SYZ WEALTH MANAGEMENT

FOCUS

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KEY THINGS INVESTORS SHOULD CONSIDER IN 2018

HIGHLIGHTS

- Macroeconomic backdrop is supportive of 'risk-on'. This can quickly change, but for now, a lack of inflation pressure and positive growth should fuel financial markets.
- Numerous macro and geopolitical risks could derail positive sentiment. Risk management is of key importance.
- Asset prices across equities and bonds are elevated. However, there are pockets of value that can offer attractive risk-return profiles.

Adrien Pichoud
Economist

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Multi-Asset Strategist

"The overall macroeconomic picture continuous to be benign."

So far, 2018 has presented investors with a number challenges that have threatened the near-decades long bull market. How will markets fare in the second half of 2018 and what does the global economy have in store for investors?

- Positive growth, accommodative financial conditions and supportive sentiment point towards global growth, but with growing divergences between the U.S, Europe and the rest of the world.
- Inflation, currently not a material factor, will remain a focal point as it will shape monetary policy normalisation speed and magnitude going forward.
- Asset prices are elevated, but pockets of value can be found. We favour U.S. Equities, U.S. Treasuries and selective Emerging Market bonds.

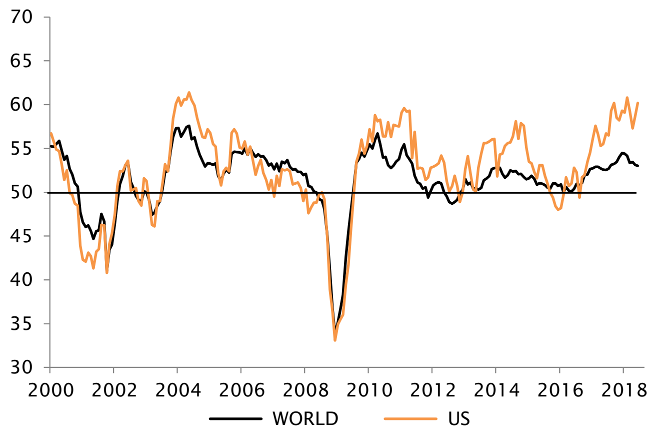
Macroeconomics

Starting with the top-down picture

The global growth dynamic has soften somewhat, but the United States has carried on displaying strong economic momentum. The strong results out of the U.S. show no signs of abating in the months ahead and might even be reinforced by another tax cut plan before Mid Term elections. As of today, we still see no clouds on the horizon for the world's largest economy.

1. **A strong, or relatively too strong, U.S. economy may well be a poisoned chalice for the global economy.** The issue is that a U.S. strong economic dynamic is very much at odds with what is to be found across most of the rest of the globe. Growth and monetary policy divergences are already causing some cracks, especially in the Emerging world. A stronger US dollar and higher USD rates are not good news for economies that have benefited from cheap foreign currency funding for years. Unfortunately, those headwinds seem unlikely to abate in the near future as they merely are the flip side of the "strong US economy" coin. Indeed, protectionism and the prospect of a possible large-scale withdrawal of the U.S. from the global trade field risk amplifying this trend. President Trump may indeed "Make America Great Again", but at the expense of the rest of the world.

Manufacturing PMI indices



Sources: FactSet, SYZ Asset Management
Data as at: 29 June 2018

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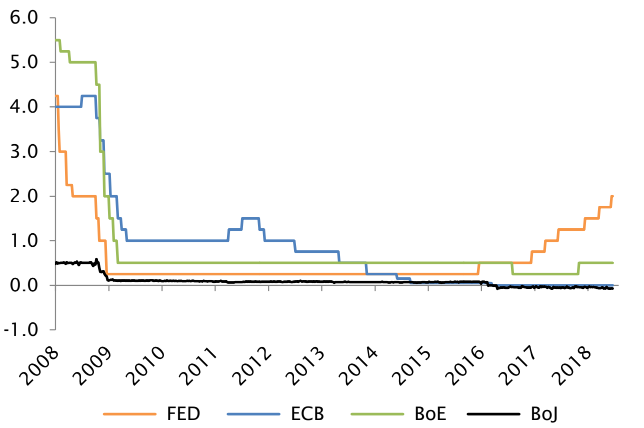
2. **Softer growth dynamic witnessed in Europe is possibly a blessing in disguise.** Weaker growth has led the ECB to postpone any monetary policy tightening for the moment, further widening the gap with the Fed's rate trajectory. The ECB's commitment to maintain accommodative financing conditions will support European domestic growth going forward, even if industrial sectors stay under pressure from U.S. tariffs threats. It may also ensure that global financing conditions don't get excessively tight despite rising U.S. rates.

Central Banks' key short term rate



Sources : Bloomberg, SYZ Asset Management
Data as at : 22 June 2018

3. **We expect the global economic backdrop to remain positive in the second half of the year.** Significant disparities in terms of growth dynamics (unlike the quite synchronized year 2017) are likely to persist. Overall, we expect to see a global economic backdrop that is characterised by a roaring U.S. economy, a modestly growing and stable rest of the developed world - after a soft patch, and several EM economies continuing to struggle amid higher USD rates, elevated oil prices and slowing global trade.

Asset Valuations

3 Ideas for the rest of 2018

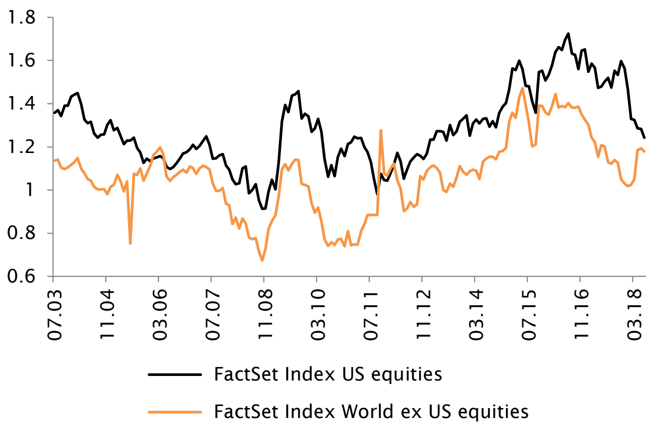
1. **Harvesting equity risk premium in a risk controlled way**

Fears about trade wars and European politics have triggered a mild market correction in the US equity and a more pronounced selloff elsewhere notably in Emerging markets. But the overall macroeconomic picture continuous to be benign, as noted above.

We are fairly constructive on overall equity risk with a preference for US equities as they offer a comparatively low risk contribution within the context of a diversified portfolio of assets as well as relative to other equity markets.

On various valuation metrics U.S. equities appear to be more expensive than the rest of the world. But, if you look at the price earnings to growth ratio that frames the P/E ratio in units of growth, you see that the valuation difference has narrowed substantially and is today nearly at the same level compared to other broader global equity markets.

Price/ Earnings to growth Ratio



Sources : FactSet, SYZ Asset Management
Data as at : 29 June 2018

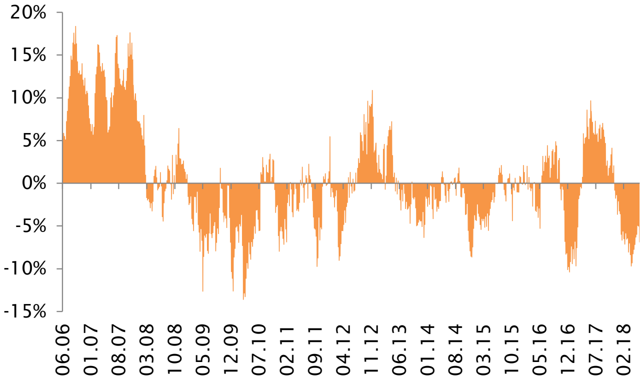
Analyst's earnings revisions show that the World ex U.S. has broadly gone sideways whereas the U.S. has seen a sharp increase in earnings revisions. This is mainly due to the corporate tax reform enacted by President Trump and backed by the Republican Party, as well as ongoing deregulation that should continue to provide a favorable backdrop for corporate earnings going forward. Moreover, this relative strength in earnings growth should continue to anchor the volatility of U.S. equity market going forward.

2. **Finding value in unloved US Treasuries**

The market environment for fixed income assets has clearly changed. Bond markets are not cheap and central banks are becoming less accommodative. While we are not outright positive on bonds, we are fairly relaxed about owning duration risk.

Within the high quality bond segment our favorite pick are U.S. Treasuries. Investors are still overly pessimistic towards that market and speculators are still betting on higher yields.

US 10 Year Note futures



Sources: Absolute Strategy Research, SYZ Asset Management
Data as at: 29 June 2018

At the same time, investor expectations are much more aligned with the Fed's outlook for interest rates than in the past.

The combination of a pessimistic stance towards Treasuries and the fact that expectations for further monetary tightening have adjusted considerably over the past few months, creates in our view an attractive level of asymmetry for U.S. Treasuries.

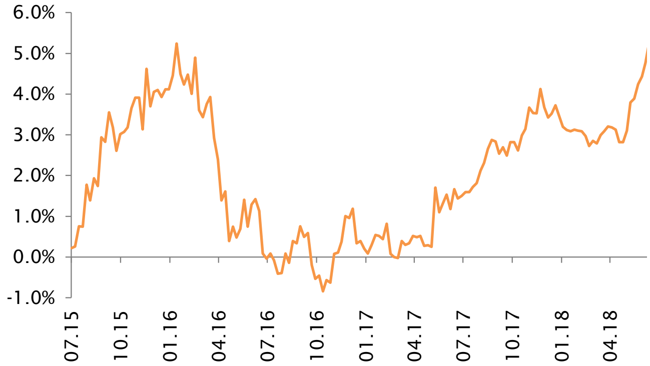
3. **Low risk opportunities across the Emerging Markets**

Recent months have brought a toxic mix between a rising USD and rising bond yields, which have significantly pushed up Emerging Market debt yields making valuation look attractive (as yields rise, prices fall). However, we believe it is too early to become overly constructive on the asset class as a whole.

Nonetheless, we have identified interesting lower-risk opportunities such as in Brazilian local bonds hedged back to different currencies (e.g. BRL vs. EUR). Up until 6 months ago, owning foreign exchange risk was the only way to access the high yield levels Brazil has to offer. Since then, the FX hedging cost to other currencies has gone down and the Brazilian yields have remained high, allowing investors to access high levels of carry without taking much currency risk or duration risk.

Taking a euro investor as an example, a fully FX hedged 5Y Brazilian bond yields approximately 4.4%. This is a very good level given its overall duration of 3.5 years.

Local Brazilian bond yields hedged to EUR



Sources: Bloomberg, SYZ Asset Management
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Carry without much duration and FX risk is another feature that we are looking for when building a very diversified multi-asset portfolio.