HYPOSWISS
ADVISORS

Review & Outlook
Q4-2019

Review and Outlook

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Hyposwiss Advisors SA

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We just finished the 2010 decade!

Every decade in the past hundred years has reshaped the world and along with it the financial markets. The 1950's were about rebuilding the landscape after WWII. The 60's main event was the race to the moon and the technological consequences. The 70's brought the oil shocks and inflation, and thereafter interest rates surged. The 80's brought Reaganomics meaning supply-side economics and lower taxes. The 90's came with the peace dividend – the economic benefit of a decrease in military spending following the collapse of the Soviet regime. The noughties were about dealing with assets bubbles – the so called dot-com crash in 2000-2002 and the 2008 crash connected to the mortgage-backed securities collapse.

S&P 500 Index – 01.01.2000 – 31.12.2019
Source: FIS Market Map

The last 10 years were about cleaning up these excesses, resulting in huge amounts of cheap central bank money which in turn produced an unforeseen rally in stock markets - led by information technology stocks. The other side of the coin is that these events are pushing the world into unchartered territories of: low growth; low inflation; low unemployment - with even negative interest

rates in some parts of the world. This current economic situation is unseen in history and as a whole might not be sustainable in the long-term.

After a review of the last quarter, we will provide in the following paragraphs our views for the year 2020.

Q4 2019 Review

Equity markets continue climbing the wall of worry

Equity markets ended the year 2019 with a very strong fourth quarter. The MSCI World gained another 8.5%, resulting in a yearly profit of 25.5%. The NASDAQ lead again the crowd with an impressive 12.6% gain in Q4 and Emerging Markets were able to outperform for the first time in 2019 with the MSCI Asia ex-Japan gaining 9.4%.

A look back at the whole of 2019 shows that the year started in panic mode after the sell-off in Q4 2018. Global monetary support and the prospects of trade war easing were supportive for markets, interrupted by some minor setbacks in May and August. During the entire year of 2019 the US-China trade war dominated market movements and led to a mild industrial recession in most parts of the world. Central banks came to the rescue, among them the US Fed which cut rates in 3 steps by overall 0.75%. Information technology stocks performed best like in past years while oil stocks and utilities stock were the laggards. Within Alternative Investments, real estate stocks did extremely well benefiting from lower rates while commodity prices sank.

Markets were off to a good start into 2020 when news came in of the US killing of Iran's general Soleimani in Iraq which triggered geopolitical tremors. The markets immediate reaction was typical. Equity markets corrected, however less than some participants predicted, Gold went up significantly proving its status as a safe haven nicely, and oil went up as the events were happening in oil producing countries, with ship movements in the Strait of Hormuz potentially in danger.

"Luck shouldn't be part of your portfolio."

Expect the expected

Fixed Income

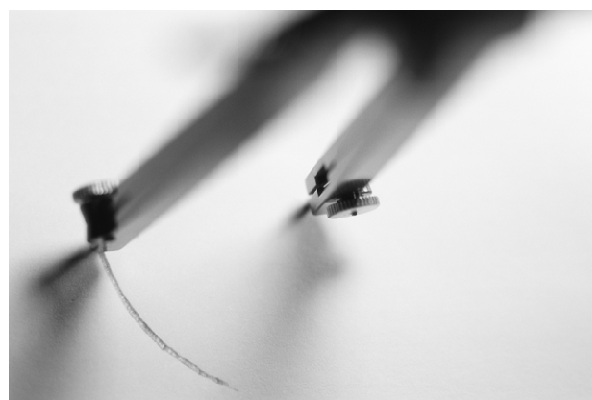
Central banks actions drove the market

Central banks will likely remain on the sidelines in 2020. Inflation is the key word and it is still running well below target (usually 2%) in most economies. Even in the US, where wage growth has finally started to rise, the core inflation rate excluding housing has averaged only 1.2% over the past 5 years. There is expectation that long-term bond yields will move higher in 2020 as investors revise their estimates of the nominal rate in response to faster growth.

The unemployment rate across the G7 countries has fallen to a multi-decade low and the share of developed economies reaching full employment has hit a new cycle high. At last, the result will be rising wages which will boost disposable income, increase spending, and ultimately prices and inflation. However it might be 2021 until inflation rises above the Fed's comfort zone and forcing the Fed to take action – which would be to increase interest rates.

We were overweight in the Fixed Income asset class in USD bonds for much of 2019 and therefore did profit from rising bond prices. In Q4, we have gradually reduced our bond holdings back to benchmark levels and are ready to reduce even further should there be more evidence that interest rates start to climb.

Next to the core holdings of bonds with Investment Grade ratings and TIP's / FRN's, we prefer High Yield (HY) bonds to long-term duration in order to generate higher returns with acceptable risk. Emerging market government and corporate bonds also remain attractive in our view. They pay higher yields than their developed market counterparts, despite their lower debt level in many cases. Obviously we are closely monitoring such bonds.



Equity

Equity markets still hovering around all-time highs

The scenario with new all-time highs in equity markets, interrupted by geopolitical events and the corresponding correction of the markets, which dominated most of 2019, continued so far in 2020.

The reaction of stock markets to the events in Iraq was surprisingly modest, and even more the speed in which markets have shrugged off this latest geopolitical crisis, and this by itself is another sign of the strong magnitude of the current bull market. Many private investors, who sold too early and are following the 'buy on weakness' strategy, did not seize this small window of opportunity and are still waiting for the big correction. Institutional investors such as pension funds and asset managers were heavily buying stocks the last few weeks which is reflected in a record market breadth, with more than 80% of US stocks in a positive trend.

The upcoming Q4 earnings season will determine the trend for individual companies, which are confronted with undemanding

expectations. Consensus expects -1.5% Q4 earnings growth (versus -2.2% in Q3 2019). Management guidance for the year 2021 and the developments of the earnings revisions for Q1 and the full year 2020 will be key factors to watch over the coming reporting period.

We have increased our equity allocation slightly in the last months of 2019, reflecting also partially on the higher valuation of equity assets. Our main scenario remains that we are in a secular bull market in US equities with the rest of the world following in different magnitudes. This bull market will only end by either a reversal in the inflation / interest rate situation, an economic downtrend of magnitude, a yet unknown geopolitical event or by an exaggeration of valuations – a so called buying climax. We don't think we are there yet!

Currencies

A stronger economy will put limits on a stronger USD

The popularity of USD assets and their relative outperformance to the rest of the world was the major structural support for the USD in the current cycle. However the ongoing weakness in industrial activity could limit the ability of the USD to appreciate much further in 2020.

A better growth backdrop in Europe and a changing policy mix away from the exhausted monetary policy towards fiscal policy could make European currencies more attractive going forward.

The outlook for the British Pound (GBP) is more promising than for the negative-yielding Euro (EUR) and Swiss Franc (CHF). A looser fiscal policy and the Brexit uncertainty reduced to the economic outcome of this move might support the GBP even further.

The Chinese Yuan (CNY) remains under pressure as a looser monetary policy by the Chinese authorities to support their debt-burdened financial system will put pressure on the CNY, but the weakening will proceed gradually as the currency remains tightly controlled.

Economics

Global economic activity is expected to recover during 2020

There is mounting evidence that the global manufacturing cycle will be bottoming out during the next few quarters. The PMI data for the US still gives mixed signals, but the trend is improving. The euro area PMI increased during Q4, led by Germany and France and the official Chinese PMI figures produced by the National

Bureau of Statistics started to rise for the first time in Q4 since May 2019.

One sector which was particularly hard hit during the current manufacturing downturn is automobiles; this industry is now showing signs of life, both in the US and in China. Europe is still lagging but there are indications that even Germany's automobile production should rebound in 2020.

In the US the 0.75% rate cut has led the residential housing sector – the most interest rate-sensitive part of the economy – into accommodative territory. As housing inventory levels and vacancy rates are both at multi-year record levels, the shortage of homes should further stimulate the construction industry. This strong housing market and a still strong labor market, together with more business capital spending benefiting from lower rates should all support consumer spending – which represents nearly 70% of the US economy and will ultimately increase economic growth.

The UK economy should start to recover in 2020 as we advance into the Brexit process and fiscal policy turns more stimulative. Prime Minister Boris Johnson is supposed to fulfill his pledge to pass a budget that boosts spending.

In China the structural slowdown will continue beyond 2020 as the economy continues its transition to a consumption driven structure and the government tries to bring a large debt burden under control. China might even lower its growth target for 2020 real GDP to around 6% at the annual session of the National People's Congress in March, tolerate slower growth and focus instead on reforms.

Commodities

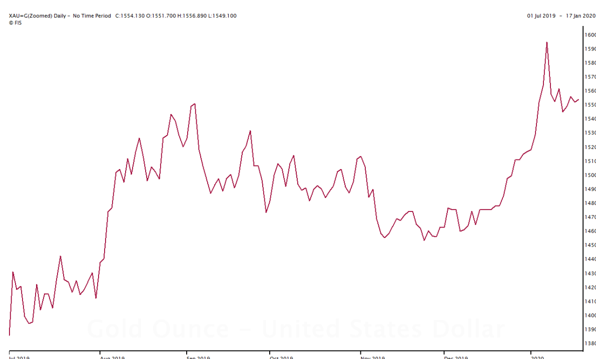
The economy matters more for oil than military attacks

Commodity prices tend to closely track the global growth cycle. That is why the manufacturing downturn, the recession in the automobile business and the Chinese slowdown have put pressure on economic activity and in particular on resource consumption which led to lower commodity prices in 2019. The current soft economy therefore leaves prices without clear direction, while geopolitical events might result in occasional price swings. Should the global economy finally bottom out in 2020 as we foresee, the picture might change in favor of higher commodity prices.

Regarding the oil price, the old saying goes that 'political markets have short legs'. This first week of January this was particularly true. Oil prices went up due to the escalation between the US and Iran, only to give up all these gains

after the missile attack on US–military bases in Iraq and the subsequent statement by the US administration calmed down fears about supply disruption risks in the Middle East.

Gold showed the typical reaction to the killing of Iran elite general, spiking on the news but giving away the gains, however not all of it for the moment, and the upswing on the news was fairly impressive by jumping from around 1525 to above 1600$ per ounce. Gold's short–term upside looks limited unless some new geopolitical event of major magnitude occurs. Long-term, a renewed slowdown in global growth, a weakening dollar coupled with a renewed demand for safe-haven might benefit the gold price.



Gold spot prices (XAU) in USD – 01.07.2019 – 17.01.2020
Source: FIS Market Map

Outlook

2020 is a US presidential election year

Looking into 2020, there will be three topics dominating the news and therefore the markets:

1) Politics will dominate the headline news with the upcoming **US election**. It is still early to assess the impact on financial markets as the current roster of candidates in the nomination race presents some extreme alternatives. More guidance is expected after the first few primary elections during Q1 2020. Depending on the results, market reaction might occur well ahead of election date on single primaries or polls. As of today, the market consensus is expecting a re-election of President Trump. Should the final results be different, markets might suffer heavy negative reactions, varying on who would be the alternative candidate.

2) **Negative yields** will continue to put pressure on investors. The longer they last, the more it hurts. At the end of 2019, almost 17 trillion USD worth of global Fixed Income assets did have a negative yield. To make things worse, the end of this unhealthy situation is not coming anytime soon. In the meantime, prices of alternatives to non–yielding bonds/notes will thrive as investors are desperate for yields. This could ultimately lead to exaggerations and miss-pricings in some asset classes and the ultimate correction back to normal valuation levels will be heavy.

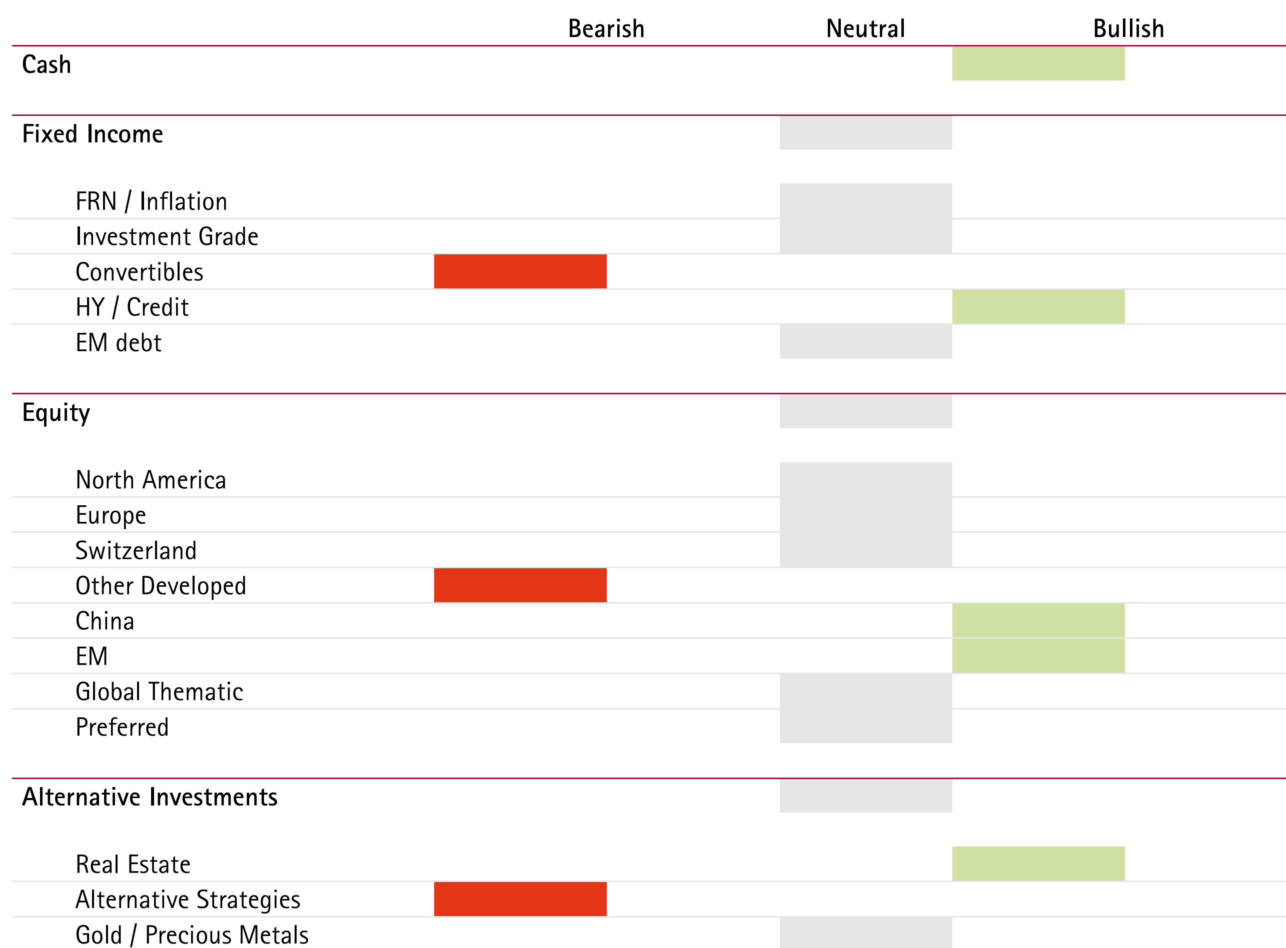
3) A **bottoming of the economy** is in the cards for the first half of 2020, as monetary support and economic sentiment is improving. The missing part for a more meaningful upturn is government spending and whether governments – in most countries burdened by already high debt levels – will dare to promote fiscal spending.

Entering 2020, the counter for financial markets is set back to zero – same as every year – and we are confident that our current asset allocation will allow client portfolios to achieve their goals. We expect the global economic activity to recover into 2020 and equity markets to respond accordingly despite their all-time high levels. We are aware about the principal risk to our mildly optimistic view, which include politics (US elections and geopolitical events), a resumption of inflation and a weaker US dollar.

Walter Küng – Senior Portfolio Manager

Asset Allocation

USD Reference – Balanced



Thematic investment idea

Digital Payments

Investing in a future megatrend

Digital payments are changing the way we spend money by making payments more convenient. Splitting a bill, paying a babysitter, or paying back a friend has never been easier. Mobile payments allow your debit card to stay in your wallet while you make a contactless payment at the point-of-sale, or purchase goods online right from your smartphone.

The digital payment industry is one of the most attractive opportunities in the co called 'FinTech' industry. It is supported by strong secular drivers, including the rise of digital commerce, increasing smartphone penetration, rising payment complexity and regulation-led industry consolidation.

This attractive growth momentum will of course bring increased global competition into play, but we expect technologically superior, integrated payment solutions vendors to disintermediate legacy merchant acquirers and payment processors. On top, high-tech entrants will continue to work with the dominant card payments networks for now, which will reap the benefits of their global near-duopoly.

For investors, this is an opportunity to invest in a secular trend within a narrow niche: mobile payments. We prefer to invest in a diversified basket of securities and have selected proven investment solutions. Should you want to know more, please feel free to contact your Relationship Manager.

"Don't let your money work for you. Because it doesn't."

Expect the expected

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

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