MORABANC asset management

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MARKETS & STRATEGIES

Our vision

Editorial: December is here

The truth is, the more time passes, the faster it seems to go. This is usually attributed to Weber's law: with small stimuli, just a small difference is noticeable, but with large stimuli you need a large difference to see the change.

So, it is easier to note the difference between 100 grams and 200 grams, than between 20 kilos and 20 kilos 100 grams, even though the difference is 100 grams in both cases. The same happens with height or time: the younger we are, the less we notice the passage of time. A year is always a year but it is not the same to age from 3 to 4 than 37 to 38.

Well, the point is that we are already in December. We are reaching the months when brokers, managers and other agents publish their outlooks for the market for the next twelve months. I won't deny their usefulness: there is no better gauge of market sentiment. But sometimes, a glib headline seems to matter more than content.

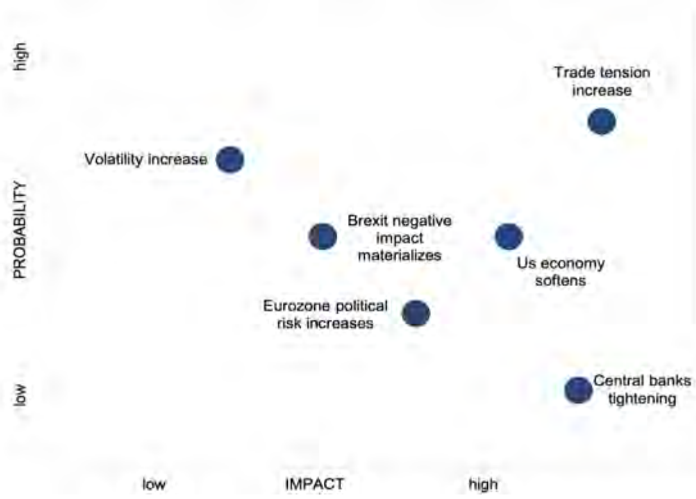
The only headline we'll use in this document is "we don't know what the markets will do next year". Luckily, our job is not to predict the future but to manage the risks.

True, there do seem to be some green shoots at the crossroads which we have been talking about (see *Markets and Strategies*, October 2019 and November 2019). Some indicators of sentiment seem to at least show a bottom. And the support from the central banks makes us slightly optimistic: cycles don't die of old age, but from a deterioration in the macroeconomy in a context of toughening financial conditions.

It also seems unlikely that a potential future bear market could be provoked by contagion from the private sector. That happens after shocks that put the system at risk (e.g. a financial crisis). Private debt has increased in recent years but the state of fundamentals is healthier than on other occasions before this kind of bear market. Moreover, the financial position of businesses and families is positive (total income less total spending).

However, we continue to make the case for an increased probability of seeing a bear market in the next twelve months. Note, first, the word *probability*: this is why we are cautious and not pessimistic. We are cautious because we have slightly reduced risk in the face of things, and we are cautious because we stay invested: the cost of coming out too soon is very high (see *Markets and Strategies*, November 2019).

Graph1: Risk map



Source: Bloomberg and Morabanc Asset Management

Secondly, the probability is still lower than that of a continuing trend. Our main scenario is not an extreme correction in time and price.

That said, we do believe that if it did occur, it would be short but intense. Namely, a bear market provoked by an event. Considering the geopolitical situation and current risks, this seems a possible alternative scenario.

In short, we confirm what we have been saying in recent months: the fact that the market is at a high should not be a reason to sell, but might be a reason to adjust our portfolios to our risk profile, diversifying appropriately, and even in the positions of greatest risk, for the most sophisticated investors to consider the possibility of realising profits or hedges.

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Fixed income

Bipolar markets?

Now we are reaching the end of the year, we would repeat: 2019 has left no one unmoved.

The media show of the trade war launched by the Trump Administration is still perplexing investors in all regions and still causing major fluctuations in many assets or sectors of international debt and credit markets. A trade war which, in the case of USA-China, we could now call "the never-ending story". On the other hand, the main central banks, forced to play a more "lenient" role in monetary policy, within a context of depressed interest rates, have adopted different focuses: in the case of the Fed, making three cuts in the interest rate to bring it into the 1.50%-1.75% range; in the case of the ECB, continuing to repurchase assets together with the "indirect request" for help from the public administrations, e.g. in fiscal policy.

Within this context, we can highlight the good performance of investment-grade credit which, at the start of December, is at six-month lows in relation to credit spreads. The same cannot be said about the high yield universe or emerging markets universe, which are being eroded, to a greater or lesser extent, by the uncertainties, trade wars or macroeconomic data.

Graph 2: High yield credit and emerging market spreads

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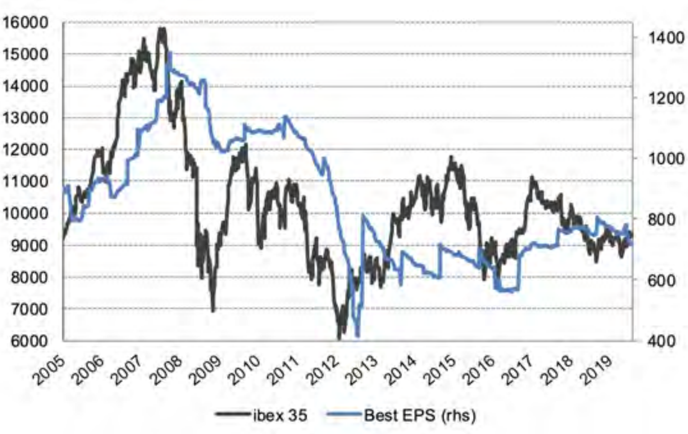
Variable income

Waiting for the Christmas rally

This November, the major world markets closed with rises. The American market continues to scale new highs, with an index increase of more than 3%. In Europe, the Stoxx 600 (+2.7%) has tested – but not overtaken – the historic highs reached in 2015. Specifically, on the Old Continent, the CAC 40 was the star of the month with a rise of more than 3%, followed by the Dax (+2.9%), and finally, the IBEX 35 (+1%), which hasn't quite taken off.

The latest publications of macroeconomic data are showing slight improvements in some indicators, implying a recovery in investor sentiment, greatly affected by the growing tensions from the trade war and some very worrying advance data which suggested a greater slowdown in the global economy. In this regard, we think that the US and Chinese governments will, sooner or later, reach an agreement. In fact, since the last correction in October, global markets have relied on the optimism about this agreement to reach historic highs. This recovery was interrupted by the surprise announcement of a new round of tariffs for China, France, Brazil and Argentina, affecting a whole range of products. Finally, we will mark December 15 in red on the calendar, a key date for investors as, on that day, President Trump should implement the tariffs he has scheduled. If he doesn't implement or reduce them, we could see the awaited Christmas rally, the climax to an exceptional year. Otherwise, the rally would not appear as in previous years.

Graph 3: Evolution of the IBEX 35 compared with profits



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