BAD OMENS?

The return of volatility has shaken things up of late, but what does 2019 hold? Five independent asset managers reveal the challenges and opportunities they foresee for the year ahead

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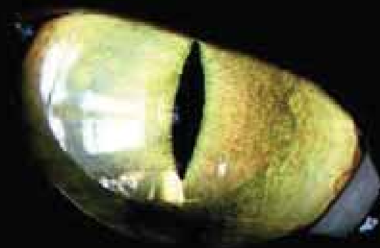

URS IMBER
Swiss Wealth Protection
Zug

The expansive monetary policies of central banks have fuelled bull markets, and bull markets end not because their time is up, but because of impending recessions. So, while many observers wonder when the next correction is coming, the real question is, what might trigger a crash?

We're seeing little in the way of serious signs that the world economy is on the edge of a cliff. Yes, the US economy may have peaked, but there are no signs of any excesses or inordinate wage growth. Inflation remains under control, corporate order intakes and profit growth remain positive, pressure on margins continues to be low, and stock buybacks and takeovers are on the rise.

With Congress now divided, we predict that the tax reform process will stall in 2019 and that there will be little in the way of new initiatives, leading to an easing of growth. But while the US economy may lose a little momentum, it is possible that Europe will slowly pull out of its current lull.

There are plenty of potential crises in the offing – but how much of a risk do they pose? The trade war between the US and China is a significant factor, and in Europe we have mainly political risks, such as Brexit, Italy and a potential leadership vacuum in Germany. Regarding the latter, a change at the political helm to a reform-minded Friedrich Merz would provide fresh impetus.

Largish market corrections may potentially originate in China, where the pace of growth is slowing and debt is rising.

In this late phase of the current economic upturn, defensive and value stocks offer the best growth potential. Further corrections in the course of 2019 cannot be ruled out, but if you're confident in the quality of your investments and have a long-term investment horizon, then you should have nothing to fear from market turmoil in 2019.

HUBERT-LANCE HUET
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Geneva

All financial forecasters should be required to give some information about themselves:

1. Are they any good?
2. Do they have any skin in the game?
3. On what grounds are the forecasts based?

To start with number three first, our forecasts are based on a combination of context analysis, market signals, long-term secular trend analysis, some supply and demand characteristics of each market and very little economics.

This means that our forecasts will be forward-looking. Economics gives backward-looking forecasts.

Turning to the second question, we believe forecasters should manage money. Otherwise their forecasts have little real-world value. Our forecasting team manages money.

Finally, regarding question one, each forecaster should display their track record so that the forecast can be given a weighting in the eyes of the beholder. Our website shows our track record.

Our asset allocation currently is 0% equity, 30% fixed income and 20% other, with 50% cash and 50% dollars. This is based on a long-standing forecast (2015) that equities would correct in 2018. We think this will continue until the spring of 2019, after which markets will bounce.

Fixed income is a buy at these levels, but only the government sort and preferably US government. Inflation scares are just that.

Finally, the dollar will continue to rise into 2020 and this will keep risk markets down and potentially push the US into recession. Happy holidays!

2019 MARKET OUTLOOK

CARMINE ORLACCHIO
OLZ
Bern

Central banks around the world employed unorthodox policies to protect the financial system from implosion during the 2008 financial crisis. Their measures have been instrumental in extending the duration of economic expansion to a new record length.

At the same time, central bank interventions have systematically repressed volatility, encouraging investors to buy the dip and chase returns regardless of the underlying risk.

In the current late-cycle framework, we have to deal with a financial system that is more vulnerable to shocks, with debt levels (government, corporate and household) much higher than before the crisis. The path in front of us can be characterised by the following unfolding dynamics:

- Normalisation of central banks' balance sheets, which implies a massive withdrawal of liquidity from the market;
- Tightening of monetary policy with rising financing costs for a highly leveraged system;
- A noticeable slowdown in global growth, which offers less support for equities and leaves high yield valuations stretched (especially in the US).

Investors would be well advised to refocus on the fundamentals of investing in order to adequately address portfolio risk, in particular liquidity risk, and diversification. They should ensure they have: clear segmentation of risk in the portfolio, more defensive and less cyclical equity investment, no compromise on the issuer quality and on the liquidity of the investment.

The European and, in particular, Swiss markets have to face the headwind of getting out of the negative interest framework. Just returning to a level more or less in line with inflation poses a major challenge for bonds and interest-rate sensitive investments.

GIANPIERO STURZO
Lobnek Wealth Management
Geneva

At a time where market participants are nursing the wounds of the recent sell-off, the time has come to prepare portfolios for a challenging year to come.

Trade tensions, global economic slowdown, populism, central bank balance sheets, Italy's debt issues and global interest rates will probably remain in everyone's mind. The rise in volatility following sell-offs in February and October has impacted investor sentiment. At this point, it is difficult to find a catalyst that would change the direction of this momentum.

At Lobnek, we believe investors should maintain a decent cash allocation for the foreseeable future in order to reduce global volatility in their portfolio while offering opportunities to tactically increase allocations in the case of sharp corrections in the equity market. In order to manage drawdowns, derivatives look to be an attractive way to implement such positions.

On the fixed income side, we favour the short end of the USD curve, which offers a decent yield in the current environment. Spreads will probably continue to widen and may offer some interesting opportunities later in the year.

On the equity side, we see the current trend of US equities outperforming Europe and emerging markets continuing unless the dollar strengthens to levels unsustainable for the US economy. We will continue to maintain a rather defensive equity approach and we aim to maintain our longstanding healthcare overweight. We would wait to see the dollar weakening before increasing allocations to emerging market equities and gold.

Finally, due to poor investor sentiment and possible liquidity traps, we remain wary of illiquid strategies and leverage while closely monitoring the risk contribution of each investment.

BENOÎT DERWAEL
PLEION
Geneva

Is 2019 set to be a 'paperless' year? This sentiment is of course reminiscent of immigration. We will get to that.

By 'paperless', we refer to the end of various financial aids (quantitative easing) and the resulting difficulty in finding yield. The US dollar has been strengthening since the end of the QE, and this trend should continue over the coming months until the ECB puts an end to negative rates. The relative strength of the dollar will weigh on US companies which, through their exports, are a pillar of growth for the US economy. These companies are typically small and medium-sized businesses relying on so-called shadow banking for access to credit. We therefore remain cautious on leveraged loans and high yield bonds in general.

'Paperless' also refers to the rise of cryptocurrencies. The managing director of the IMF sent the price of Bitcoin and others tumbling by suggesting that each state should issue its own cryptocurrency. However, the wave cannot be stopped and sectors related to technology, services and security remain attractive despite high P/E ratios.

Germany, Japan and other developed countries are in need of cheap labour. Immigration and control of undocumented workers are only a temporary solution. For our part, we avoid student loans as the US model is clearly unbalanced, and prefer microfinance and private equity investments addressing the education needs of developing countries.

2019 will very likely be volatile, despite the drawn out recovery cycle and largely homogeneous global economic growth. The increasing volatility we have witnessed so far this year, especially in February and October, could foreshadow deeper troubles for 2019, and this would be the time to invest in quality stocks with strong pricing power.