Multi Asset
Navigator
WEEKLY STRATEGY
UNIGESTION
7 October 2019

NO USE IN CRYING Rolling Stones, 1981

The deterioration in US macro data weighed on market sentiment last week, triggering a large risk aversion move. Consequently, markets are now pricing in an increased likelihood of a US recession. While market sentiment is a key driver for asset returns, it can be affected by human behaviour patterns, which tend to 1) overestimate short-term events relative to broader perspectives, 2) follow the trend without discriminating between noise and fundamentals, and 3) focus more on negatives than positives when confidence is weak. We believe that we are in this kind of an environment, with investors overreacting and amplifying the nature of risks that are on the horizon. We are not saying that there are no risks, rather that the current situation warrants a thorough analysis of the facts to see if market pricing reflects reality and to avoid crying for nothing.

WHAT'S NEXT?

Did You Say "Recession"?

For the second month in a row, the ISM manufacturing reading in the US came in below the key threshold of 50, which historically highlights a slowdown in the economy. The last time we had such an occurrence was at the end of 2015. In 2016, the situation improved thanks to delayed monetary policy normalisation from the Fed. Today, in an environment of inversed yield curves, a sharp slowdown in global trade and increased uncertainties surrounding the trade war, the US political situation and Brexit, the negative macro momentum has led to higher recession pricing.

US bond yields are pricing in between one and two cuts from the Fed before the end of the year, while both implied volatility and volatility of volatility have increased sharply, and safe haven assets such as defensive FX and gold have also performed well recently. Reflecting this negative mood, the New York Fed's probability of a recession within twelve months hit 38%, its highest level seen since 2008. Based on this, perhaps our song of choice should have been "Paint It, Black".

What is a Recession?

However, if black is the colour of current market sentiment, the facts are a bit less dark. Despite the current economic slowdown, we are far from recession. Firstly, recession historically means negative GDP growth, falling employment, muted wage growth and poor housing investment. Secondly, recession typically comes from two key elements: 1) An economic unbalance between supply and demand. This can come from monetary policy tightening which aims to prevent economic overheating by controlling the demand side, or from a shock in supply which pushes inflation to unsustainable levels. 2) An asset bubble that bursts because financial pricing has diverged from the real economy. Thirdly, when recession does kick in, the macro economic deterioration is broad, reaching all components of GDP, including housing, consumption, production, investment and employment. Does the current situation tick all of these boxes? The answer is a clear cut no.

Where Are We Today?

Since 1979, the National Bureau of Economic Research has identified four recessions in the US. On average, the ISM Manufacturing reading has been 42 during these periods, while Non-manufacturing was a bit higher at 46. One year before the official start of a recession, these figures were 49 and 53 respectively. Today, these numbers are at 47.8 and 52.6, far from recession levels but in line with 12-month forward ones, which would tend to confirm market expectations.

However, the situation is very different in other key sectors of US economy. During recessionary periods, the consumer confidence reading from the Michigan University was, on average, at 70 and, one year before an official recession, it was at 84. We are currently at 93.2. The picture is similar for retail sales and household disposable income, which are at levels far from recession averages or one-year forward readings. Employment is a key component of US GDP and this remains solid, as reflected by the large employment creation numbers in September. During recessions, non-farm payrolls are negative (-225k on average since 1979) and at 88k one year before recessions. The latest number, released last week, was 136k and the average over the last twelve months has been 170k. Consequently, it would be difficult for us to agree with market sentiment about the high probability of recession in US within the next year.

That view is confirmed by our proprietary US Nowcaster, which tracks the US economy in real time by monitoring a large spectrum of data across the sub components of GDP: housing, durable goods consumption, production expectations, non-durable consumption, employment, financing conditions and investment. Currently, all components are in positive territory except for durable goods consumption, which is slightly negative. Historically, these components are all in negative territory one year ahead of a recession. To conclude, in terms of macro risks, there are currently few elements that validate the imminence of a negative outcome for the US economy. This view is also shared by the Fed, as illustrated by their economic forecasts for the coming years, which show US GDP close to its potential.

Risks Exist, But Investors Are Prepared

Risk is multidimensional and, beside macro risks, we monitor market sentiment and valuation, which can also drive asset returns over the short and medium term. Regarding these two dimensions, the global picture is more mixed. On the market sentiment side, confidence has been affected by negative news flow about impeachment and the unresolved situations around the trade war and Brexit. This has driven the recent risk aversion move and will continue to weigh on markets, with a worst-case scenario being a vicious cycle driven financial panic, freezing any investment decisions from corporates and households.

However, we believe that the surprise could be more on the upside than on the downside. Positioning in favour of risky assets is small and demand for hedging has been large. Consequently, any rally in the equity and credit space could trigger an unwinding of hedges and amplify the positive trend, which could lead to equity indices testing previous highs. It is not our central case scenario, but the odds for this are much higher than market expectations suggest.

Finally, contrary to 2001 or 2008, we do not see any bubble in the pricing of risky assets. Carry delivered by equity and credit spreads remains attractive and is not disconnected from fundamentals, as shown by the continued growth in earnings over the last few years.

After 10 years of positive economic growth in the US, it is odd to bet on an end to this cycle. However, big data development and systematic signals are there to help investors to put the facts into perspective and then take advantage of markets overshooting. The robots are saying there is no recession on the horizon and we are listening to them, not crying, and maintaining our growth-oriented asset tilt in our dynamic asset allocation.

Listen to: No Use in Crying by Rolling Stones

STRATEGY BEHAVIOUR

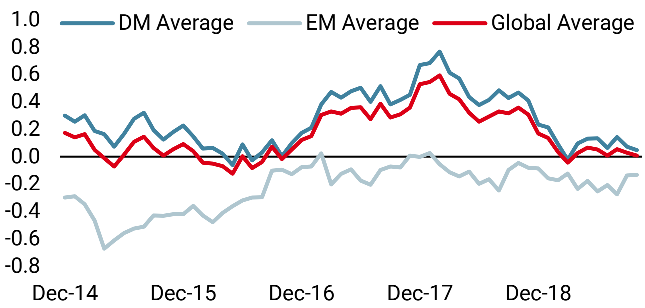
Our medium-term view is currently more constructive, as we are still overweight growth assets and underweight real assets. Given the current cost of hedging, we are using forex-based strategies exposures to hedge ourselves against adverse market conditions.

PERFORMANCE REVIEW

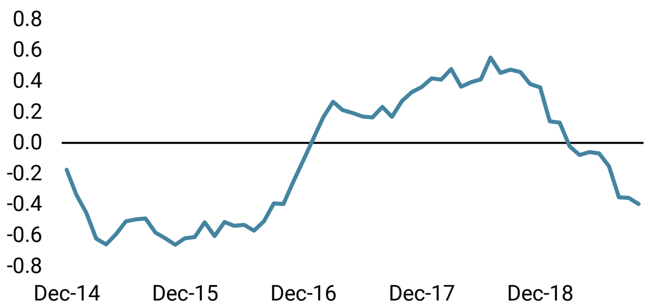
Over the month of October to date, the Uni-Global – Cross Asset Navigator fund lost -0.6% versus -1.1% for the MSCI AC World index and -0.4% for the Barclays Global Aggregate (USD hedged). Year-to-date, the Uni-Global – Cross Asset Navigator has returned 9.6% versus 14.9% for the MSCI AC World index, while the Barclays Global Aggregate (USD hedged) index is up 9.2%.

UNIGESTION NOWCASTING

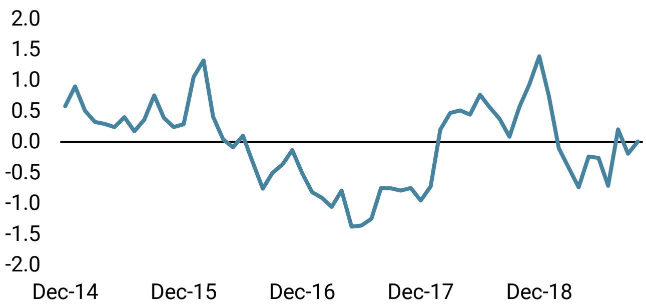
World Growth Nowcaster



World Inflation Nowcaster



Market Stress Nowcaster



Weekly Change

- Our world Growth Nowcaster marginally decreased last week, essentially driven by weaker US data.
- Our world Inflation Nowcaster continued to stabilise last week, after a long period of decline.
- Market stress increased last week as volatility rose.

Sources: Unigestion. Bloomberg, as of 07 October 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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