ETHENEA

Outlook 2020

Macro-economic house view: the end of the cycle delayed once more

Despite all of the gloomy predictions, for the stock markets, 2019 will be one of the best years in recent history. The global recession that was priced in at the end of last year has not materialised. Instead, despite the ongoing trade dispute, and with central bank support, the global economy has "muddled through". Freed from concerns of an imminent economic crisis, the global capital markets were able to make up for the price losses of 2018, even without rising corporate profits. It should also be noted that valuations have returned to the level of previous years. The million-dollar question for asset allocators, however, is to what extent this will continue in 2020, or, in other words, what is needed to reduce the gap between economists' growth estimates and the valuations of risk assets.

We see the current situation as follows: any type of agreement between the U.S. and China will prevent a further escalation of the trade dispute for the foreseeable future. This will provide the executives of globally active companies with increased planning security for necessary investments, value chain structuring and, last but not least, trade flows. Increased security could potentially break the spiral of restrained investment, less growth, less profit, and, ultimately, layoffs. The latter is important, as employees also have an impact on consumption. Supported by a monetary policy that clearly shows that the "lower for longer" motto will remain in force, we are seeing a good environment for positive economic development. In our view, without tensions easing in the trade dispute, accommodative monetary policy alone is not enough to accelerate the economy. It is more likely that, with a solution to the trade dispute and an economy improving as a result, a normalisation of monetary policy - albeit very slowly – is possible without immediately triggering a crisis on the capital markets.

We believe that the global capital markets have already begun pricing in this more positive environment and, as such, are acting as an additional leading indicator. If the recent stabilisation of survey-based leading indicators, such as the Purchasing Managers' Indices (PMIs), is followed by a sustained improvement in sentiment, this could lead to a turnaround in real growth. Based on the aforementioned factors, we consider this quite probable. Following such a trend reversal, the gap between fundamental growth figures and the valuation of risk assets discussed previously will automatically disappear. Consequently, we expect additional upside potential on the equity markets. A further extension of the economic cycle will inevitably lead to higher valuation, due to the ongoing pricing process. Finally, although we won't see an end to the "Wall of Worries", the equity rally that was missed by many investors will continue. We do not expect credit spreads to rise in this environment. As long as nothing happens on the interest rate front, corporate bonds will continue to be supported. However, as we assume that the central banks will not change course again despite the signs of economic stabilisation and subsequent improvement, we do not see any immediate danger. The only critical factor for this scenario is inflation rising faster than expected. In this type of situation, the central banks would find themselves caught between fighting inflation and high public debt. Although we do not expect this to happen, it is important that future inflation data is closely monitored. To sum up, provided a trade agreement is reached, the hope-based valuation of the capital markets could become a reality and even offer upward potential.

Ethna-AKTIV: multi-asset allocation in 2020 very promising

Given the aforementioned macro-economic situation, the Ethna-AKTIV has adopted a positioning that is rigorously designed to profit from the anticipated rise in risk assets. To implement this, we use the advantages of a flexible multi-asset fund to their fullest. Assuming the trade dispute does indeed de-escalate, we will start the new year with an above-average equity exposure without having to reduce our bond allocation. This is because by using mainly equity index futures, we are able to participate in both asset classes in parallel. In terms of regions, we will continue to be overweight in U.S. indices, as the underlying growth in this region is still higher. However, over the course of the year, we could envisage increasing the allocation in Europe. Through active management and option-based hedges, we can ensure asymmetry in our risk/return profile. In addition, in an environment of globally low interest rates and moderate growth, there are few alternatives to equity investments. Interest rates are at record lows worldwide and, as we assume that this will not change in the near future and that even lower interest rates can be expected in the long term, we will continue to have a high duration in our bond portfolio. We will achieve this through corporate bonds maturing in six to eight years and an opportunistic interest rate future overlay. We will continue to focus on the high quality of issuers and, with a few exceptions, will avoid the high-yield and non-rated areas. We are planning to maintain the Ethna-AKTIV's gold allocation within the high single-digit percentage range. This is because the precious metal is not only a good diversifier within the portfolio but also represents a solid investment due to our interest rate and inflation expectations. In 2020, currency allocation will also play an important part in the portfolio. Although growth prospects in Europe are slowly improving, and hopefully there will at least be a decision regarding Brexit in the foreseeable future, the euro is still struggling with structural problems. This is why we will continue to hold our positions in the Swiss franc and the U.S. dollar.

Ethna-DEFENSIV: still attractive opportunities in the bond markets

In our last outlook from the middle of this year, we predicted that yields on 10-year U.S. Treasuries would head in the direction of 1% - 1.5% by mid-2020. This move took place quite quickly and yields briefly fell below the 1.5% mark at the end of August/beginning of September. Yields have since risen again despite three rate cuts by the U.S. Fed in the second half of 2019. With the last rate cut in October, the Federal Reserve determined that its Fed Fund rates are currently at an appropriate level. Therefore, before it considers further rate cuts, it will wait and see how the economy develops. As outlined in our macroeconomic house view, our economic expectations are positive. Nevertheless, we believe that interest rate hikes are unlikely for the time being. Even though risk premiums on corporate bonds have already fallen significantly, we still see potential for further tightening. In our expected macroeconomic scenario, the companies we have selected will continue to grow and generate stable to rising profits. In addition, these companies took advantage of the favourable financing conditions in 2019 to extend the average remaining term significantly. They are now under no pressure to refinance and global investors are even talking about a shortage of bonds with short to medium-term residual maturities. Therefore, we have reduced the duration of the bond portfolio in the Ethna-DEFENSIV and, in the coming months, will focus more on medium-term investments. This is where we see the opportunity to benefit from yield curve effects and where we are relatively safe from price setbacks due to the high demand for these limited securities. If yields on long-term bonds rise, there will be virtually no noticeable decline in fund performance.

Due to the ECB's asset purchase programme, we still expect yields in the eurozone to remain low. Alongside corporate bonds, we consider Spanish sovereign bonds to be very interesting. The latter, in particular, should benefit from the ECB's asset purchase programme, as the Spanish government's higher creditworthiness makes them attractive for other groups of buyers and there is a limited supply yet a high demand. The ECB is also continuing to buy a significant number of high-quality corporate bonds. In this respect, we are following in their footsteps and will maintain our high weighting of euro-denominated corporate bonds. Medium-term residual maturities are still our first choice. In the area of corporate bonds, new issues continue to be of interest to us, as they offer attractive premiums over previously issued bonds. In this way, the Ethna-DEFENSIV bond portfolio is not only able to achieve a stable income from coupon payments, but can also generate further capital gains.

Ethna-DYNAMISCH: many factors argue for a continuation of the bull market

Before we talk about our outlook for 2020, I would like to say a few words about the market trends in recent months. To date, the approach we described in our outlook for the second half of 2019 has been rigorously implemented and has proven to be correct. We consistently used the uncertainties and the associated price setbacks in the summer of 2019 to expand our equity quota to over 70% for the first time. The mixture of low interest rates, negative investor sentiment, liquidity provided by the central banks and possible Brexit solutions, as well as the hopes for an agreement in the trade dispute, led to a strong upswing on the stock markets from mid-September – and the Ethna-DYNAMISCH profited from this.

So, what do we expect in 2020? The power struggle between the central banks and the economy will continue. The equity markets are currently discounting an economic upswing, including rising profits. The economy now needs to deliver on this expectation in 2020. If this is not the case, i.e. there is weak economic development; this could result in declining equity markets. We currently consider this scenario to be unlikely and instead expect the economy to pick up. The corporate reporting season was good and even the majority of the manufacturing sector offered positive surprises. In our opinion, these are the first clear signs of an imminent upswing. Economic indicators are also showing improvement and are now no longer at their all-time lows. For example, the expectations of German companies surveyed in the widely-regarded ifo Index have recently risen for the second time in succession. Three consecutive increases are closely related to rising equity markets. Further support for the equity markets will come from the interest rate side. The sharp drop in yields increases the attractiveness of equities whose valuation can be regarded as average in the historical context. If we compare these valuations with the bond market, equities are favourably priced and therefore particularly interesting for investors. In 2020, this optimistic view will continue to be reflected by the Ethna-DYNAMISCH's high equity ratio. However, we do not want to rely solely on rising prices. There will also be some surprises and challenges in 2020 and, thanks to its flexibility both in terms of allocation and selection, the Ethna-DYNAMISCH will be well placed to manage them.

Press contact

Comfi
Wim Heirbaut
T +32 2 290 90 95
E wim.heirbaut@comfi.be

About ETHENEA

Managed by ETHENEA Independent Investors S.A., the Ethna Funds are conservative investment funds focused on continuous performance and risk minimisation. The Portfolio Management Team actively manages assets of 4,28 billion euro, which are spread across three funds: Ethna-DEFENSIV, Ethna-AKTIV and Ethna-DYNAMISCH (as of 30/9/19). ETHENEA is a non-bank affiliated investment company headquartered in Luxembourg. For further information, please visit **ethenea.com.**