SYZ WEALTH MANAGEMENT

1 MONTH IN 10 SNAPSHOTS

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Adrien Pichoud
Economist

Wanda Mottu
Analyst

Maurice Harari
Analyst

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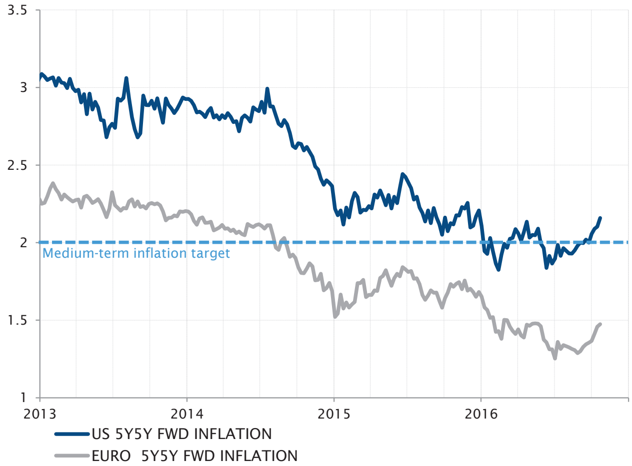
1. Rebound in inflation expectations

- In the past two years, inflation expectations have been steadily declining, dampened by the fall in commodity prices and global growth concerns.
- Recently, this trend has reversed. The rebound in energy prices, on top of fading base effects, has fueled a rebound in headline inflation indices. The growth backdrop has also become less worrisom, with resilient US and European growth, and stabilization in China. The deflationary threat that was hovering at the beginning of the year has been, at least temporarily, dissipated.
- Such a rebound in inflation expectations, from a depressed starting point, is still very far from suggesting any sort of inflation risk at the global level. Actual and expected inflation remain low and, in many developed economies, still far below the targeted level. But the recent reversal in trend reduces the pressure on central banks, relieving them from the need to repetedly send dovish signals.

Medium term inflation expectations have recently rebounded from their lows

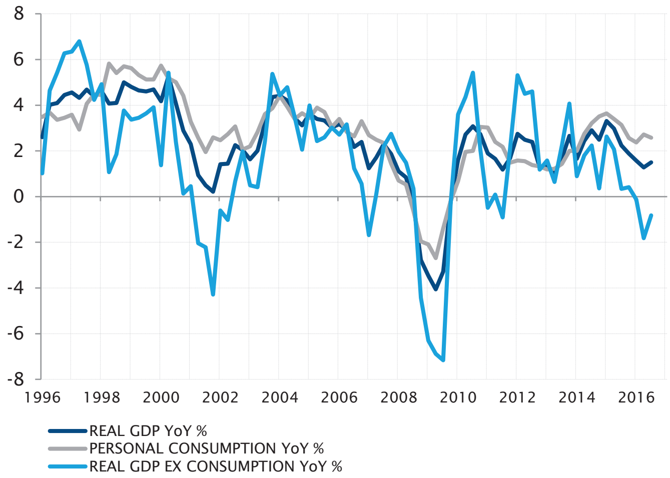


Source: SYZ Asset Management, Bloomberg

2. Welcome rebound in US GDP, but nothing to cheer excessively

- US growth has rebounded in Q3. The GDP was up +2.9% (annualized), after +1.4% and +0.8% in the previous quarters. Such a rebound is rather a relief than a very positive development, as it will barely lead, if extended in Q4, to an annual growth rate of 2% for 2016.
- Moreover, this summer rebound does not reflect any change in the underlying structure of growth, still driven by household consumption. But the US economy still blatantly lacks cyclical drivers likely to trigger a sustained growth acceleration. Business equipment investment has experienced a 4th consecutive quarter of decline in Q3, dampened by declining corporate profits and low capacity utilisation rates. Even residential investment has turned negative in the past two quarters, and housing is no longer a support to growth.
- Indeed, since 2015, US GDP growth relies exclusively on consumer spending. US GDP growth excluding consumption has since then been negative…

US GDP growth remains positive only because of consumption expenditures

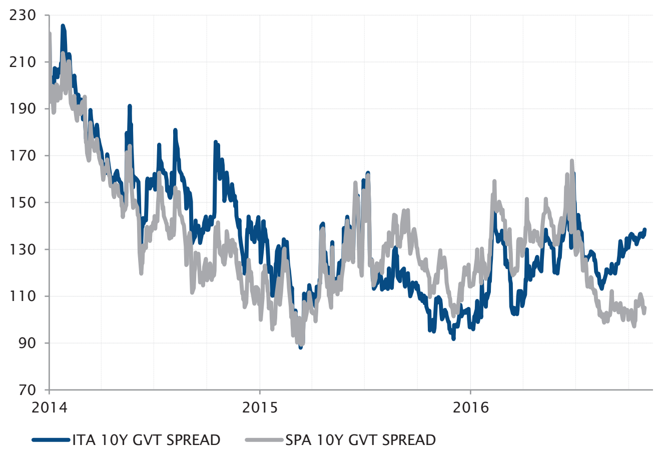


Source : Datastream, SYZ Asset Management

3. Political risk is now the key issue for Europe

- The euro area has been experiencing steady growth since 2013. The last quarter was no exception, with GDP up +0.3% in Q3 and +1.6% over a year. Moreover, early October indicators all improved and point to a firm growth dynamic going into Q4.
- In fact, the key issue clouding the outlook of the euro area is political risk. In the next twelve months, the possibility of a disruptive vote threatening the current European framework cannot be dismissed. The Italian constitutional referendum on December 4th is first in line and is already weighting on Italian assets' valuation, with a steady widening in government spreads since the summer.
- The Brexit vote has shown that popular discontent can realistically trigger political instability even with positive growth trajectories. In 2017, French, German, but also Dutch elections also bear the same kind of risk, as a Damocles' sword hanging over an economy growing satisfactorily.

Italian government spreads reflect growing political risk before the referendum



Source : Bloomberg, SYZ Asset Management

4. China's short-term growth concerns have abated

- According to the latest data, Chinese authorities have managed successfully the "soft landing" of the economy. In Q3, China's GDP growth has remained stable at 6.7% for a third consecutive quarter.
- Unlike in 2015, there has been no interest rate cut in 2016, although the impact of last year's easing may have fed through economic activity. Most of the active support has come from budget policy, with support to the real estate sector, and from currency depreciation.
- The yuan has indeed extended its decline, to hit its lowest level in six years against the US dollar. This has contributed to contain the slowdown in exports. It has also helped to alleviate deflationary pressures, thus triggering a slight rebound in nominal GDP growth. While structural issues remain acute in China (fast-growing debt, excess capacities, demographic…), such accommodative economic policy mix has dissipated for now short-term risks on economic growth.

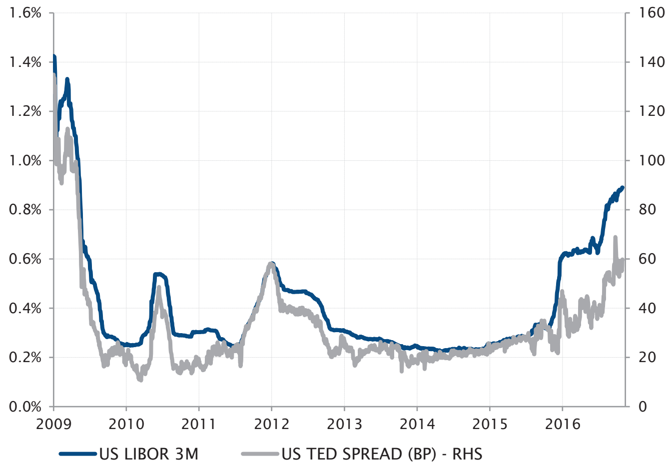
The yuan's depreciation helps to stabilize China GDP growth

Source : Bloomberg, SYZ Asset Management

5. US Libor and TED spread reach 7-year highs

- USD Libor rates have climbed to their highest level since 2009. The +27bp rise on the 3-month rate this year has been driven by a reform in the US money market fund industry, that triggered about USD 1 trillion of flows from prime funds toward government funds.
- The resulting increase in market funding costs for banks and companies has not been related to the Fed's monetary policy, contrary to the Libor increase of 2015. Indeed, in the meantime, short term government rates have remained stable, around 0.3% for 3-month rates.
- As a result, the TED spread (difference between Libor 3M and US Treasury 3M rates) has widened to its highest level since the 2008/09 crisis. While the recent increase is not directly comparable to the 2008/09 episode, it is still the sign of tightening credit conditions for businesses and of an undisputable preference for liquidity by investors.

Financing conditions have become less accommodative even without Fed hike



Source : Bloomberg, SYZ Asset Management

6. Despite solid UK growth, a bad month for GBP markets

- The British economy has exhibited unexpected resilience since the Brexit vote, its GDP being up +0.5% in Q3, supported by the service sector. While any impact on growth might still materialize later when the exit process enters a concrete phase, it is however already visible on the currency and long term rates.
- Theresa May's clarifications on the timing and expected shape of Brexit negociations have led to another drop of the GBP in October (-6%), to a 30-year low against the USD. Unlike the immediate vote aftermath, however, this GBP fall has not been accompanied by a drop in rates. Inflation expectations have indeed risen, fueled by the inflationary impact of the currency depreciation, and long term rates have jumped back toward pre-referendum levels. An unconfortable situation for the BoE, caught between rising inflation and a falling currency and, on the other side, a likely slowdown in activity in 2017…

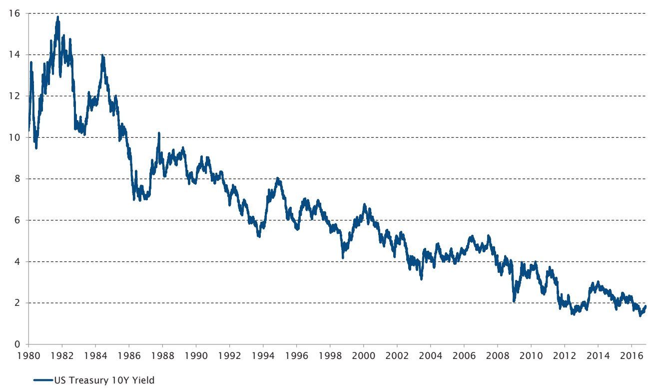
The inflationary impact of a falling currency finally pushes rates higher

Source : Datastream, SYZ Asset Management

7. Bonds - Is the bond bull market (finally) over?

- Interest rates experienced a sharp increase in October, pushing long term government rates to their highest level since last spring. A combination of positive economic data globally and of rebounding inflation expectations contributed to reverse the post-Brexit summer rate decline. Indeed, rising oil prices and positive base effects on inflation indices have pushed medium term inflation expectations to their highest level of the year. Nominal rates were also driven higher by the prospect of less accommodative monetary policies due to this growth and inflation environment, with the Fed now expected to hike before year end and speculation about an ECB QE tapering in 2017. As a result, US 10y rates rose to 1.83% by the end of the month (+23bp in October).
- Finally, many investors are concerned that it could be the first signs of the end of this bond bull market era. But it could also simply be another cyclical period of rising yields…

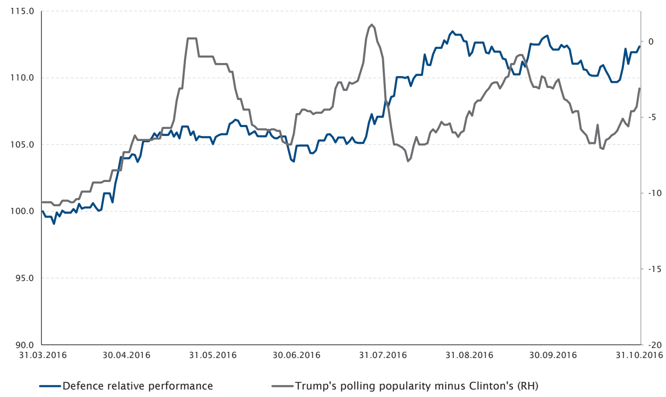
US Treasury 10 Year Yield since 1980



8. Equity - Correlation between the defence sector in the US and Trump's popularity in the polls

- Europe and United States defence spending represent 18% and 10% of GDP, below their twenty year average but recently on an upward trend. Nevertheless, they are still at low levels compared to Russian defence spending, up nearly 50% in the past five years.
- In the United States, if Donald Trump becomes the new President, he may increase defence spending by 15% (compared to actual 2017 budget drafted by Barack Obama).
- Trump has also mentioned that his country support to members of the North Atlantic Treaty Organization would only be implemented if they raise defence spending to 2% of GDP (for the time being, only two countries meet this requirement).
- Therefore and logically, when polls favourable to Trump increase, the US defence sector outperforms the broad US equity market. Moreover, the sector has a low correlation with the market as it's disconnected from the economic cycle.

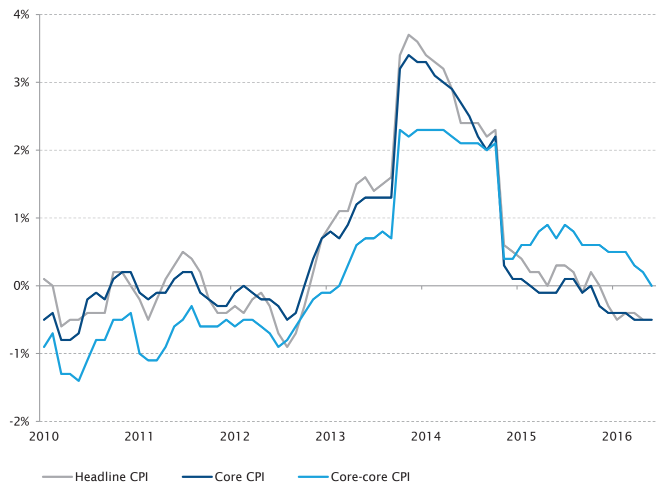
US defence sector relative performance vs. Trump's polling popularity



9. The BoJ delays (again) its inflation goal

- Three years after the start of a surprisingly aggressive quantitative and qualitative monetary easing, Japan still has difficulties to boost inflation. Core CPI, excluding fresh food, stands at -0.5% and the BoJ has been forced to cut its inflation forecasts. Kuroda admitted that the Central Bank will not be able to achieve its 2% inflation target by March 2018 and pushed it back to March 2019.
- Decline in commodities prices, a slowdown in consumer spending following the consumption tax hike as well as weaker growth in emerging economies are the main factors explaining a seventh negative print of the core CPI.
- Despite the adoption of various fiscal and monetary policies, Japan appears to be stuck in a low inflation environment. While inflation expectations are improving in the US and in Europe with the rebound in oil prices, the Japanese five-year inflation swaps remains below 0.5%.

Japanese inflation at a 3-year low



10. Low Volatility ETF fails to maintain low volatility

- After the strong sell-off early in 2016, investors turned to alternatives in a search for stability in their portfolios. The S&P Low Volatility ETF attracted substantial inflows on the promise of exposure to US stocks showing less volatility than the market. During the summer, this trend reversed and outflows were strong.
- Low volatility stocks have been favored by investors as the outlook for global economy was unclear and rates low. They have been considered as a complement to corporate bonds. The high demand on those stocks had the effect of inflating their valuations well above historical averages. Additionally, the perspective of a rate hike pushed many to reconsider allocations to low volatility stocks.
- A number of those stocks started being sold off during the summer; they underperformed the S&P, added unwanted volatility to the S&P Low Volatility ETF and triggered a wave of redemptions. On the long run, it is still very likely that this ETF shall remain less volatile than the S&P. But short term investors may be disappointed.

S&P500 Low Volatility ETF strongly underperforming the S&P500 index