Review & Outlook
Q1-2019

Hyposwiss Advisors SA

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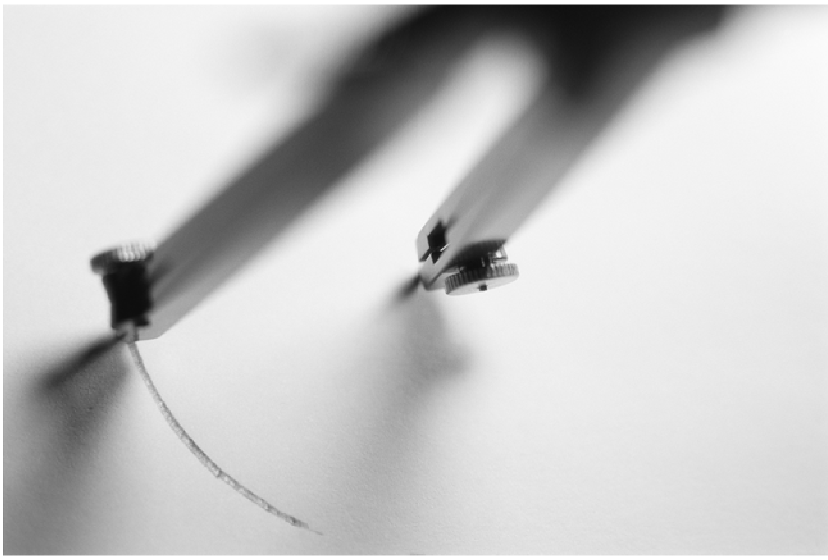
Q1 2019 Review

Stock markets seem to have shown irrational behavior over the last few months. First there was this sharp sell-off prior to the year-end of 2018 and thereafter in Q1 2019 came this steep rally and now investors are wondering what the future holds, or – if you take a more long-term view – weather this secular bull market which started on March 6th, 2009 (with the S&P 500 at 666), and therefore already lasts an astonishing 10 years, will continue for the rest of 2019. Younger investors don't even know what a real bear market is as they have never experienced such a situation.

One underlying reason for the current 10 year bull market was the simultaneously global decline in interest rates which was vice-versa the main reason for the end-of 2018 sell-off, when a too stubborn US FED gave signals for additional rate hikes combined with balance-sheet shrinking almost on autopilot; only to change its policy in Q1 2019 and becoming super dovish. Recent macroeconomic data confirms this view and the cooling of economic activity continues, particularly in Europe, but a resilient US and some signs of a recovery in China, which increased its fiscal support, are reasons for cautious optimism going forward.



Fixed Income

Bonds rallied in Q1 2019 – alongside stocks – and in late March, US 10-year yield dropped below 3-months yield, the first inversion of this important part of the yield curve since 2007. 10-year US Treasury yields peaked in October 2018 at 3.26% and collapsed down to 2.27% on March 27 to end the quarter at 2.40%. Usually, bonds and equities display a negative correlation, meaning they move in different direction, but interestingly in Q1 2019, despite the rally in equities, also bond prices moved up as US 10-year T-yields declined by 30 basis points.

Central banks have deprived bond holders of any hope of normalizing interest rates. Risk-free investment grade bonds in many currencies including Euro and CHF will continue to have low or even negative yields maybe for a long time to come. The US FED keeps on repeating its new mantra of raising rates patiently, if at all, and the European Central Bank (ECB), the Bank of Japan (BoJ) as the Swiss National Bank (SNB) alike have all taken back earlier guidance of rates hikes.

In this challenging environment for bond investors, we have during the last quarter slightly increased our bond holdings for USD accounts, as USD bonds offered solid returns in our view, but we hold back and underweight bonds for CHF and EUR accounts. In addition to high quality investment grade bonds, we have also allocated – in line with the risk profile of each client - some carefully selected high-yield bonds in order to generate additional income for the portfolios with a reasonable risk. We obviously monitor these high-yield bonds closely.

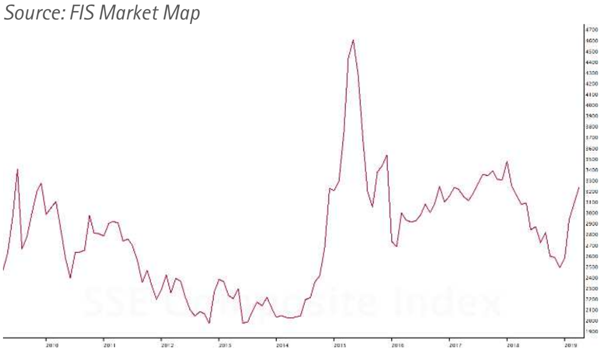
> "Luck shouldn't be part of your portfolio."
>
> Expect the expected

Equity

Global stocks (measured by the MSCI World) rose by 12% in Q1 2019, the best start to any year since 1991 and by 17% since their December lows, helped mainly by a shift to a more accommodative central bank policy. Global equity markets came within 2% of their all-time highs reached last September 2018.

Most markets moved almost in line with the MSCI World (+11.88%), with the NASDAQ again leading the crowd with +16.49% YTD, whereas not surprisingly the UK FTSE 100 only made a modest +8.19% and the NIKKEI 225 in Tokyo only +7.47%. While most emerging markets were lagging the North American and the European Indices, the by far best performance was reached by the Chinese Indexes (SHANGHAI Comp + 26.62%), surely also because the Chinese markets were poor performers in 2018 and had to catch up to some extent. We still expect Chinese equities to continue their upward trend due to the Chinese government domestic stimulus measures and the easing trade tension between the US and China. Valuations are still below their historical averages (Shanghai trades at a P/E 2019 ratio of 11.5x) and the fact is that Chinese equities are becoming a core asset class for many US and European investors. Another point is that US markets are close to all-time highs and have a 10-year run behind them whereas Chinese markets are not much higher than they were in 2009 and still well below their 2015 peak values.

S&P 500 Index 10 years – 01.04.2009 – 31.03.2019
Source: FIS Market Map



SSE Shanghai Composite Index 10 years – 01.04.2009 – 31.03.2019
Source: FIS Market Map

For US markets or equity markets in general, even after this Q1 rally, equity valuations remain attractive based on historical valuations like forward price-to-earnings ratio multiples or undemanding consensus expectations in many sectors and ultimately, when comparing dividend yields to expected bond returns, equities look relatively more attractive .

> “We think about your investments all day.
> So you don’t have to all night.”
>
> Expect the expected

We are relatively highly invested in equities alongside the risk profile of each client – still below maximum allocations, and have at the year-end of 2018 not reduced our equity allocation despite elevated volatility. We are however keeping a conservative approach by maintaining relatively elevated levels of cash and liquid investments, taking into account that equity markets have had a long bull run. We still feel comfortable with our equity position as of now as it leaves room to increase exposure in case of a correction. A meaningful correction cannot be excluded in the coming months ahead. We will continuously reassess the situation, but should the economic situation remain as it is and interest rates remain at their record lows, we might even increase our equity allocation.

Currencies

Attractive interest rate compensation increases the popularity of the US dollar which has digested the dovish shift of the FED, however US money market imply no additional rate hikes this year. Nevertheless, other Central banks are displaying the same reluctance to hike interest rates and the European Central Bank (ECB) even extended its commitment not to hike rates until the end of next year. As a result, the USD maintains its lead among the developed economies when it comes to interest rate carry. On top the ongoing superiority of US growth ensures that the US dollar will continue to offer higher rates in the future.

Despite these generally known facts, investors have been reluctant to buy the US dollar. This cautious sentiment seems to be turning now, also because investors see the economic weakness in the Eurozone.

Economics

The cooling of economic activity continues, however at three different speeds. After a period of slowing of economic activity, the US is showing some resilience with improved activity in February, and its GDP is expected to grow by 2.5% in 2019, which is on top supporting momentum in the whole of the Americas. In export-oriented Europe, the manufacturing sector has slid into contraction and a lack of domestic growth drivers makes this region particularly vulnerable to slower economic demand. As a whole, the Eurozone is expected to grow only by a modest 1.2% in 2019. This is in stark contrast to China, where signs of recovery are becoming visible, as leading indicators are recovering from contradiction towards neutral territory, and China is expected to grow by 5.9% in 2019 (6.6% in 2018).

These improvements in two of the three global main economies foster optimism that on a global scale the economic slowdown could even find a bottom in the upcoming months. Furthermore, monetary policy of the major central banks has turned from a headwind to a tailwind for financial markets as they committed themselves to hold rates down over the next months to offer the global economy time to find more solid ground.

“Don’t let your money work for you. Because it doesn’t.”

Expect the expected

Outlook

When the next recession will occur is still the most discussed topic in the camps of economists, with two completely different opinions: One crying for a recession just around the corner, hoping to become famous for getting the recession timing right and the others explaining that this time is different from the past.

The following fact remains: When taking data since 1950, economists calculated that equity markets peaked a full 15 months after a yield curve inversion, and then it took another 6 months until recession eventually started. When taking into account that a minor yield inversion started just this March, this signal of the bond market would call for a late 2020 USA recession. Furthermore such yield inversions have historically been a fairly reliable leading indicator for an upcoming equity bear market. For the moment, our opinion is that the inversion is sending a false signal at this point and is not calling for an immediate recession: the proportion of inversion is still relatively too weak, only the short-end is showing signs of inversion and it has not lasted long enough.

The Q4 2018 market anxiety led to irrational and counterproductive investment decisions by some market participants and the rebound thereafter in Q1 2019 showed that it pays not to panic, when holding quality investments. Even after the recent rally, we stay invested with an approach which allocates capital across liquidity and longevity to avoid costly investment mistakes by reducing the need for forced asset sales should markets move lower. **Diversification** remains the key solution to ensure not being caught on the wrong side of a policy error and our portfolios include all asset classes and regions, including emerging markets.

To summarize, we stay invested along the risk profile of each client and think that markets will remain volatile going further into 2019 and are aware that a market correction could occur anytime.

Walter Küng

Senior Portfolio Manager

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- Hyposwiss Advisors' mission is to offer **personalized asset management services and financial advice** to high net worth individuals and families based in the **USA** and **Canada** with the overriding objective of **capital preservation** and **asset growth** performance oriented.

- Investments in compliant global assets are used to construct a **diversified balanced portfolio** tailored to the investor's requirements and deposited with **international banks** acting as qualified custodians.

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