Multi Asset
Navigator
WEEKLY STRATEGY

UNIGESTION

12 August 2019

Daydreamer David Cassidy, 1973

Over the year so far, 16 central banks have eased for a total of 23 moves and a cumulative 1,060 basis points. Understandably, macro data, except inflation, did not get a lot of attention as most investors are convinced that central banks will successfully re-stimulate the economy as they did during the late '90s pre-emptive easing cycles. The market's preoccupation with interest rates has been notable for some time, leading investors to read bad news as good news and vice versa. Interest rates have been the main driver of almost all asset classes and the steady "everything rally" forced even highly risk-averse investors up the risk ladder into more crowded positions. The trade talks between China and the US ended on a "constructive" note and the next round of talks were scheduled for September. The Fed meeting passed and implied volatilities were pricing a quiet summer. Sentiment was upbeat, valuations were mostly irrelevant… until the daydreamers were woken up by a tweet.

WHAT'S NEXT?

Game of chicken

Market expectations were high going into the long-awaited Fed July meeting, so it proved tough to deliver a dovish surprise. Donald Trump made no secret of the fact that he was not happy with Jerome Powell's decision, and shortly thereafter, he increased the pressure on China by taxing essentially all Chinese imports. Is the US president convinced that he has discovered a free lunch? The Fed has remained politically independent so far, but Trump seems very confident that central bankers will react to changing economic and financial conditions. In his view, he will be able to bash the Fed and China, which appears to be popular with voters, without paying the price for it.

However, the White House's high-stake game of chicken with China and the Fed could have serious consequences. Trump will probably succeed in pressuring the Fed, as the risk of recession would be too high to face if it backfired. However, comments like "we will be taxing the hell out of China" will not work, as the Politburo is fully aware that a trade war-induced recession would greatly reduce the probability of Trump's re-election. By contrast, the Chinese president, Xi Jinping, does not have to think in election cycles and therefore time seems to be ticking in his favour.

Is the US consumer immune to tariffs?

Our US proprietary macro Nowcasters show a similar picture as during the 1995-1998 period: decent levels of growth with falling inflation. However, the backdrop is more challenging this time. During the late nineties, emerging markets were suffering from a currency crisis, but developed countries were in a much better situation than they are currently. Over the past months, the global business cycle has decelerated noticeably and global trade has been hit hard by the trade war. Open, export-oriented countries like Germany are caught in the crossfire. German industrial production in June saw its largest fall in almost a decade and business expectations have fallen below the levels seen during the last European recession.

The latest threat to raise tariffs on the remaining USD 300 bn of Chinese exports to the US will put even more pressure on the fragile manufacturing sector. This will be a real game-changer for the US consumer, who was largely immune until now as consumer products were excluded in the earlier rounds of tariffs. This comes at a time when upbeat consumers (US consumer confidence is at an eighth-month high) are the only major growth driver.

The key question will be how much more desperately needed stimulus will come from the consumer given that unemployment is already at a five-decade low and sustained wage gains and more affordable mortgages are already priced in? Private and corporate debt will no longer fuel the economy as consumers (beyond mortgages) and corporates have aggressively levered up during this extended business cycle.

Liquidity is a coward; it disappears at the first sign of trouble

The market was very nervous going into the Fed meeting as most of the systematic strategies had increased exposure to risky assets and even the most defensive discretionary investors were forced up the risk ladder due to the steady "everything rally". There was some kind of a relief, despite a disappointing cut, after the Fed meeting had passed. The S&P 500 index was about to retest its highs and complacent investors were about to fall back into daydreaming. But then President Trump's tweet hit the market. Over the next three days, the major US indices dropped over 8% on an intraday basis and the VIX spiked to 24.8, driven by the threat of tariff increases. However, the market shock seemed to be short lived and complacency and confidence were back almost as fast as they had disappeared. If a tweet can provoke such an overshoot in the most liquid instruments, it will be interesting to see how illiquid, crowded passive instruments will absorb a market shock that lasts longer than three days.

Valuations do not matter until they do

The dovish Fed pivot has clearly driven the equity market rally in 2019. More than 90% of the gains in the S&P 500 index have been driven by valuation expansions, as earnings growth expectations weakened but the market priced in central bank cuts. The market consensus is that the move lower in rates is supportive for equities, justifying above-average valuations going forward.

But shouldn't lower yields also be a reflection of weaker growth? Even if sales can grow moderately during low growth, profit margins are likely to remain under pressure from wage growth, supply chain disruption, rising input costs and slowing capex due to the trade war. The earnings cycle remains crucial for equity markets, and while central banks are starting to loosen their monetary policy to reflate the economy, we doubt this will be enough to save current expectations of double-digit EPS growth for 2020 and 2021.

Cross asset allocation: cautious and dynamic

We see a low recession risk probability, coupled with increased odds of negative inflation surprises. Therefore, central banks will have enough flexibility to pump even more liquidity into the system, which favours carry strategies.

Markets are clearly on-edge regarding trade, but equally willing to "buy the dip". Accordingly, sentiment and valuation have made a comeback, leading to a reduction of our overall market exposure. We keep on protecting tail risk via convex option strategies.

Listen to: Daydreamer by David Cassidy

STRATEGY BEHAVIOUR

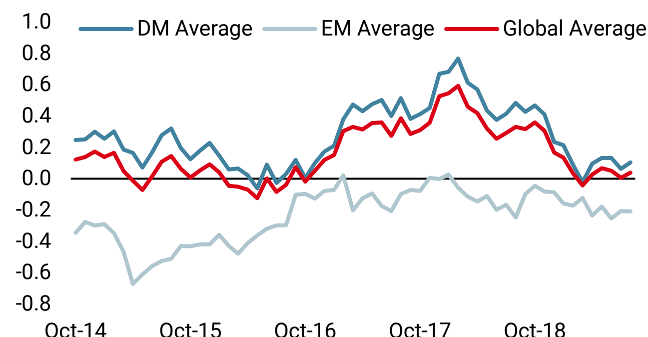
Our medium-term views remain cautious, and we prefer to get exposure to growth via high yield corporate credit. We are also complementing our modest equity exposure with options to protect the portfolio in the case of equity drawdowns.

PERFORMANCE REVIEW

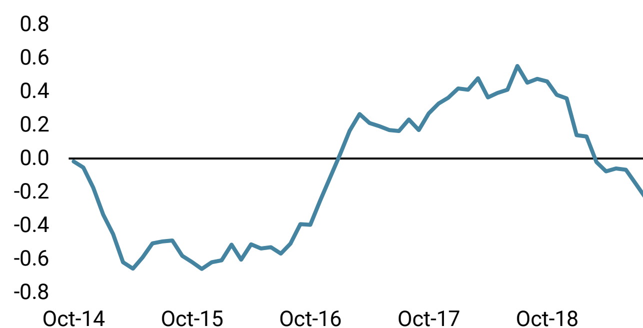
Over the month of August thus far, the Uni-Global – Cross Asset Navigator fund is down 0.6% versus a 2.7% fall for the MSCI AC World Index, while the Barclays Global Aggregate (USD hedged) is up 1.0%. Year-to-date, the Uni-Global – Cross Asset Navigator has returned 7.7% versus 13.5% for the MSCI AC World index and 8.0% for the Barclays Global Aggregate (USD hedged) index.

UNIGESTION NOWCASTING

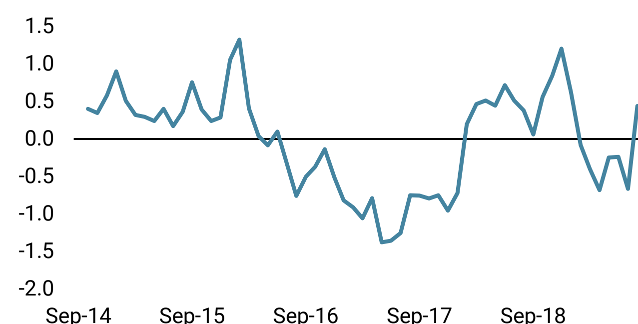
World Growth Nowcaster



World Inflation Nowcaster



Market Stress Nowcaster



Weekly Change

- Our world Growth Nowcaster improved this week, largely driven by an improvement in US consumption.
- Our world Inflation Nowcaster declined further this week, with both the US and Switzerland seeing weaker supply-side inflation.
- Market stress picked up this week, as the trade war uncertainty continues, lifting volatility and widening spreads.

Sources: Unigestion, Bloomberg, as of 12 August 2019.

NAVIGATOR FUND PERFORMANCE

Performance, net of fees	2018	2017	2016	2015
Navigator (inception 15 December 2014)	-3.6%	10.6%	4.4%	-2.2%

Past performance is no guide to the future, the value of investments can fall as well as rise, there is no guarantee that your initial investment will be returned.

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