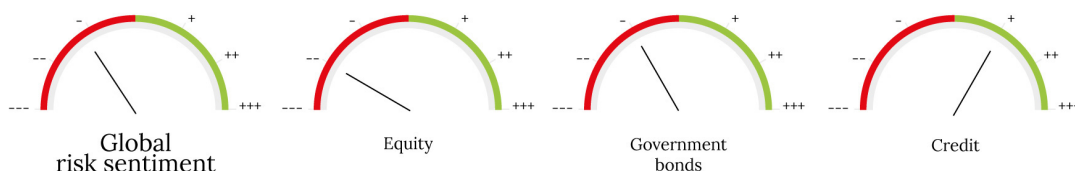




## OUR MONTHLY VIEW ON ASSET ALLOCATION



### ▶ TINA IN ZOMBIELAND - THE DESPERATE HUNT FOR YIELD

*TINA is back, with negative-yielding debt  
Low rates not a remedy for structural issues*

Here we go again – the desperate hunt for yield is back. In a world with more than \$13trn of negative-yielding debt, and where holding cash in developed market (DM) currencies is punitive, there is no alternative (TINA).

*Zombie companies on the rise*

This is courtesy of ultra-dovish DM central bankers who will do whatever they can to jump-start nominal growth. We do not underestimate their creativity, but we are challenging the efficiency of low rates and unconventional measures for economic growth and inflation. Unfortunately, lower rates do not mean more nominal growth, as the key issues are structural. Slowing growth and inflation coupled with rising debt is not a new trend. Low rates are not the remedy, but merely a way to extend and pretend.

*Low-to-moderate equity beta as gains less likely*

A report from the BIS found 12% of publicly listed companies around the world can already be described as zombie firms – where earnings do not cover interest payments. Not yet convinced? Think about Italian government debt or unfunded liabilities around the world, or just ask a Japanese central banker.

*Favouring EMD and European credit with attractive spreads*

So, let's be pragmatic about our current positioning, which can be summed up as keeping a low-to-moderate equity beta and reloading debt carry. Equity markets are stuck in a certain range, where they are now more prone to further volatility than gains. The Fed will perhaps not deliver as much as is priced in this summer, and earnings growth will likely continue to disappoint, as downside risks to growth materialise.

*Look to growth stocks, EMs and steady income*

As far as the fixed income allocation and duration stance is concerned, our message is stay invested, keep a certain level of duration, favour emerging market (EM) debt and add to European credit. Rates are negative on Germany and France government bonds, as well as on 5Y Spain and Portugal bonds. Furthermore, European spread valuations remain quite attractive, and investment grade credit could be the target of the ECB's next round of QE.

*Gold comes to the fore as fiat money tested*

In this context of low rates, it still makes sense to lean into growth stocks – in the technology sector – scour EMs for opportunities and stay exposed to high quality investments offering resilient and stable income streams.

Last but not least, we still like the Japanese yen and gold as diversifiers. The 'barbarous relic' is coming back into favour as the credibility of central bankers, and thus fiat money, will continue to be challenged going forward. Markets have suddenly realised the US economy is just one recession away of falling into the same liquidity trap as Japan and Europe, meaning even cash rates in US dollar may cross the Rubicon in a not so distant future.



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**ECONOMIC BACKDROP IN A NUTSHELL AND GLOBAL ECONOMIC REVIEW**

*Central banks turn to monetary policy as headwinds gather*

Central bankers have finally given in to the accumulation of adverse developments and mounting downside risks. The combination of slowing global growth, weak inflation, falling expectations, rising geopolitical tensions and extended impact of trade tensions led to the same conclusion in Washington, Frankfurt and Tokyo - it is time for monetary policy to be eased in concrete terms. The ECB president and the Fed's Board both warned they expected short-term rates to be cut in the coming months, while the BoJ governor was signaling some flexibility (to the downside) on the long-term yield range.

This simultaneous pivot from central banks is obviously linked to the broad-based trend of slowing activity across developed and emerging economies. Defying expectations of a pickup in activity, especially in Europe and China, global growth dynamic has remained on the soft side and keeps losing steam, with recent indicators pointing to slowing growth even in the United States. However, for the moment, resilient domestic demand across most developed economies prevents them falling into recession and has so far prevented central banks embracing effective monetary policy easing. The straw that probably broke the camel's back has rather been the drop in actual and expected inflation, further threatening central banks' inflation - targets that were already missed, especially in the eurozone. Whether monetary policy easing will have an impact on inflation rates remains to be seen, but as long as growth and inflation dynamics remain subdued, central bankers will have reason to ease and maintain a very accommodative stance, if anything to try to preserve their credibility.

**Growth**

*Global growth dynamic softens*

The persistence of growth slowdown in DM economies, and of trade tensions between the US and China, finally appears to have taken its toll on the encouraging dynamic that had been witnessed among many EM countries in the past few months. With only a few exceptions, the whole global economy is slowing down ...

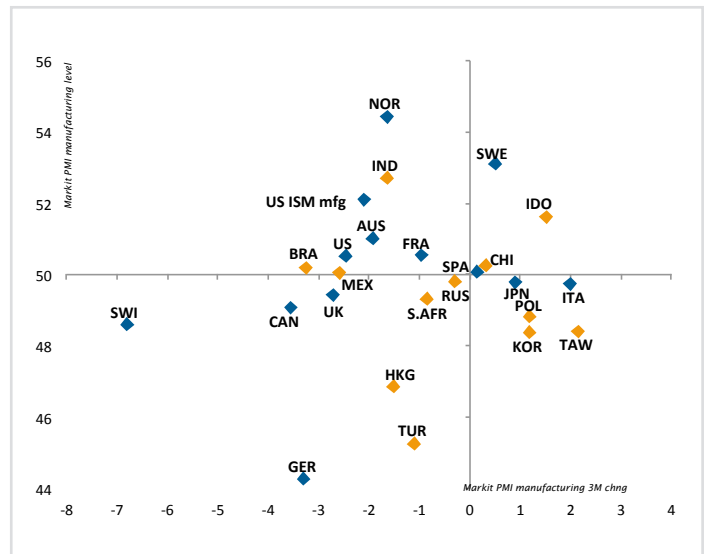
**Inflation**

*Global Japanification*

Inflation dynamics remain dull across the board, not helped by the recent decline in oil prices which will affect headline inflation. More worryingly for central banks, medium term inflation expectations have also dropped. The world is increasingly turning 'Japanese'...

**Broad based growth slowdown across DM and Ems.**

Sources: Factset, SYZ Asset Management  
Data as of: 27.06.2019



*Monetary easing spreads to EMs*

**Monetary policy stance**

Beyond the well-advertised and spectacular easing pivot from large developed central banks, the trend towards monetary policy easing is also gradually encompassing EM central banks. This is against a backdrop of soft growth and inflation combined with a US dollar that is no longer appreciating.

*Convergence to the downside*

**Global economic review**

No major developed economy is spared by the slowing growth dynamic at play since last year. While manufacturing indicators appear to have stabilised in Europe, they remain at quite depressed levels and revive the risk that such cyclical sluggishness might finally spread to the so-far resilient domestic, consumption-driven side of the economy. Some damages could in fact already have been done, as sentiment keeps weakening and employment dynamics are faltering, even in Germany. Some evidence of similar trends has also become

“*The combination of slowing global growth and weak inflation led to the same conclusion in Washington, Frankfurt and Tokyo: it is time again for monetary policy to be eased.*

**Adrien Pichoud**

*US-China trade war lowers GDP growth*

apparent in the US, with a convergence to the downside of manufacturing indicators within the already weak levels of the rest of the world, but also softer job growth and declining household confidence. Part of this is certainly related to the dissipation of the fiscal stimulus of 2018, but weak global growth and uncertainties around trade are also exerting downside pressures on the business cycle. Japan is no different, with its external sector affected by China's weak growth, trade uncertainties and the yen's appreciation, while the domestic side of the economy is under the threat of the VAT rate hike scheduled for October. Commodity producers such as Australia or Canada are also impacted by weaker global (and especially Chinese) demand.

*Political uncertainty adds further headwind*

**Emerging economies**

In a pattern like the eurozone's, the Chinese economy has failed to materialise the glimmer of hope for a pick-up that appeared over Q1. Continuing, and even intensifying trade tensions with the US not only affects the export-driven manufacturing side of the economy, but also the drag on domestic consumption, keeping GDP growth at its lowest level in decades, with negative ripple effects across other South-East Asian economies such as Korea or Taiwan.

Political uncertainty is another headwind to growth dynamics in some large emerging economies where elections were recently held and where the implementation of reforms is crucial for the long-term stability. Brazil, with its pending pension reform, South Africa and Mexico with the Eskom and Pemex situations respectively, and Turkey, walking an incredibly thin line between stabilising the lira to maintain access to global capital markets, and a willingness to secure a sufficient level of internal support for the president.

Oil price developments have weighed down on Russia's growth dynamic, but since inflation appears to have also lowered, it opens room for the central bank to finally ease its so-far quite restrictive stance.

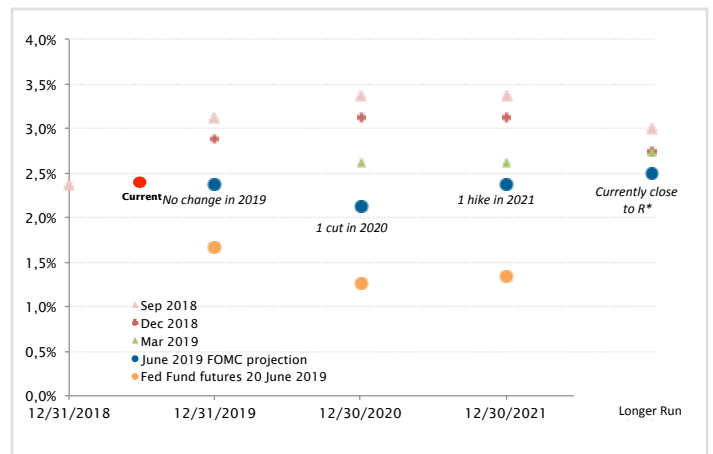


**Adrien Pichoud**  
Economist

**FOMC participants' assessments of appropriate Fed Fund rate level and market-based expectations**

Within a year, the Fed has pivoted from expecting to hike to expecting to cut rates. Future markets are pricing 100bp of rate cuts in the next 12 months

Sources: Federal Reserve, Bloomberg, SYZ Asset Management  
Data as of: 20.06.2019



## ASSET VALUATION & INVESTMENT STRATEGY GROUP REVIEW

### Risk and duration

*Dovish pivot will have deep implication for markets*

During the month under review, we upgraded back the risk stance to “mild disinclination” and kept the duration at “mild disinclination” in our asset allocation.

The pivot of monetary policy from the US Fed and the ECB to a dovish stance will influence the future path of policies and have a significant impact on financial markets (far outweighing growth or inflation dynamics). Hence, it will force market participants to keep or add more risky assets to avoid the monetary forces of financial repression.



*The risk stance has been upgraded back one notch to “mild disinclination” by increasing the exposure to riskier assets in the fixed income world that are supported by an overall more accommodative monetary policy regime in most major developed economies.*

**Maurice Harari**

*Equity markets to remain volatile*

As long as there are no tangible signs of economic growth re-acceleration, equity markets should remain volatile with only limited upside. With rates at artificially depressed levels, equity allocation should be very tactical depending on growth trend, as valuations are becoming of less importance. However, we are implementing this increased risk stance through some “carry” assets in fixed income markets via credit and emerging market debt in foreign currency.

*Selective fixed income offers superior relative risk dynamic*

As we did not fully participate in the core government bonds interest rates rally, we are not comfortable to add pure duration at this point (expecting a temporary pullback after such a rally and steep rise in valuations). However, we are taking some indirect duration risk through additional credit and emerging market debt in hard currency.

As a result, the risk increase will be implemented only through the “riskier” part of the fixed income world and not in the equity part.

### Equity markets

*High dividend stocks could shine in low rate environment*

European, Chinese and Japanese equity markets are scored at “mild disinclination”, while the US and emerging markets broad exposure are one notch higher at “mild preference”.

Europe, China and Japan will potentially be the first direct or collateral victims of growth disappointment and an intensifying trade war, over the next few months.

Moreover, we still prefer not to express too strong sectors bias, neither with defensives or cyclicals as no sectors stand out in terms of both valuation and earnings momentum.

But we are still keen on high dividend stocks, as they should be less at risk of a temporary interest rates repricing and also offer a real medium to long term alternative to this low interest rates environment.

### Bond markets

*Preference for high-yield European credit*

Following the upgrade in our risk assessment, we decided to bring higher investment grade credit up by two notches to “mild preference” and high yield by one notch to “mild disinclination”. We continue to express a preference for European credit over US on valuation grounds, coupled with the steepness of the euro yield curve and dovishness of the ECB.

Regarding investment grade credit: US, Europe and UK were upgraded respectively to “mild disinclination”, “mild preference” and “disinclination”.

No changes for our relative preference for real over nominal government bonds and emerging markets hard over local currency bonds.

Italian linkers and nominal bonds are becoming one of our top picks (with the US) and were both upgraded to “mild disinclination” and “mild preference”.

*Favourable backdrop for emerging market debt*

For emerging market debt, the current backdrop remains favourable, especially if the Fed will ease going forward, and, according to our central economic scenario, the US economy does not fall into recession in the short term. Moreover, valuations remain attractive, especially in relative terms vs. credit or European peripherals.

In the hard currency bucket, Mexico was downgraded to “mild disinclination” and Brazil upgraded to “mild preference” benefitting currently from the support and confidence of foreign investors.

Indonesia (local currency) was upgraded to “mild disinclination” as the economic environment remains favorable with inflation under control and a central bank that could soften its restrictive stance. Recently, S&P also upgraded its debt rating and Indonesia could be among the main beneficiary of a more accommodative Fed.

### Forex, alternatives and cash

*Greenback trumps euro and yen offers safe haven*

The US dollar is preferred to the euro despite the greenback’s higher valuation, as it offers a better growth outlook and a still positive yield differential.

For the Japanese yen, scored at “mild preference”, our assessment of the currency continues to be favoured to the Swiss franc after the latter’s status as a safe haven status currency was diminished on the back of the Swiss National Bank monetary policy easing bias. Finally, gold is ranked at “mild preference” for its diversifier characteristic in a risk-off environment.



**Maurice Harari**  
Multi-Asset Strategist