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MARKETS & STRATEGIES

Our vision

The Bohr-Einstein debate

Niels Bohr, the Danish physicist awarded the Nobel Prize in 1922, is remembered for his remarkable discussions with Einstein about quantum physics. Contrary to popular opinion, Einstein did not reject quantum theory. His argument went much deeper and transcended the purely scientific to delve into the philosophy of science.

Without going into the details of the conversations (being limited not only by the purpose and length of this editorial but also by my ignorance), Einstein believed that the "quantum revolution" was incomplete unless the causes of the apparently random models were understood, beyond their purely predictive use. In fact, for him, the search for general and universal principles was the ultimate goal of physics. Bohr, on the other hand, focussed on a more mundane goal: for physics to try and predict experimental measurements.

"God does not play dice with the universe", Einstein stated. To which Bohr replied: "Stop telling God what to do with his dice".

Equally, we could spend our whole time trying to understand and explain the causes and consequences of the swings in the financial markets. Indeed, this is necessary to a certain extent, especially if we are the type of investor who tries to make the best of any possible tactical opportunities. However, from a strategic point of view, a much more pragmatic approach is usually more profitable. As we have often stated, the cost of staying outside the market is high, and rotating portfolios only on consequences (because markets fall) tends to involve costs that negatively impact our portfolio in the long term. So, we maintain our double approach: pro-market but pro-reality.

Yet, from a tactical point of view, we still believe the risks are high, so we would keep our exposure adjusted to seize opportunities that may arise in the event of a correction.

The yield offered by the government benchmarks for fixed income discounts the probability of a deeper recession than in variable income or credit. 10-year bonds in the US or the Eurozone have been revised downwards, probably lower than the macro would have put them, and it is true that our outlooks for the global economy (improved economic growth and lower expectations of recession) do not justify such low interest rates. However, it is difficult to take a position: the reasons for this market reaction remain unchanged and it looks like they will generally last beyond the short term.

As for variable income, uncertainty is high, as it generally is in higher risk assets. Moreover, in the short term, this depends a lot of geopolitical events (tariff increases, Brexit, the Italian government, etc.). All in all, this is still out preferred option for the mid-term and we believe that if the market sentiment continues to worsen, more tactical opportunities could appear.

In any case, as Bohr also said: "Prediction is very difficult, especially about the future". Luckily, we don't need this in the financial markets either. As we have consistently stated in this publication, month after month, we must act only on what we can influence: adjust positions and keep a diversified risk exposure that fits your profile. More sophisticated investors can try hedging against tail risk or make the most of any tactical opportunities that may arise.

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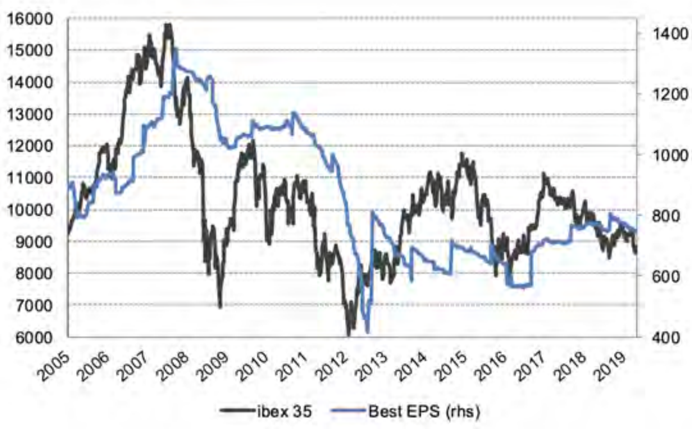
Variable income

Further reductions

This August, the global market suffered major downturns, easing in the last week. Specifically, the most significant falls were -7% in the Chinese Hang Seng and -5% in the UK's FTSE 100. The reasons for the first are clear: the new tariffs announced by Trump that month and repeated incidents in Hong Kong. As for the UK, Brexit and more specifically the idea of a hard Brexit continues to have a negative impact. The US market had one of the smallest declines, -1.8% in the S&P 500, still at the forefront of market rises this year. Europe had the best results this month, with -1.5% in the Stoxx Europe 600. Looking at the performance by sectors, on the negative side are Materials (-9%), Cars (-6%) and Oil (-4%), so all cyclical elements are still being punished. On the positive side are Utilities (+4%), Non-cyclical Consumption (+3%) and Health (2%), still a safe haven for investors looking for the famous bond proxy sectors, i.e. whose defensive nature make them similar to fixed income, as long as you are aware that they are shares, not bonds. Ultimately, these are the collateral effects of having negative interest rates in fixed income. This month we witnessed further reductions in the stock markets, preparing us to go *back to school*.



Graph 2. Evolution of IBEX 35 compared with its profits

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Fixed income

A very hot summer

No-one could be nonchalant about this summer season: the interest rates of the main developed economies dropped again, to historic lows in many cases (namely the German Bund, -0.71%). The US Federal Reserve lowered the reference rate 0.25%, claiming "mid-cycle adjustments". Conversely, the trade war launched by the Trump Administration continues its calamitous show, tweeting new confrontations and new tariffs in real time that erode expectations of a resolution this year and damage the market mood. In this context, risk assets such as investment grade and high yield credit and emerging market debt are suffering, although to a lesser extent, without panic or notable contagion to date in the international markets. At present, looking at the next four months (January 2020), the market discounts three interest cuts in the USA as the most probable scenario, almost 40%.

As we anticipated before the summer, the lack of a government solution to the uncertainties is forcing the central banks to play the role of "good cop" more than they'd like (evident at the meeting of central banks at Jackson Hole in August). On the other hand, the ECB's successor has been confirmed: Christine Madeleine Odette Lagarde will take charge as of November. So, we still cannot discount rises in volatility over the next few quarters.

Sovereign Yields

September 1st, 2019	2 Years	3 Years	5 Years	7 Years	10 Years	15 Years	30 Years
Switzerland	-1,20%	-1,21%	-1,16%	-1,10%	-1,07%	-0,86%	-0,63%
Japan	-0,31%	-0,32%	-0,36%	-0,39%	-0,27%	-0,09%	0,14%
Germany	-0,94%	-0,96%	-0,92%	-0,88%	-0,69%	-0,54%	-0,17%
Austria	-0,85%	-0,83%	-0,74%	-0,61%	-0,44%	-0,20%	0,16%
Denmark	-0,95%		-0,89%		-0,67%		
Sweden	-0,67%		-0,74%		-0,37%	-0,21%	
Netherlands	-0,91%	-0,93%	-0,82%	-0,71%	-0,54%	-0,42%	-0,18%
Finland	-0,88%	-0,84%	-0,80%	-0,64%	-0,42%	-0,25%	0,04%
Belgium	-0,84%	-0,83%	-0,67%	-0,56%	-0,35%	-0,06%	0,52%
France	-0,85%	-0,88%	-0,77%	-0,63%	-0,40%	-0,10%	0,43%
Ireland		-0,67%	-0,56%	-0,36%	-0,09%	0,21%	0,74%
Spain	-0,58%	-0,57%	-0,37%	-0,16%	0,10%	0,53%	0,99%
Italy	-0,27%	-0,02%	0,35%	0,64%	0,98%	1,49%	2,01%
Canada	1,35%	1,28%	1,18%	1,16%	1,16%		1,42%
Norway	1,07%		1,06%	1,05%	1,11%		
United Kingdom	0,35%	0,31%	0,31%	0,28%	0,46%	0,69%	1,00%
United States	1,50%	1,43%	1,39%	1,45%	1,50%		1,96%
Singapore	1,62%		1,62%		1,70%	1,82%	1,99%
Australia	0,73%	0,68%	0,69%	0,80%	0,92%	1,13%	1,48%

Graph 3. Table of main sovereign yields

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