%	7.3%
Event Driven	657.2	n.a.	-1.1%	5.7%	-3.9%	6.3%
Fixed Income	349.5	n.a.	0.2%	2.8%	1.1%	6.5%
Global Macro	964.3	n.a.	-0.9%	3.1%	-0.1%	2.1%
Long/Short	741.2	n.a.	-2.4%	4.8%	-4.6%	13.4%
CTA's	299.5	n.a.	-0.6%	5.3%	-6.7%	3.3%
Market Neutral	269.3	n.a.	1.7%	1.8%	-5.0%	8.5%
Multi-Strategy	598.5	n.a.	0.0%	4.1%	-1.1%	6.8%
Risk Premia						
AQR Risk Premia	106.6	-0.4%	-0.6%	-1.6%	-9.7%	7.3%
AXA Multi-Risk Premia	102.15	0.8%	2.3%	3.7%	-4.8%	n.a.
BlackRock Risk Premia	108.2	-0.8%	-1.7%	2.1%	-4.8%	1.5%
BoAML Risk Premia	337.5	-0.9%	2.2%	5.3%	-7.5%	8.5%
ERAAM Premia	1 027	-0.6%	0.5%	1.8%	-4.2%	n.a.
GAM Risk Premia	9.740	0.0%	0.0%	2.5%	-6.3%	0.7%
Goldman Sachs RP	8.841	0.6%	1.3%	2.7%	-17.3%	n.a.
LFIS Vision - Premia	1 171	0.2%	0.4%	2.8%	-1.8%	2.0%
R CFM Diversified Fund	106.1	0.9%	2.5%	4.3%	-7.4%	8.6%
Uni-Global Risk Premia	959.9	0.1%	0.3%	1.0%	-8.4%	n.a.
Hedge Premia	885.6	-0.9%	-2.7%	-12.9%	2.0%	-5.1%
Volatility						
VIX	15.52	0.8%	3.0%	-39.4%	130.3%	-21.4%
VSTOXX	13.90	-6.8%	-15.4%	-43.9%	76.6%	-25.4%
Commodities						
Commodities (CRB)	392.8	-0.1%	-0.2%	0.5%	-7.1%	0.0%
Gold (Troy Ounce)	1 403	4.7%	9.2%	9.4%	-1.6%	13.1%
Oil (WTI, Barrel)	57.28	10.3%	-9.1%	26.1%	-24.8%	12.5%
Oil (Brent, Barrel)	64.99	3.1%	-10.0%	21.9%	-20.4%	20.6%
Currencies (vs USD)						
USD (Dollar Index)	96.190	-1.4%	-1.5%	0.0%	4.4%	-9.9%
EUR	1.1376	1.4%	1.5%	-0.8%	-4.5%	14.1%
JPY	107.41	1.1%	1.8%	2.1%	2.8%	3.8%
GBP	1.2726	1.5%	0.1%	-0.2%	-5.6%	9.5%
AUD	0.6946	1.4%	0.3%	-1.5%	-9.7%	8.3%
CAD	1.3197	1.6%	1.8%	3.3%	-7.8%	6.9%
CHF	0.9774	2.2%	2.5%	0.5%	-0.7%	4.5%
CNY	6.8821	0.6%	0.3%	-0.1%	-5.4%	6.7%
MXN	19.116	0.3%	-0.3%	2.8%	0.0%	5.4%
EM (Emerging Index)	1 643.2	1.2%	1.8%	1.8%	-3.8%	11.4%

Source: Bloomberg, Atlantic Financial Group

Performance (Negative \ Positive)

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