MORABANC asset management

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MARKETS & STRATEGIES

Our vision

Editorial: Umberto I

The story goes that on 28 July 1900, King Umberto I of Italy was dining in a restaurant in Monza. When the owner came out to greet him, all those at the dinner were surprised by how much he resembled the king.

They soon discovered that the similarity was more than physical: both were called Umberto, were born in Turin on the same day, were married on the same day to women with the same name (Margherita), and on the day that one was crowned the other opened his restaurant.

The king was so surprised that he invited him to a competition the next day. However, his alter ego was shot dead on the morning of the 29th. As the king expressed his condolences, Gaetano Bresci jumped out of the crowd and shot him dead.

Could Umberto I have been saved on hearing of the death of the restaurant owner?

The S&P 500 has closed positive in 61 years since 1927 (about 66% of years). On 18 occasions, it produced returns of over 25% (almost 30% of its bullish years). The year after these returns, returns were close to 6% on average, ending "green" on about 66.5% of occasions (i.e. with a lower return but with the same percentage positive as in an average year).

16.5% of the bullish years ended with returns of over 28% (28.8% in 2019). The year after, it achieved returns of over 11% on average, and closed positive on 70% of occasions.

What does this tell us about 2020?

Nothing.

2019 was good but not exactly outstanding in the context of the last 100 years. And nothing would lead us to conclusions about 2020.

For that, we have to accept two facts: firstly, we have to work with the data we have, and second, as we have always said (see Markets & Strategies in December 2019), we cannot predict the future.

That isn't our job either. We manage risks.

The current scenario looks similar to the one at the end of last year. There are enough green shoots in the economic indicators to be relatively optimistic. Even in the US, with a falling ISM Manufacturing Index, there is room for uncertainty. Financial conditions seem to indicate a rebound in activity (see graph).

Source: Bloomberg and Morabanc Asset Management

Graph 1: ISM Manufacturing

In this context, we should stay optimistic about 2020. It looks like a scenario of positive (if dynamic) growth and controlled inflation will enable central banks to maintain their expansionary policies.

However, the second fact forces us to be cautious. Stock market values are very adjusted, with the fourth quarter bolstered by multiple expansion. All within an environment of extreme complacency, with indicators like the AAII Sentiment Survey at highs since the first quarter of 2018. This complacency seems excessive when combined with the notable rise in the Economic Policy Uncertainty Index (EPU at highs since its creation in the 90s).

So, despite maintaining a positive outlook on variable income in 2020, we think that the probability of a short but intense bear market occurring in the next 12 months has increased. Therefore, we are slightly reducing the risk, without wholly leaving the market – the cost of leaving the market too early is very high (see Markets & Strategies in November 2019).

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Fixed income

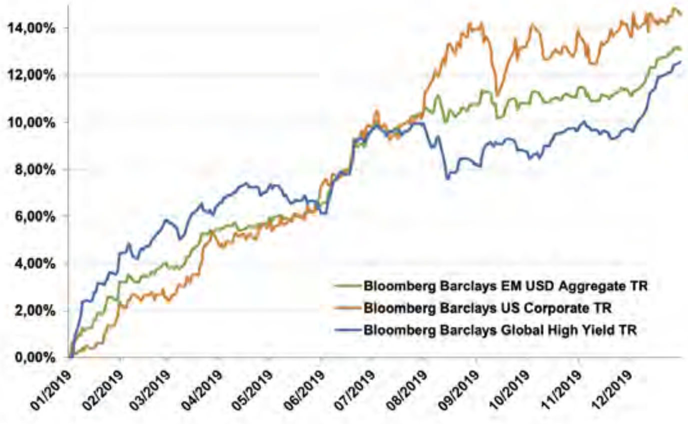
What next after a star-spangled year in credit?

In the last 12 months, the main global credit and debt indexes have generated extremely high returns. For example, US corporate credit ended 2019 at +14.54% (the second strongest in this millennium, only surpassed by the +18.68% in 2019).

The media show of trade wars between the US and China, general deterioration in world macroeconomic data and the inability of political leaders to resolve social unrest and tension were some of the most worrying symptoms last year that did not derail the bullish rally in international markets. It is true that the main central banks provided important support by keeping monetary policies loose (e.g. the Fed lowered rates three times over the year), but the conclusions of the latest meetings are also notable, warning that the central rates scenario will be difficult to move either up or down over the next few months/quarters. So, we start 2020 with:

- significantly lower global interest rates than in 2019,
- the diminishing capacity of central banks to combat "the unexpected",
- and a trickle of worrying symptoms awaiting solution.

We won't be reinventing the world in this context. Diversification, patience and caution seem to be far more important in the coming year than they were in the last.



Graph 2: Main indicators of world credit

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Variable income

2019: A memorable year

The main market indexes ended the year at annual highs and, in some cases, historic highs. The SP 500 (+31.4%) has been on the ascent for years; Stoxx 600 (+23.2%) equalled its historic highs; the Dax (+24.5%) imitated the Stoxx 600; the CAC 40 (+26.4%) stands at 15% of its historic highs of 2000, while lastly, the IBEX 35 (+11.8%) features as one of the worst European indexes in the last year and is still 40% below the 2007 highs. Ignoring the latter, such impressive returns make 2019 a memorable year. I would like to point out that much of the good performance of variable income indexes can be explained by the tremendous rise in growth stocks at the expense of value stocks. This difference in both returns and value, which has been developing over the last few years, can be clearly seen in the factorial indexes. In Europe, the MSCI Europe Value has annual returns of +14%, much lower than the MSCI Europe Growth at +30%, listed at a P/E 2020 multiple of 11.4x and 20.6x, respectively. More of the same in the US: the MCSI USA Value (+27%) is lower than the MSCI USA Growth (+40%), listed at a P/E 2020 of 14.9x and 24.8x, respectively. We believe these differences in value and returns are unsustainable (graph 1) and can't last much longer, so we think there will be a veer from growth to value, the question always being: when?

Graph 3: MSCI Europe Value / MSCI Europe Growth

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