Review & Outlook
Q2-2019

Review and Outlook

-Q2 2019 Review
-Fixed Income
-Equity
-Currencies
-Economics
-Commodities
-Outlook

-Thematic Investment idea

Mission Statement

Contact

Disclaimer

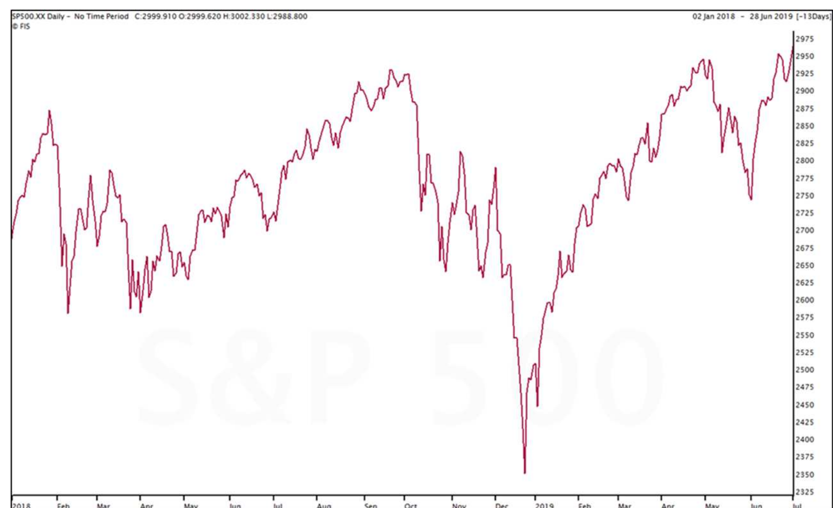
Hyposwiss Advisors SA

www.HyposwissAdvisors.ch

Q2 2019 Review

US-China trade war dominates the news and moves the markets

Investors' nerves were tested again in the month of May, as global markets declined by 5% to 10% - and Chinese markets by almost 15% - from their April highs. This ended a 4 month run on equities, after seemingly being in a healthy state back in April, while global interest being in decline. The main reason for this shock down-wave was the renewed escalation in the US-China trade war. Fresh memories of the Q4 2018 correction came also to everybody's mind. However, similar to the recovery of Q1 2019, in June 2019 all of the May losses were regained, and as a result, Q2 of 2019 was another positive quarter for equity owners.



S&P 500 Index – 01.01.2018 – 30.06.2019
Source: FIS Market Map

The G-20 meeting in Osaka / Japan at the end of June was the main event in Q2 and world leaders met expectations with a ceasefire on tariffs, a planned return to negotiations and a partial concession on Huawei. While the conditions for settling the trade dispute are in place, the potential for escalation remains as the

two sides agreed only to restart negotiations to solve their dispute and no schedule for the talks has been given. The ban preventing US companies from selling products to Huawei was lifted. Huawei, however, remains on the blacklist and President Trump makes the final decision on Huawei dependent on progress in the trade talks, keeping this issue as a bargaining chip. Already being in election mode for 2020, Trump has many incentives to agree with China so as to sell himself to the US electorate as a successful dealmaker, while keeping the option open for renewed escalation.

Regardless of what will happen in the trade negotiations, China is stimulating its economy, which will benefit global growth. June 2019 also marks the longest economic expansion in US history, reaching 10 years in a row. Outside the manufacturing sector, the US economy continues to grow at an above-trend pace and the unemployment rate is at a 40 years low and below most estimates of full employment.

Fixed Income

Inflation expectation continue to decline – it is too late to buy long bonds

Central banks around the globe are keeping interest rates low and are even signaling further cuts. Interest rates in USD continued to fall in Q2, with the US treasury 3-year yield at 1.90 % at the end of Q2 (above 3.00% in the autumn of 2018) and the more important 10-year rate at 2.01% (from 2.60% at the beginning of 2019), while the US FED Funds Rate remained unchanged at 2.50%. In Germany or Switzerland, investors have had to accept a 20 to 30 year duration in order to obtain positive bond yields in the government sector.
Two interlined factors are driving bond yields down worldwide: inflation expectations are slowing from already low levels and central banks are responding with more monetary stimulus. Furthermore, the bond market is simply ignoring the decline in global unemployment rates.

The bond market has reacted with higher yields across the whole curve to the strong US labor market data released on July 5. Nevertheless, given the low inflation expectations, the market overall is still pricing in a rate cut by the FED at the end of July and investors' "hunger for yield" is still alive and many opt for higher credit exposure in order to improve compensation.

We are generally overweight in the Fixed Income asset class in USD bonds and therefore our clients did profit from rising bond prices. Next to the core holdings of government and high quality corporate bonds with investment grade ratings, we still prefer High Yield (HY) bonds to long-term duration bonds to generate higher returns with acceptable risk.

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

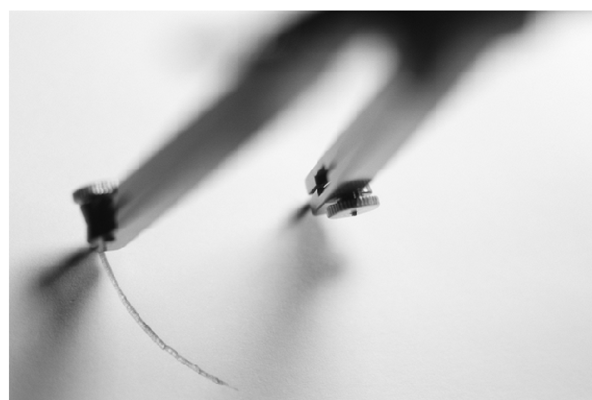
Equity

'Sell in May and go away' – not a wise move so far in 2019

Despite its 7% drop in May, the US S&P 500 managed to finish Q2 with a 3.20% gain, bringing the YTD figure to a solid 17.35% and thereby keeping its persistent outperformance among global equities. The leadership role of technology index NASDAQ, which managed to climb by 20.66% YTD, is uncontested. This outperformance came amid a general distrust in the continuation of the 10 year uptrend in US equities, which also can be measured by the fact that foreign investment into the USA is on track to reach record outflows in 2019. The apparent bearishness towards US equities leads to the question for how much longer is the US market able to climb this 'wall of worry'.

Global equities, measured by the MSCI World, managed to climb by 15.63% YTD, with multiple markets making new all-time highs. In Switzerland for example, the SMI index reached 10'000 for the first time. European markets in general were outperforming the global index, as prospects for European stocks are brightening. Europe's leading indicators have been improving the last three months, outperforming US consumption, and European stocks are cheaper than US stocks on a relative basis, calculated by different valuation models (including P/E ratio or price to sales ratio). It is political issues like Brexit, weak EU leadership or Italy's unsolved economic problems which keep valuations at their modest levels.

Asian markets were the biggest laggards so far in H1 2019, as the US-China trade war was producing negative headline news. Besides, the relations between Japan and South Korea hit a new low in their row over Japan's use of forced labor during World War II. Japan's export restrictions of key materials to South Korea leaves the semiconductor industry vulnerable, and if this dispute is not resolved soon, the global technology supply chain could even be disrupted. As economic growth rates in Asia are still well above the Eurozone - economists expect China to grow by 6% in 2019 compared to Europe's 1.1 % – equity markets will not ignore this fact going forward.



Regarding a rate cut by the FED later this year, and its consequences for the stock market, one should not forget that good macroeconomic data that alleviates fears of an economic dip (which would mean no rate cut) are basically positive for companies, in particular for industrials, materials and information technology.

Currencies

Central banks are becoming more expansive

The USD depreciated in June due to mounting expectations of interest rate cuts by the FED and a more expansive US monetary policy. The CAD and the CHF both strengthened sharply last month, appreciating by more than 3% against the USD.

The CHF, behaving as a safe-haven currency, did profit from the escalation in the Iran conflict. The Swiss National Bank (SNB) however continued to describe the CHF as 'highly valued' in June and it would most likely begin to intervene in the market again should the Euro/CHF rate fall towards 1.10.

The rise of the CAD came without the help of rising oil prices. Canada's inflation rose to 2.4% in May y/y and markets expect the Bank of Canada (BoC) to remain on hold for the time being, which is contrasting the global dovish monetary policy and providing upside in terms of expected interest rate differentials. Undervaluation is another bullish factor whereas high domestic debt levels and ongoing low oil prices are risk factors to the Loonie.

The Euro did not profit much from the USD weakness, as the markets assume the ECB is also likely to become more expansive by cutting already low interest rates by another 0.1%, taking into account Europe's weak economy and low inflation rates. The solid balance of payments situation, its undervaluation in different terms and low inflation are positive factors giving long-term tailwind to the Euro.

Emerging market (EM) currencies are the only ones that can keep pace with the USD in terms of interest rates. The compensation for the risk has increased substantially, making investments in emerging market currencies attractive from a risk/reward perspective. The Turkish Lira, Indian Rupee, Russian Ruble and the Mexican Peso are among those who offer the highest carry. Investing in a basket of these currencies is the obvious way to gain exposure and to potentially mitigate currency risk. The Swiss Franc remains a strong currency backed by a budget surplus not seen in many other countries globally, and wants to trade higher, but is kept low by the Swiss National Bank (SNB), until further notice.

Economics

Cyclical cooling continues, but the US surprises with strong labor data

The latest economic indicators were weak overall. The global Purchasing Managers Index (PMI) for industry slipped to 49.4 in June (May 49.8), the lowest level since October 2012 and the declining trend has spread throughout

Europe, USA and emerging markets. An end is not yet in sight. Particularly, the Eurozone is still losing momentum, China's stabilization is fragile and economic activity in the US is slowing.

Trade quarrels between the USA and China remain in the spotlight, but will likely not have a significant direct effect on economic growth until 2020, when adjustments in supply chains are expected to weigh on productivity. In the unlikely event of a fully-fledged trade war, with tariffs on all product groups, sanctions and broad-based boycotts, some export oriented economies could suffer heavily. We think however, this is rather unlikely to happen as Trump needs a deal for his 2020 election campaign.

The July 5 release of the US labor market data surprised positively with a stronger-than expected payroll growth, as 224'000 new jobs were created (consensus was only +160'000), which is more than any other month this year. The minor uptick in the unemployment rate (from 3.6% to 3.7%) does not dampen the positive reception, as it was due to a rise in labor market participation to 92.9% (more Americans entering the workforce). Wage growth however, remained lukewarm, as average hourly earnings failed to increase (still 3.1% y/y) and gear up wages, which would have translated into inflationary pressure.

Other data broadly surprised to the downside, showing evidence of a continued downtrend in economic activity. Since the July 5 release of the labor market data, financial markets have started to price in a reduced likelihood of aggressive rate cuts later this year. At the time of writing, the question 'will they, or won't they?' is still fairly open and depends on which economist you ask, market consensus is tending towards a rate cut of 25bp at the next meeting on July 31.

Commodities

Commodity prices already reflect weaker global growth

Prices of industrial commodities and crude oil have continued to decline in Q2, reflecting concerns about weakening global growth. While they have been moving up in line with equities for most of the year, they failed to recover in June.

The oil market fragile supply situation does not seem to play a role at the moment, considering that neither Venezuela's political turmoil nor the tensions in the Middle East and in particular in Iran/Gulf of Oman are solved problems. Fears

of falling demand are stronger forces and are weighing on sentiment, while a pickup in US shale production and above-average US oil inventories suggest the market is adequately supplied.

Industrial metals have suffered as the trade tensions have escalated. Iron ore is bucking the trend, as it is caught in a perfect storm of constrained supply, strong demand and bullish sentiment.

Gold was the best performing asset class in Q2 rising by more than 8%, as a combination of a weaker USD and safe–haven seeking investor flows pushing the price above 1400$. Some central banks have also been buyers of gold in recent months, including Russia and India among others. We have allocated a 5% position of gold in our asset allocation and intend to keep it also as a hedge or insurance against political turbulences.

Gold price in USD (XAU) – 01.01.2018 – 30.06.2019
Source: FIS Market Map

The price of Silver could not follow Gold and the gold-silver ratio has reached a new low since 1992. Silver is in a long-term downtrend.

Outlook

The Q2 earnings season, the FED and the trade war will be key factors

Q3 2019 started with a new all-time high for the S&P500 on July 1, following the equity friendly outcome of the G-20 meeting in Osaka, where President Trump and President Xi Jinping agreed not to impose new levels on US and Chinese goods after meeting on the sidelines of the G-20 summit.

The upcoming company earnings season reporting will give further guidance for the short-term equity market performance. Consensus in the US expects Q2 earnings growth of -2.6% (versus -0.2% in Q1). Early reporters and macro indicators indicate flat earnings growth, broadly in line with Q1. As consensus expectations for Q2 declined by 2.5% over the past 3 months, and investors sentiment remains at record lows, we expect no major negative surprises to the downside as a whole, single company disappointments left aside.

Normalizing global monetary policy with central banks around the world and thus keeping interest rates low amid low inflation everywhere are a dream scenario and bullish for the equity markets, even more in relation to the unattractive Fixed Income asset class which will ultimately result in further money inflows. As always, much will depend on the FED and if it will lower rates or not. Short-term market volatility risk caused by the pending US-China trade conflict and fears of an impending economic downturn are negative factors but overall we are of the opinion that equities markets will continue their H1-2019 climb, among high volatility and many concerned investors. Our gold position is a certain hedge against a possible correction caused by some yet unknown negative event.

Fixed Income will remain a difficult asset class where investors have to seek higher credit or currency risk to produce some additional return. Even worse, in the EUR and CHF world, only preserving the value of capital without negative yields has become difficult. While we have invested in some USD High Yield bonds, which on average still offer 3.8 % higher returns than US treasuries, we do not believe it is appropriate to invest in long-duration bonds at the current depressed yield levels.

All in all, recessions rarely happen if monetary policy is expansionary as at the current stage. Sustained equity bear markets, in turn, almost never happen outside of recessionary periods. With this in mind, we stay invested in equities in line with the risk profile of each client and keep the existing bonds for capital preservation.

Walter Küng

Senior Portfolio Manager

> "Don't let your money work for you. Because it doesn't."
>
> Expect the expected

Thematic investment idea

Robotics Automation Artificial Intelligence

Investing in the Future.

We are witnessing the start of a revolution in robotics, driven by groundbreaking technological innovations in computing power, material science networks and artificial intelligence (AI).

Automation is one of the most significant growth stories in the modern industrial world pushed by challenges such as aging population, a lack of skilled labor, stricter quality and safety regulations and the need for higher productivity and efficiency. Furthermore, increasingly we see robots being adopted in many other aspects of our daily life, be it in shops, restaurants, offices, hospitals, cars, planes and eventually in our homes.

The number of industrial robots shipped globally has grown three times faster the last 10 years than in the last decade and the trend will continue. According to a report on agricultural robots by Tractica, the number of robots sold by year in this field will rise from 33'000 in 2015 to 992'00 in 2024.

Investment solutions: Since identifying individual winners in a nascent industry entails specific risks, we prefer to invest in a diversified basket of securities and have selected proven active funds and ETFs. Should you want to know more, please feel free to contact your Relationship Manager.

Mission Statement

- 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.

Contact

Hyposwiss Advisors SA

www.HyposwissAdvisors.ch
info@advisors.hyposwiss.ch

Head Office	Representative Office
Rue de Hesse 7	Hufgasse 17
1204 Geneva - Switzerland	8008 Zurich - Switzerland
Mr. Elio Barzilay	Mr. Michael Bösch
Tel.: +41 22 310 76 40	Tel.: +41 22 310 76 35
Fax: +41 22 310 76 39	Fax: +41 22 310 76 39

Disclaimer

All the contents of publications of Hyposwiss Advisors SA or its affiliates are for information purpose only. Information contained herein does not constitute a solicitation or offer or recommendation to buy or sell any investment instruments, to effect transactions or to conclude any legal transaction of any kind whatsoever.

The information contained and the opinions expressed herein by Hyposwiss Advisors SA are subject to change without notice. No guarantee or undertaking is offered regarding completeness, reliability or accuracy of the information given. Financial instruments and securities or any other investments mentioned in this document may involve significant risks including the possible loss of principal. No assurance is given that the investment objective of any product will be achieved. Past performance should not be taken as an indicator or guarantee of future performance. Hyposwiss Advisors SA or any of its affiliates may or may not at any time hold a position in or with respect to the investments which could be mentioned herein.

This document may not be reproduced, distributed or published without the prior written consent from Hyposwiss Advisors SA.

Access to the information may be restricted by laws or regulations to which the individual user is subject. As a consequence, this document is not directed at, or intended for distribution to or access by any person or entity who is a citizen or a resident of any jurisdiction where the information in question would be prohibited by law or regulations.

Hyposwiss Advisors SA does not render tax, legal or accounting advice. Clients are encouraged to seek their own competent independent professional legal, tax and accounting advice.

Registrations with the US Securities and Exchange Commission and the Canadian Securities Administrators do not imply a certain level of competence, education, skill or training. The protections of the US and Canadian rules and regulations are only available to residents of the respective country, province or territory.

© 25 July 2019 – All rights reserved.