CROSSMONTHLY

January 2020

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Wealth Management since 1985

REVIEW

2019 turned out to be an extraordinary year for all asset classes (Figure 1 on next page) with strong gains in Q4CY19 after moving sideways for best part of the prior five months. Equities handily outperformed all other equity classes, led by US equities with Nasdaq the pick within this region having its best year since '09. US equity indices ended the year at all-time highs. Other equity regions saw robust gains too, but a characteristic of '19 was that equities rerated mostly on multiples expansion, thus becoming more expensive in absolute terms – this was seen most in US equities.

Fixed income (FI) had robust gains across the board regardless of quality, duration and geography with investors either chasing quality along the duration curve or hunting for yield in lower quality credit. At its peak, negative yielding FI approached close to one-third of the total market at -$17tn, but this fell to just over $11.2tn by YE19 with sentiment shifting in Q4CY19 against it as risks of a correction in '20 picked up.

Gold had its best year since '13 and rose to a new 6Y-high at $1,550/Oz as investors, especially in Q4CY19, embraced its merits as a safe haven asset and portfolio diversifier. '19 was a year of record low FX volatility with DXY up just 22bps as USD sold off against rest of world (ROW) FX in Q4 having been up c. 2.5% at the end of Q3CY19. Oil also rose strongly for its best year since '14 – again much of the gains seen in Q4CY19 after OPEC cut production further and then Saudi Arabia additionally cut more.

OUTLOOK

We are risk-on as we start the new year. A number of people see US equities underperform equities in ROW in '20 given potentially weaker earnings per share (EPS) growth of c. 5% in FY20 relative to the 10%+ for ROW. USA is late cycle with regards to expansion and faces a slower economy this year on a YoY basis relative to others which might be stable to better (EMs especially). US equities also face potential political/ regulatory headwinds – some of which have bipartisan support – and higher barriers to monetary/fiscal policy action bar a material slowdown. On the other hand, ROW economies may see a greater chance of further monetary easing/ fiscal reflation upside. Consensus favours an overweight in equities and an underweight in FI, though the latter sees polarization between those preferring quality and longer duration, to those seeing better upside in lower quality FI, given higher yields, with less duration (even short duration). Despite that, there are clearly concerns around possibilities of 'fallen angels' in BBBs and defaults in leveraged loans whilst Moody's argued that US high yield (HY) FI is overvalued with unattractive risk-reward compensation after spreads have tightened considerably in'19.

Within the FX markets, there are strategists arguing for USD relative weakness – notably against emerging markets (EM) currencies/JPY – but these same people got USD wrong for most of the last five years. Whilst we can see risks for USD in '20 – important as a driver of portfolio flows to ROW equities and EM equities more so – equally we would want to see a clear trend of USD weakness develop. We struggle to be too negative on it as opposed to other developed markets (DM) FX. Gold has merit as a 'safe haven' diversifier in a way overvalued sovereign FI is no longer. Oil has upside if one agrees on US shale oil production. Goldman Sachs (GS) forecasts that growth in shale inventory will slow sharply given firm demand from EMs, OPEC's disciplined production and IMO regulatory action. In addition, oil remains a warrant against Middle East geopolitical flare-ups, not unlike what we saw happen between the US and Iran last week.

A US airstrike killed Qasem Soleimani, a top Iranian commander, thus explicitly raising the temperature and shifts the scenario from being a proxy war to a direct confrontation. Much now depends on what happens next post Iran's retaliation – there is a sense of calm for now at least. This, however, has scope to escalate – the key question is to what degree. We do not think it is in Iran's interest to escalate this to a full-on military conflict (as much as it is not in US's interest), but it cannot sit back and do nothing. This creates uncertainty and will likely drive oil prices.

We have warned previously that Trump might behave more erratically around impeachment pressures and this deliberate attack follows the same playbook Clinton used. That impeachment process now appears it will be dragged out as opposed to hopes (for markets at least) that there will be a quick Senate trial. This is not good news for certainty and for a further risk of erratic behaviour – to the degree the US-China trade deal is not yet signed – to hurt risk-on assets.

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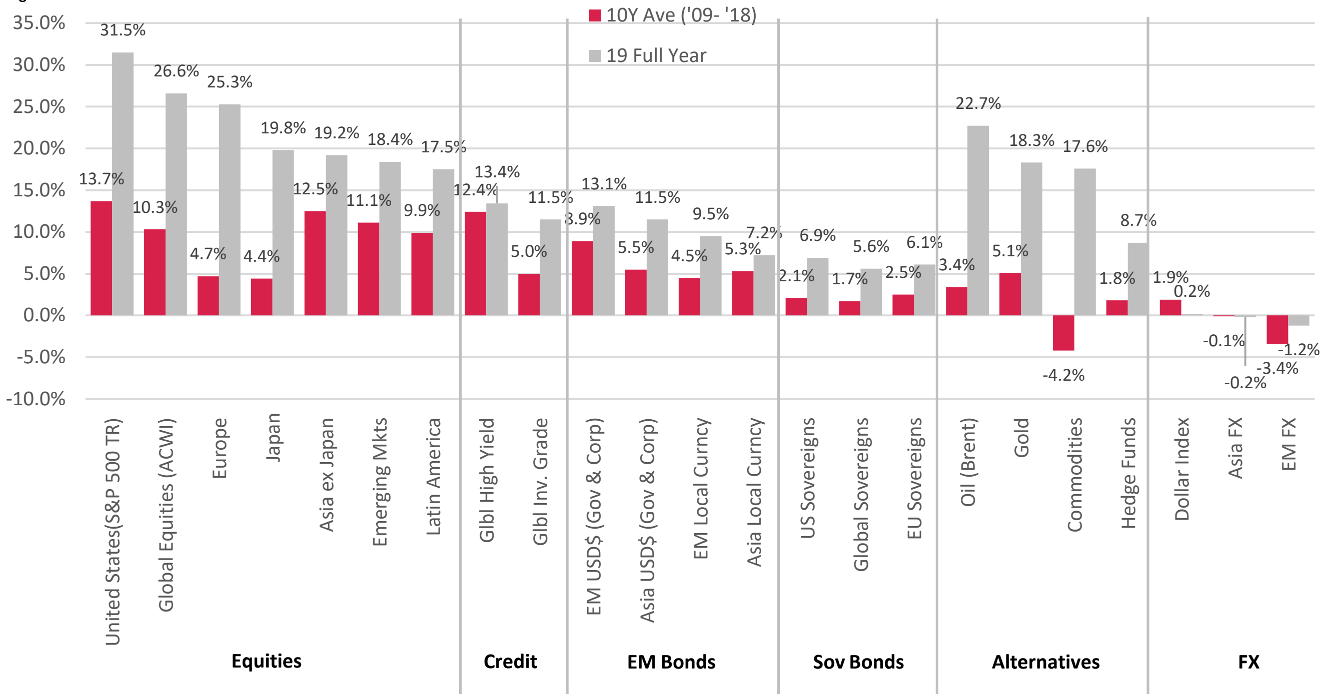
Outlook

Figure 1: Global multi asset total returns



Source: LGT, Bloomberg

As ever we continue to strongly argue that we are in a low return, high volatility set of market conditions – a strategic view that was borne out in ’18 but clearly failed (or “succeeded”, so to speak) last year – that requires us to be diversified as much as possible and seek uncorrelated alternative income strategies. On evidence the USD might ease-off, it may be appropriate to run with less USD-hedged allocations too. Capital market assumptions forecasts for the next five years suggest higher quality FI could deliver zero returns (with capital losses offset by coupons) while equities offer 5-6% with the S&P 500 closer to 3% (EM FI and equities offer highest returns but obviously at higher volatilities). These implied returns are not compelling and makes capital preservation even more important when returns are low. After equities had a banner year in ’19, we need to be quick to react to any major correction.

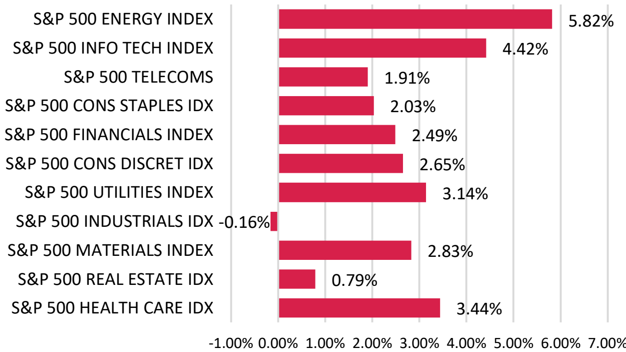
Equities

Global equities were broadly higher following Trump's sign off on a 'Phase One' trade deal with China, notably so in the US where markets dismissed impeachment news as all three major indices pushed deeper into all-time high territory. The S&P 500 gained +2.86% in December, taking '19's total return to an impressive +31.48%. Likewise, the Dow and Nasdaq gained +1.74% and +3.54% respectively this month, with the latter outperforming the year with a +36.74% total return as tech stocks led the advance (Figure 2).

Figure 2: US indices returns

Source: Bloomberg

Figure 3: S&P 500 sector returns



Source: Bloomberg

The S&P 500 saw a broad-based gain this month, with all sectors seeing a positive close. Gains were led by Energy and IT stocks, though interestingly the two were the worst and best performing sectors this year at +48.04% and +7.64% respectively (Figure 3).

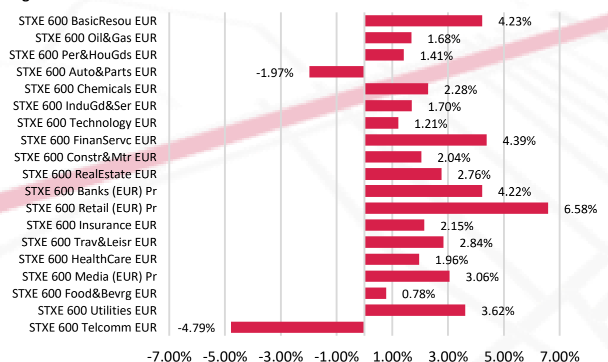
Markets in the US were also supported by generally positive data prints, with Q3 GDP matching expectations at 2.1%, while core PCE gained 2.1% QoQ for the same quarter. University of Michigan's consumer sentiment index also had a slight beat, coming in at 99.3 (vs est. 99.2). November's Non-farm payroll print came in surprisingly strong at +266k (vs est. +183k), even if one were to subtract the 48k GM workers that returned from strike. Unemployment fell to a 50Y low of 3.5%, while wage growth stood at +3.1% (vs est. 3%). The only weak spot came in US retail sales, which gained only +0.2% MoM (vs est. +0.5%), although October's reading was revised up to +0.4% from the previously reported +0.3%.

Over in Europe, the ECB left rates unchanged as expected, re-affirming commitments to its bond buying program and low rates until the region can get closer to its inflation goal. Overall, conditions were generally helpful, allowing the Stoxx 600 index to gain 2.06% for the month, taking the full year gain to +25.26%. Unlike last month, shares in the FTSE 100 outperformed at +2.67% this time round, while DAX lagged behind with a meagre +0.10%, after Germany's manufacturing PMI fell unexpectedly to 43.4 in December (vs est. 44.6) (Figure 4).

Much like their US counterparts, returns in the Stoxx 600 were also broad-based, although the Retail sector outperformed far more significantly, while Autos and Telecommunications fell, with the latter underperforming the index by far (Figure 5).

Figure 4: European regional indices total returns

Figure 5: Stoxx 600 sector returns in December



Source: Bloomberg

Equities

In Asia, equity markets were undoubtedly alleviated by the news over trade, with China understandably one of the top gainers in the region, gaining 6.20%. The HSI also rallied +7.00%, in part off the back of this news, but also as tension on the streets appeared to have tapered off toward the holiday season. Overall, the MSCI Asia ex-Japan (AXJ) gained 6.42%, while Japan and the Sensex lagged the broader region at +1.56% and +1.16% MoM respectively.

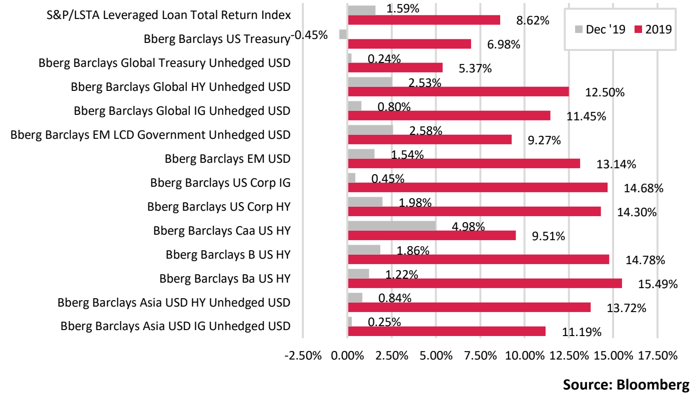
There were some encouraging numbers out of China which showed stabilization and a pickup in growth momentum, not least with November's industrial output gaining 6.2% YoY (vs est. 5%), while retail sales grew 8.0% YoY (vs est. +7.6%). However, FAI remained unchanged at +5.2% in 11M19, in-line with forecasts but still at its slowest pace since '98.

On the bright side, we did see China unveil more pro-growth measures, with financial institutions now required to price floating-rate loans on the back of the revamped LPR as of 1st Jan, which will lower costs for c. CNY 152tn worth of outstanding loans in the market. The revised securities law also simplifies the process for corporate bond issuance and raised the penalty for issuance fraud to CNY 20m from CNY 600k, which will take effect on the 1st March.

Fixed Income

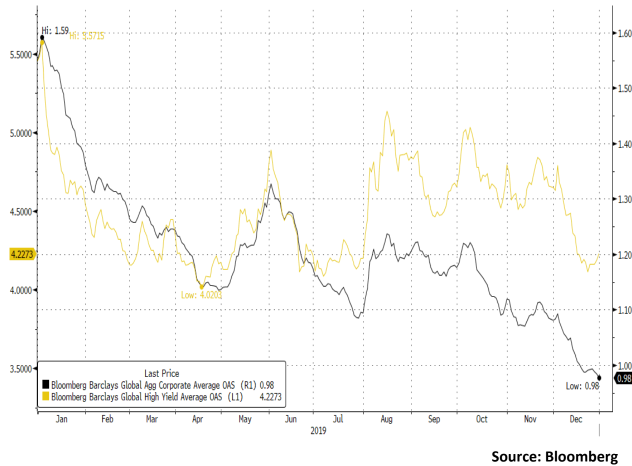
The fixed income market was positive in Dec (Figure 6), leading various sectors to see multi-year high YoY returns. Global investment grade (IG) and HY saw their best YoY performance since ’09 and ’16 respectively, while US Treasuries (UST), the only sector to fall in Dec, saw its best YoY returns since ’11.

Figure 6: FI sector returns in December and 2019



Source: Bloomberg

Figure 7: Corporate credit spreads in 2019



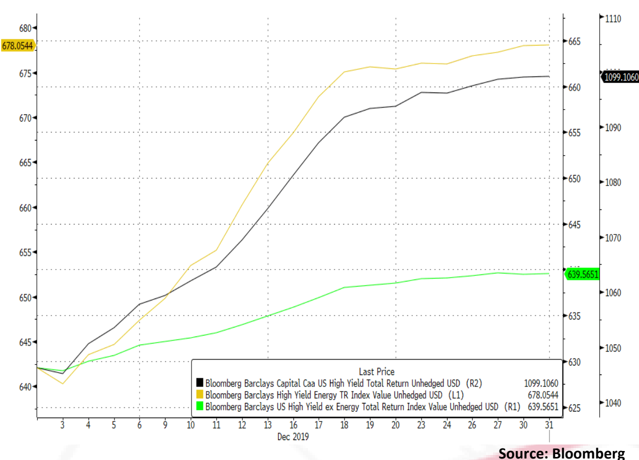
Source: Bloomberg

Global IG spreads narrowed in the last few days of ’19, ending the year at 94bps – 59bps tighter YoY while global HY spreads narrowed 127bps to 419bps. Credit spreads ended the year near/at ’19 lows (Figure 7) as central banks around the world adopted, in one way or another, monetary easing policies. Apparent progress in US-China trade negotiations and more geopolitical certainty also contributed to the risk-on sentiment, thus supporting HY debt.

Moving forward, the tight spreads are attracting primary issuance of c. $120bn in Jan after pausing for much of Dec. HY could also see a busy month as companies look to refinance debt, with c. $9.5bn worth of HY bonds scheduled to mature or be called this month.

Within HY, CCC debt ended the month as the best performing sector within FI. With spreads rising above 10% for the first time since ’16 after being sold off earlier in the year, coupled with improving market risk sentiment, yield hungry investors jumped at the chance after hiding out in the BB space for much of ’19. Energy led gains in the sector with oil prices rising for most of the month (Figure 8).

Figure 8: Returns of HY Energy debt vs CCC and HY ex-Energy



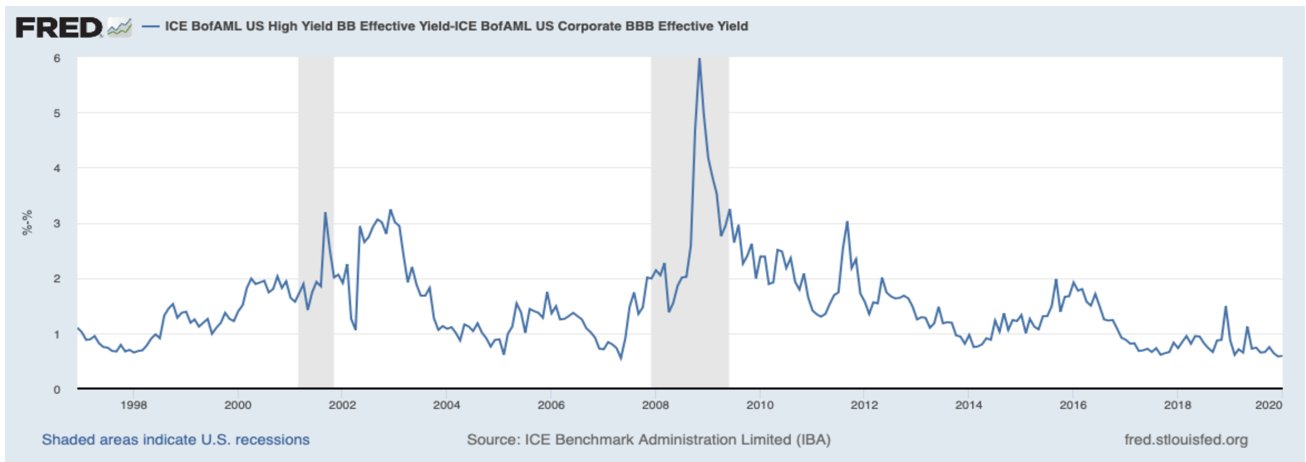
Source: Bloomberg

Fixed Income

This hunt for yield also saw spreads between IG and HY narrow. In particular, ICE BofAML data showed BB/BBB spreads to be at its lowest since pre-GFC (Figure 9), suggesting how overvalued the BB space has become. This trend is likely the reason why Wall Street analysts are forecasting gains of only 1% - 7.5% for US HY in '20.

However, not all analysts share this view – Blackrock raised its rating for global HY to overweight, arguing that the sector will be supported by stable monetary policy worldwide, and the potential for an inflection in growth. Blackrock also simultaneously downgraded global IG citing rich valuations, especially with negative rates in Europe and Japan.

Figure 9: BBB/BB Spreads



Source: Bloomberg

Blackrock also upgraded EM local currency debt (LCD) to a "high conviction overweight" noting the attractive coupons and the potential for currency appreciation as USD sees a potentially trying year in '20. EM LCD saw a strong Dec as USD weakened.

Within EM, we continue to see value in AXJ FI, particularly in the HY space. Apart from a potential reflation in the Asian economies, the sector is likely also supported by technicals. Many HY issuers advanced their refinancing to '19 and hence these volumes are unlikely to be sustained in '20, providing support for prices. While China saw another record year of onshore corporate defaults, we see little reason for concern. A number of defaults are a result of idiosyncratic reasons and is not representative of the entire market. Besides, the amount of onshore defaults (c. CNY 130bn in the last few weeks of '19) is small relative to the entire market.

Finally, we see an additional source of risk in European companies. Moody's expect companies in Europe to face more rating cuts and higher odds of default this year. It expects defaults to almost triple as more HY companies struggle with weak demand. Moody's also forecasts the rate of missed payments in the region to catch up with USA.

FX

USD was by far one of the worst performing currencies in Dec, weakening against all of its G10 peers and most of the EM currencies. DXY fell 1.92% over the month, falling below 97 for the first time since July ’19 while the JPM EMCI gained 2.66%, its best month since Jan ’19. FX movements continue to be driven by geopolitical events like Brexit and US-China trade over the month. The dollar recovered slightly on the back of positive economic data but failed to sustain the momentum. The weakening sentiment for the USD was reflected in the extended fall in aggregate long USD positioning while GBP positioning turned marginally net positive for the first time in ’19 (Figure 10).

The Dec weakness for DXY led the index to end ‘19 just 22bps higher while CAD ended the year as the best performer within the G10 group. Asian currencies saw a good year too, with most currencies stronger against the dollar, led by THB. However, tensions and protests in larger European and LatAm EM markets, particularly in Turkey and Chile, weighed on the JPM EMCI, which ended the year -1.36%. Volatility in FX markets also spiked up in the first week of ’20 following US’s assassination of Qasem Soleimani with haven currencies strengthening.

Figure 10: USD and GBP positioning as at 24 December 2019

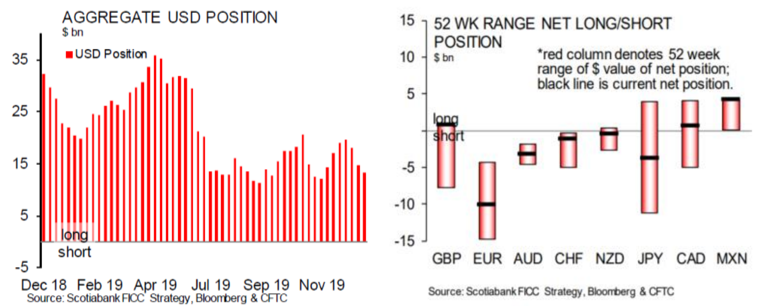
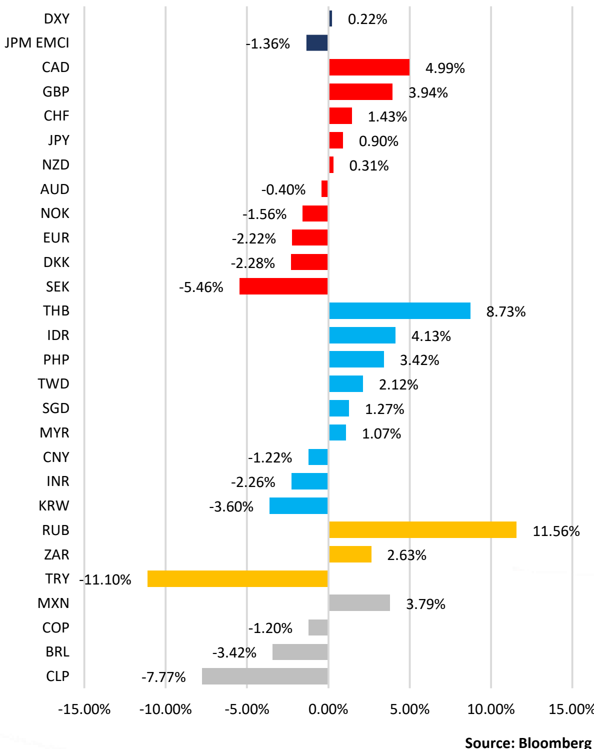


Figure 11: FX returns in 2019



Source: Bloomberg

Looking forward, we continue to remain a USD bull until proven otherwise. Despite recent events, USD has proven to be very resilient since the global financial crisis and remains to us the least bad major DM currency fundamentally. However, we are more cautious on USD this year than in the previous five years as US GDP might slow relative to its peers while the S&P 500 looks relatively unattractive. Swaps around fully hedged FI is also not supportive of FIIs buying hedged USTs despite the relative real yield differential positives. If FIIs anticipate a weaker USD, this will boost hedging demand or reduce unhedged buying. Lastly, fiscal reflation looks improbable in USA this year but more likely to happen in Europe, Japan and ROW – fiscal spending helps strengthen currencies where this happens. In addition, a key catalyst for EUR gains would be signs that Germany is closer to abandoning its overly prudent ‘zero budget’ policy that has become institutionalized.

Commodities

The Brent oil price extended its uptrend in Dec after an initial tumble in the first week of the month, resulting in its best year since ’14. Much of the gain here was on the back of an OPEC production cut, with Saudi Arabia committing larger than required cuts. Gold also had its best year since ‘13 and rose to a new 6Y-high at $1,550/Oz as investors, especially in Q4CY19, embraced its merits as a safe haven asset and portfolio diversifier.

Brent oil rallied in the first few days of January following the assassination of Soleimani, but it was surprising that it failed to break above its resistance at $70 until today (08 Jan 2020). This suggests that either markets doubt a severe Iranian response or that oil fundamentals are looking ‘softer’. Oil is still technically in the range of $55-75/brl with low $80s an even bigger resistance. Bears continue to point to an expected surplus of production and building inventories as reasons to be wary of upside from here. However, the fact is Iran probably has the military capability and proximity to close Hormuz Straits through which 40%+ of world’s sea-bourne oil exports travel.

Markets

Name	31.12.2019	29.11.2019	MTD	YTD	Total Return MTD	Total Return YTD
Equities						
MSCI ACWI Index	565.24	546.70	3.39%	24.05%	3.55%	27.30%
S&P 500	3230.78	3140.98	2.86%	28.88%	3.02%	31.48%
DJIA	28538.44	28051.41	1.74%	22.34%	1.87%	25.35%
NASDAQ	8972.60	8665.47	3.54%	35.23%	3.65%	36.74%
RUSSELL 2000	1668.47	1624.50	2.71%	23.72%	2.89%	25.49%
Russell Top 200	775.87	753.50	2.97%	29.13%	3.11%	31.75%
STOXX 600	415.84	407.43	2.06%	23.16%	2.15%	27.75%
Euro Stoxx 50	3745.15	3703.58	1.12%	24.78%	1.23%	29.37%
FTSE 100	7542.44	7346.53	2.67%	12.10%	2.78%	17.23%
MSCI AXJ	688.27	646.73	6.42%	15.37%	6.51%	18.25%
Stock Exchange of Thailand	1579.84	1590.59	-0.68%	1.02%	-0.49%	4.27%
Jakarta Composite	6299.54	6011.83	4.79%	1.70%	4.91%	4.17%
Philippines Stock Exchange	7815.26	7738.96	0.99%	4.68%	1.05%	6.47%
NIKKEI 225	23656.62	23293.91	1.56%	18.20%	1.70%	20.69%
KOSPI Index	2197.67	2087.96	5.25%	7.67%	5.28%	8.39%
Nifty 50	12168.45	12056.05	0.93%	12.02%	0.95%	13.48%
S&P BSE SENSEX 30	41253.74	40793.81	1.13%	14.38%	1.13%	15.67%
Straits Times Index	3222.83	3193.92	0.91%	5.02%	1.11%	9.39%
Hang Seng Index	28189.75	26346.49	7.00%	9.07%	7.02%	13.02%
Shanghai Comp	3050.12	2871.98	6.20%	22.30%	6.21%	25.30%
SHANGHAI A SHARE	3195.98	3009.43	6.20%	22.39%	6.21%	25.38%
S&P/ASX 200	6684.08	6846.00	-2.37%	18.38%	-2.17%	24.99%
MSCI AC ASEAN Index	799.24	774.63	3.18%	5.24%	3.33%	8.79%
MSCI EM Ex. Asia Index	1464.50	1355.21	8.06%	12.22%	8.51%	16.85%
MSCI EM Asia Index	566.11	529.78	6.86%	16.63%	6.94%	19.34%
MSCI EM Index	1114.66	1040.05	7.17%	15.42%	7.35%	18.64%
Fixed Income					**MTD bps**	**YTD bps**
US10YT Yield	1.9175	1.7758	7.98%	-28.56%	14.17	-76.67
US2YT Yield	1.5691	1.6119	-2.66%	-36.93%	-4.28	-91.87
Bunds 10Y Yield	-0.1850	-0.3600	-	-	17.50	-42.70
Global Investment Grade	511.67	508.70	0.58%	6.84%		
Global High Yield	1414.56	1378.84	2.59%	12.56%		
Forex						
EUR	1.1213	1.1018	1.77%	-2.22%		
JPY	108.6100	109.4900	-0.80%	-0.98%		
SGD	1.3459	1.3677	-1.59%	-1.25%		
GBP	1.3257	1.2925	2.57%	3.94%		
AUD	0.7021	0.6763	3.81%	-0.40%		
US Dollar Index	96.3890	98.2730	-1.92%	0.22%		
China RMB Spot Currency	6.9632	7.0324	-0.98%	1.23%		
Offshore Deliverable CNY	6.9617	7.0309	-0.98%	1.33%		
Gold/Oil						
Brent Crude	66.00	62.43	5.72%	22.68%		
Generic 1st Crude Oil, WTI	61.06	55.17	10.68%	34.46%		
Gold Spot Price	1517.27	1463.98	3.64%	18.31%		