MORABANC
asset management

JUNE 2019

MARKETS & STRATEGIES

Our vision

Too late for decisions?

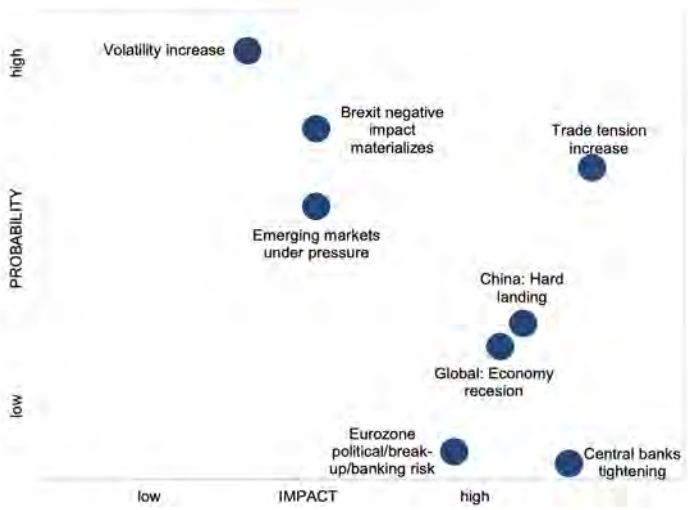
We began our May "Markets & Strategies" with the words "following the significant recovery in risk assets this year and given the high level of uncertainty, it is the moment to make decisions." The fact that the timing was spot-on is anecdotal; the important question now is "is it too late?"

The answer is simple: it is not so much that it is late, but rather that it is now more expensive. It is not that the opportunity has been lost, but it is now more expensive. Taking decisions today is more costly because when it comes to reducing risk prices are less attractive. And of course, if we reduce risk and there is then a bounce, we will lose it.

Is it too late to diversify? That the correlation between assets increases when the appetite for risk diminishes is a proven fact. It is for this reason that the benefits of diversification only become visible over the long term. If we want to maintain our risk profile (and sleep at night), the only strategy that works in falling markets is reducing positions. Obviously, this does not mean selling indiscriminately, but reducing exposure to those assets with the highest valuations or those that have not worked as we had expected. This enables us to increase our liquidity and to take advantage of the opportunities that arise in such scenarios.

The correction looks likely to continue, at least in the short term. For the time being, neither the indicators measuring sentiment nor those measuring outflows are showing any extreme signs of panic (unlike last December, for example). We are seeing certain weakness in some indicators, such as the deterioration in the leading indicators (PMI), the flattening of the interest rate curve (tends to be a precursor to increased volatility), results in the semiconductor sector (often a precursor for the rest), and negative seasonality, among others. Technically speaking, the 2,750 zone on the S&P500 is extremely important; and, if it were to be lost, there is no more significant support before 2,650.

But the main question is whether this correction is likely to develop further (in time and size). It is a difficult question, particularly given the possibility of a substantial improvement in the outlook due to political factors. As we have said on many occasions, trying to estimate economic developments is difficult enough, but when it comes to politics it is virtually impossible.



For these reasons and given this backdrop, we are sticking to a neutral tactical position (not bearish) on equity, taking the view that setbacks to certain important levels should be regarded as buying opportunities. We also believe that the current economic slowdown is synonymous with a final phase of the cycle, and within such a phase we could still see another rally in share prices. In fact, the main indices remain structurally bullish. But most importantly, we see little point in assuming the risk of a significant bounce and we are waiting on the side lines for the moment, our stance on equities being bullish from a strategic standpoint.

While in markets like these it is impossible not to be afraid, it is possible not take decisions based on this emotion alone. So, it's a moment to try and keep calm, to make sure any changes are well thought through (given their high cost), and to re-read the classics: André Kostolany for example, who said that " in the stock market it is often necessary to close one's eyes in order to see better".

Tomás García-Purriños. CFA, CAIA
tomas.garcia@morabanc.ad

Fixed income

Interest rates: under the waterline, and sinking...

The second quarter has not been an easy quarter for anyone either. Continued poor macro data together with lack of progress at the geopolitical/trade relations level is putting additional strain on the outlook, bringing with it new fears and driving core interest rates lower around the world (see table). The 10-year Bund has hit a new all-time low at -0.20%, while the main European countries are seeing new lows in the mid and short sections of the curve. The market is currently discounting more than a 50% probability of 3-4 rate cuts in the US over the next 12 months, and economists are not expecting the US economy to stabilise until 2020.

Given this mix, it is hardly surprising that we have seen these flight-to-quality moments over the last quarter. In credit markets, spreads have widened on investment grade paper, while higher risk assets such as High-Yield paper or Emerging Markets are adding to the uncertainty with their even greater widening of spreads, especially in those regions battling with the US over trade issues. Despite all this, credit markets are still showing significant YoY returns: Investment Grade +5%, Emerging Markets +6.5%, High Yield +6%.

So, it does now look like being a cautious year from now on, this assuming that the big uncertainties that the market is pricing in are not resolved.

Sovereign Yields

May 31st, 2019	2 Years	3 Years	5 Years	7 Years	10 Years	15 Years	30 Years
Switzerland	-0,89%	-0,87%	-0,84%	-0,71%	-0,50%	-0,24%	0,02%
Japan	-0,18%	-0,20%	-0,20%	-0,21%	-0,11%	0,09%	0,45%
Germany	-0,68%	-0,69%	-0,58%	-0,47%	-0,20%	0,04%	0,44%
Austria	-0,62%	-0,55%	-0,36%	-0,15%	0,11%	0,48%	0,89%
Denmark	-0,70%	-0,66%	-0,59%		-0,11%		
Sweden	-0,59%		-0,45%		0,10%	0,28%	
Netherlands	-0,65%	-0,67%	-0,55%	-0,29%	-0,01%	0,16%	0,48%
Finland	-0,62%	-0,62%	-0,47%	-0,29%	0,03%	0,42%	0,72%
Belgium	-0,59%	-0,55%	-0,28%	-0,07%	0,30%	0,70%	1,36%
France	-0,62%	-0,57%	-0,39%	-0,15%	0,22%	0,63%	1,27%
Ireland		-0,40%	-0,26%	0,04%	0,43%	0,82%	1,44%
Spain	-0,37%	-0,29%	0,02%	0,31%	0,76%	1,36%	1,92%
Italy	0,74%	1,39%	1,76%	2,21%	2,72%	3,12%	3,58%
Canada	1,52%	1,48%	1,44%	1,50%	1,55%		1,80%
Norway	1,24%		1,31%	1,39%	1,58%		
United Kingdom	0,58%	0,55%	0,62%	0,69%	0,86%	1,20%	1,46%
United States	2,00%	1,95%	1,96%	2,06%	2,16%		2,61%
Singapore	1,91%		1,90%		2,07%	2,30%	2,55%
Australia	1,11%	1,10%	1,16%	1,30%	1,46%	1,71%	

Chart 1. Main sovereign debt yields

Miquel Soca, CEFA
miquel.soca@morabanc.ad

Ruben Giménez, FIC
ruben.gimenez@morabanc.ad

Equity

A "sell in May..." for the text books

May 2019 will be remembered for the sell-off we have seen in global equity markets: MSCI World -5.2%; S&P500 -5.2%; and Stoxx600 -5.3% at the time of writing (see chart), triggered by the increased trade tensions between the US and China. Any delay to a potential resolution of the conflict could weigh further on markets, more so still following the latest macro data that still shows no signs of recovery. Like at the end of last year, the more cyclical sectors have been the hardest hit, some companies having started to trim their year-end forecasts. Having said all this, we continue to believe these are extremely attractive levels, with many stocks trading on multiples that are significantly below their historic averages. This is particularly the case in cyclicals, where growth estimates are being cut due to the current economic uncertainty. In the end, it was certainly a year to "Sell in May…". All we can hope for now is that the US-China trade conflict terminates as soon as possible, bringing about a market bounce and improved sentiment, and that investors at least don't "…go away"!

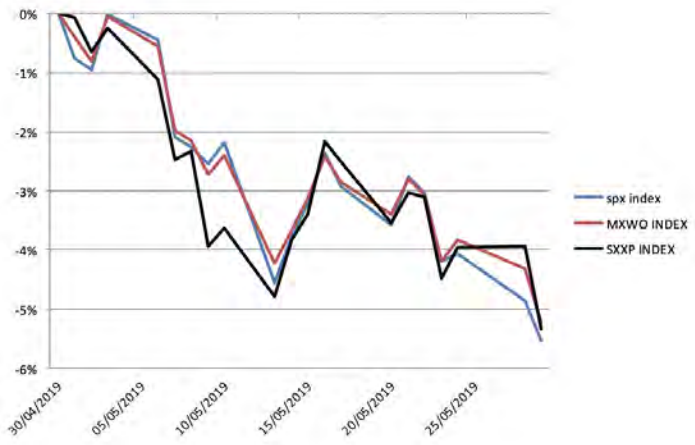


Chart 2. MSCI World, SP500 and Stoxx600 in May 2019

Gerard Garcia, CEFA - Equity Fund Manager
gerard.garcia@morabanc.ad