MORABANC
asset management

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MARKETS & STRATEGIES

Our vision

Adjusting expectations

Our image of 2018, particularly following a final quarter in which virtually all asset classes registered negative returns, was formed by three main investor concerns: 1) that economic data would prove the slowdown in Europe and China to be something more than a blip; 2) that increased instability at the geopolitical level (trade tensions, Brexit, rise in populism, etc…) would end up taking its toll on growth data; and finally 3) that hawkish central bank rhetoric would turn out to be misplaced.

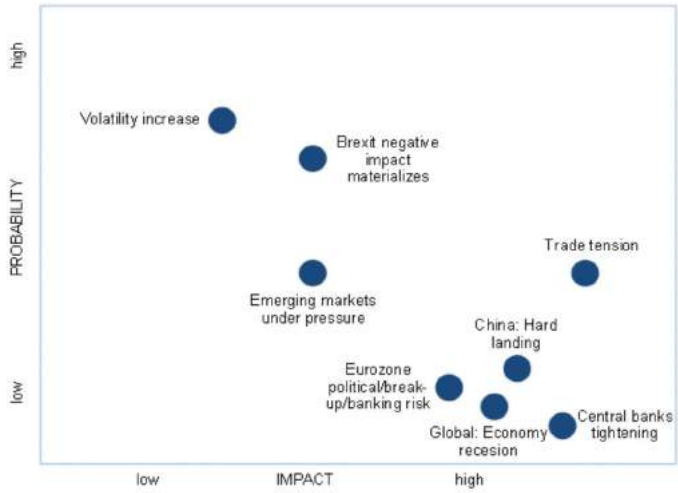
Regarding the concerns about the economy, while they have yet to be resolved we have already seen a swift adjustment in expectations both at the macro and micro level. Virtually all organisations have lowered that growth outlook; and, while a global recession looks unlikely, a decrease in activity is now being taken for granted. Meanwhile, both management and analysts have reduced their forecasts significantly.

This perception of a less dynamic macro backdrop has weighed on the trade negotiations between China and the US, which had progressed from their stagnated point in November to "going very well" (in Trump's words) by the end of the year, thereby coinciding with the significant slowdown in economic activity indicators. Since then, they have continued their positive evolution, gaining momentum when disappointing macro data is published on either side of the Pacific.

As for monetary policy, the shift in Powell's stance shows that the famous Fed Put is still very much alive, and the futures market is now indicating that Fed Funds are more likely to be cut than increased in 2019.

This backdrop (continued negative indicators encouraging not only an eventual trade deal between China and the US but also more lax monetary policies) could lull investors into a false sense of security, with the idea that bad news could in fact be good news. Bear in mind that bull markets grow accustomed to climbing walls of fear.

The adjustment in expectations has meant that economic surprises have become more positive; risk asset valuations have been corrected, making the underlying more attractive; and, to paraphrase J. Templeton, bull markets don't die of uncertainty but of euphoria. And based on the



data we follow (sentiment surveys, ETF flows, and hedge fund positioning), it is too early to talk about euphoria.

This said, we must remember that there is no such thing as a vertical market. And we must not forget that some economic indicators are cause for concern, and that geopolitical tensions are not diminishing (Brexit, European elections, US Government shut-down, new trade tensions, OPEC, etc…). What is more, the inversion of the interest rate curve indicates a decoupling between Fed expectations and market expectations.

It was supposedly Heraclitus who said "There is nothing permanent except change". And it is against this changing backdrop that we need to understand that an investor's success depends on his/her capacity to survive in different market contexts. There is no one strategy that generates above-average results consistently, which means that strategy has to be changed to adapt to the new environment.

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Fixed income

Interest rates: below the waterline

There was something for everyone in the first quarter, but not much of it was positive! Continued downbeat macro data (across-the-board over the period), Brexit developments, European and Spanish elections, discontent in Italy, and US-EU and US-CN trade relations all took their toll and played their own part in the renewed collapse of core interest rates. In core Europe, yields in the mid-section of the curve are actually lower than in mid-2016, in large part due to the Fed's confirmation that it will not be raising rates in 2019 and Draghi's commitment to low rates for some time to come.

Sovereign Yields

March 27th, 2019	2 Years	3 Years	5 Years	7 Years	10 Years	15 Years	30 Years
Switzerland	-0,86%	-0,84%	-0,79%	-0,67%	-0,48%	-0,21%	0,06%
Japan	-0,18%	-0,19%	-0,19%	-0,20%	-0,08%	0,13%	0,52%
Germany	-0,63%	-0,62%	-0,47%	-0,36%	-0,09%	0,14%	0,54%
Austria	-0,59%	-0,48%	-0,30%	-0,07%	0,21%	0,58%	0,99%
Denmark	-0,69%		-0,53%		-0,03%		
Sweden	-0,50%		-0,29%		0,28%	0,46%	
Netherlands	-0,64%	-0,62%	-0,46%	-0,29%	0,01%	0,26%	0,58%
Finland	-0,61%	-0,57%	-0,39%	-0,20%	0,13%	0,50%	0,83%
Belgium	-0,54%	-0,47%	-0,19%	0,02%	0,39%	0,75%	1,40%
France	-0,57%	-0,49%	-0,29%	-0,07%	0,29%	0,67%	1,24%
Ireland		-0,29%	-0,14%	0,13%	0,52%	0,89%	1,30%
Spain	-0,39%	-0,24%	0,03%	0,57%	1,04%	1,49%	2,18%
Italy	0,18%	0,73%	1,44%	1,99%	2,44%	3,05%	3,46%
Canada	1,45%	1,44%	1,40%	1,44%	1,52%		1,82%
Norway		1,21%	1,27%	1,33%	1,50%		
United Kingdom	0,64%	0,65%	0,77%	0,82%	0,99%	1,30%	1,51%
United States	2,16%	2,12%	2,14%	2,25%	2,36%		2,82%
Singapore	1,67%		1,89%		2,03%	2,27%	2,48%
Australia	1,47%	1,39%	1,43%	1,60%	1,77%	2,03%	

Chart. Main sovereign yields

Despite this, we have not witnessed any specific flight-to-quality, or at least any recognisable classic flight-to-quality. Thanks in part to the massive credit tensions in the final quarter of last year, 1Q19 has been a risk-on quarter across the board: international investment grade credit ended the quarter with a positive return of 3.9%; emerging credit +5.2%; and international high-yield paper +6%).

In this scenario, the German 10-year once again broke down through the 0% level. In fact, at the short end (particularly around 2 years) all Eurozone countries are issuing at negative rates (except Italy). On the other side of the Atlantic, the inversion of the US Treasury curve continues to capture the media's attention. So, caution must be the name of the game in 2019, because geopolitically things are likely to remain pretty intense.

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Equity

Earnings and share prices

One of the few things we can be sure about when investing in the stock market is that when a company improves its earnings its share price will end up improving too. And normally the size of these movements will be the same. We can translate this rule to indices as well. Take the S&P 500, for example: in the period 2012-2019e, we can see in the chart alongside

Chart 2. IBEX 35 versus earnings

how earnings rose by 70% and the index by 98%. And now take the IBEX 35, whose earnings have also risen by 70%; yet the index is just 12% higher. Each of us can make our own calculation as to where it should be!

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