MONTHLY HOUSE VIEWS

March 2020

Growth Backtracks for Now

Macro

In recent days, the coronavirus epidemic has spread more widely beyond China's borders, raising fears of a hit to global growth. At the same time the rate of progression of the virus in China has slowed, enabling many companies to reopen offices and factories, although not yet at full capacity. We expect a sharp slowdown in China's output in the first quarter, followed by a pickup from Q2. In other countries, outbreaks of the virus are likely to be met with the same measures as in China – quarantine, travel restrictions, factory closures etc. – meaning that the impact on their growth may continue into the second quarter, before recovery takes hold.

Central Banks

Market expectations for US Federal Reserve (Fed) rate cuts have risen in recent days in response to the unfolding epidemic. We expect policy-makers to be on high alert for any deepening of risks but they may hesitate to cut in the short term. The European Central Bank (ECB) remains unlikely to cut rates further into negative territory and may prefer to boost its asset purchases if called on to ease policy. The Peoples' Bank of China (PBoC) has cut a number of its key rates and stands ready to ease further were the return to work to be delayed again. Other emerging world central banks have followed suit, taking advantage of current low inflation levels.

Markets

After a period of resilience, western world equity markets have sold off in recent days as the coronavirus spread beyond China, a typical reaction to such outbreaks. On the other hand, Chinese equities have begun to outperform as the number of new cases of the disease there showed signs of peaking. We expect global stock markets to recover lost ground once the epidemic begins to come under control. Safe havens such as G7 government bonds, gold and the US dollar have provided useful diversification. However, we suggest more caution on lower-quality higher-yielding (HY) corporate bonds – issuers may face cash-flow problems as the crisis drags on.

Bottom line

We suggest keeping a broadly diversified approach to portfolio construction, with a focus on safe-havens such as fixed-income and gold, which remains our preferred diversification tool. Given the risks to credit quality in HY bonds, we propose locking in some profits to reduce exposure. We suggest keeping a Neutral stance on global equities given the short-term risks but remain confident that markets should rally in the medium-term once better news about the coronavirus outbreak emerges. Similarly, Brent prices should rally back towards our target $60-70 range by year-end.

OUR ASSET ALLOCATION

The table below presents the latest conclusions of our Global Investment Committee

Summary house views

			Strong UW	UW	N	OW	Strong OW	Change since last GIC
EQUITY		**GLOBAL EQUITY**			■			
		United States			■			
		Eurozone			■			
		United Kingdom			■			
		Japan			■			
		Emerging				■		
FIXED INCOME	SOVEREIGN	**GLOBAL RATES**			■			
		U.S. Treasuries				■		
		U.S. Breakeven				■		
		Bunds		■				
		EMU Breakeven			■			
		Gilts		■				
		Gilts Breakeven			■			
		JGBs			■			
		EM Govies ($)				■		
	CORPORATE	**U.S. IG**				■		
		U.S. HY		■				-
		EMU IG				■		
		EMU HY			■			-
		UK IG				■		
		UK HY				■		
		Duration USD*			■			
		Duration EUR*		■				
		Duration GBP*		■				
FOREX		**EURUSD**			■			
		USDJPY			■			
		GBPUSD				■		
		EURCHF			■			
		EM FX (vs. USD)			■			
CMDTY		**Brent**				■		+
		Gold				■		
ALTERNATIVE		**ALT. STRATEGIES**			■			
		L/S Equity			■			
		Event-Driven				■		
		FI Arbitrage				■		
		Global Macro / CTAs			■			

	Positioning	*Duration
O/W	Overweight	Long – 7-10 years
N	Neutral	Intermediate – 5-7 years
U/W	Underweight	Short – 3-5 years

SOCIETE GENERALE
Private Banking

EQUITIES	
United States	Despite the recent sell-off, demanding valuations should limit the upside for US equities this year. We remain Neutral.
Europe	The coronavirus epidemic has continued to depress market sentiment, especially once international contagion began to accelerate in the second half of February. We remain Neutral.
Eurozone	Coronavirus fears have overwhelmed the improvement in various measures of business confidence. We are Neutral.
UK	Given the cross-currents at work, we remain Neutral.
Switzerland	Swiss equities have demonstrated resilience. However, the Swiss franc has strengthened on safe-haven inflows. We suggest a Neutral stance.
Japan	Despite attractive valuations, poor economic data and coronavirus risks suggest a Neutral stance.
Emerging (EM)	Chinese equities have demonstrated resilience as new Covid-19 cases begin to slow and valuations are attractive. We are Overweight.

FIXED INCOME	
Sovereigns	Until the epidemic provides reassuring signs of containment, it is unlikely we will see much upside in sovereign yields, as investors flock to safe havens.
Duration*	We prefer intermediate maturities in the US and shorter-dated bonds in EUR and GBP. In the near-term, 10-year US rates can provide some diversification against volatility spikes.
Inflation-linked	Given attractive valuations, we remain Overweight on US inflation contracts (“breakevens”).
Investment Grade	Given the current macroeconomic backdrop, we still prefer better quality corporate bonds.
High Yield	While we assume growth and markets will eventually recover, uncertainty is set to linger for now. In the near term, we expect rates to stay low and riskier credit to suffer. We therefore turn tactically cautious on High Yield.
Emerging debt (in € and $)	For now, we see expect EM debt markets to continue to deliver positive returns given attractive valuations and supportive fundamentals.

CURRENCIES	
EUR/USD	Rising expectations of Fed rate cuts have served to weaken the perceived yield advantage of the dollar over the euro. we expect modest upside in EUR/USD by year-end.
GBP/USD	We expect sterling to rally back above 1.35 once uncertainties about EU-UK negotiations are lifted.
EUR/GBP	As negotiations on future relations between the UK and the EU start, we don’t expect major moves in coming months.
USD/JPY	Given disappointing economic data and its safe-haven role, the yen should continue to trade in a relatively narrow range against the US dollar.
EUR/CHF	Any sustained weakening in the franc against the euro will need confirmation that the Wuhan flu outbreak has been contained. We remain Neutral.
Emerging	A recovery in EM currencies is unlikely before the epidemic comes under control and safe-haven buying of the dollar peters out.

ALTERNATIVES	
Hedge funds	Within hedge funds, Fixed Income Arbitrage should benefit from the bull run in rates while Event Driven is set to recover once the Wuhan flu scare abates.
Gold	Gold should continue to provide useful safe-haven benefits.
Oil	Oil prices should recover by year-end and we suggest moving Overweight.

Source: SGPB, 28/02/2020
* Duration: short = 3-5 years, medium = 5-7 years, long = 7-10 years
HY = High Yield bonds (higher return but greater risks), IG = Investment Grade bonds (higher quality but lower return)

ECONOMIC OUTLOOK

Ill at ease

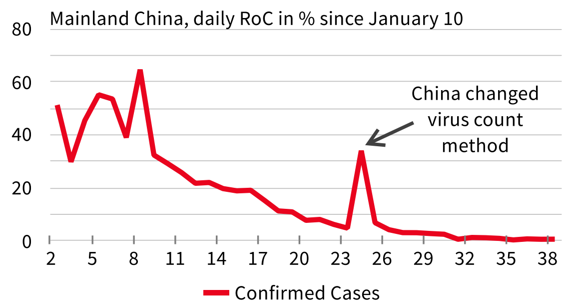
The near-term outlook for global economies will be heavily affected by prudential measures taken to stem the spread of the coronavirus epidemic. While the crisis appears to be coming under control in China, outbreaks elsewhere must be dealt with. A recovery in global output has probably been postponed to the second half of 2020, and 2021.

If markets had been somewhat complacent to the economic threats posed by the coronavirus, late February saw them scrambling to reassess the risks. Following all-time highs for global equities in mid-month, MSCI's All-Country World index has declined 10%. In that time, safe-haven assets surged: gold hit its highest level since the Eurozone debt crisis and US government bond yields plunged to record lows. All-time equity market highs followed by a sharp sell-off suggest investors grappling to accurately price an epidemiological outcome which is unknowable, particularly in the short-term.

The recent spread of the coronavirus epidemic in major global economies such as South Korea and Italy, where some 52,000 people in the north face travel restrictions, has caused a reassessment of global risks. Economic data is already beginning to reflect diminished activity levels. Oil prices have fallen to levels last seen during peak trade-war fears in December 2018. In the US, Markit's preliminary manufacturing and services purchasing manufacturers indices (PMIs) for February fell compared with January – final figures to be released in early March may well be worse. In China, there has been renewed downward pressure on the Chinese yuan versus the US dollar since mid-February. Moreover, it is inevitable that some economic activity, particularly in areas such as travel and leisure, is lost forever, not merely delayed.

However, there are other important considerations. Eurozone preliminary PMIs for February were better than expected, and above figures from January. The UK's preliminary PMIs are unequivocally showing surging economic sentiment, with the manufacturers reporting the fastest rise in output in ten months.

In China, the growth rate of confirmed cases has eased



Source: SGPB, Macrobond, 28/02/2020

Moreover, while the spread of the virus beyond China is troubling, the growth rate of confirmed cases appears to be declining in mainland China, enabling the situation to start to normalize at its epicentre: most car plants are reported to have reopened; passenger traffic remains low but migrant flows into major cities have rebounded; coal consumption has started to pick up; container ship activity has almost recovered to normal levels. Only hindsight will tell if the worst is indeed behind us, but there are some signs of stabilisation.

We expect macro data to worsen in coming weeks as the economic impact of China's draconian measures – quarantines, travel restrictions, factory and office closures – becomes clearer. China's GDP figures for the first quarter – due by mid-April – are likely to reflect a sharp slowdown. However, the steady return of workers to their workplaces suggests that Q2 could already see a pickup in output towards previous levels. Elsewhere, the spread of the virus has come later and should be met with the same measures deployed in China. This means that the economic impact in economies affected could drag on into the second quarter, with recovery setting in by the summer. All in all, the pick-up in global output we expected in 2020 is likely to be postponed until the second half of the year, and then extend into 2021.

Bottom line. Our investment process is based on a number of factors which have demonstrated their dependability over time. We will always determine the course of asset allocation based on the prevailing economic regime, and the current valuation, momentum and sentiment signals. In recent months, the economic regime has fluctuated between growth and slowdown, both of which represent positive environments for risk assets. Should the virus worsen, and the macro-regime deteriorate from slowdown into recession, we would of course take action. We will continue to monitor the situation very carefully.

FIXED INCOME

Short-term uncertainty means tactical cautiousness on HY

As long as the spread of Covid-19 continues to gather pace, investors will remain nervous and wary of riskier assets. While we assume growth and markets will recover in due course, uncertainty is set to linger for now. In the near term, we expect rates to stay low and riskier credits (i.e., corporate bonds) to suffer. We therefore turn tactically more cautious on High Yield.

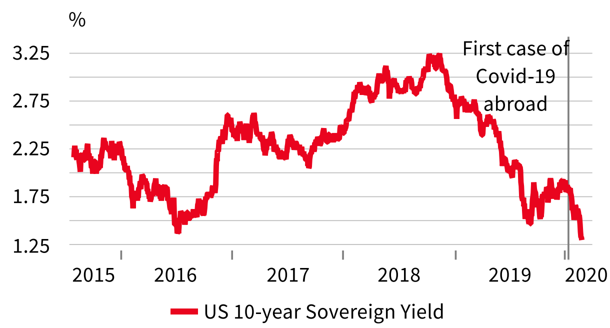
Sovereigns

US. Coronavirus outbreak worries have pushed US sovereign yields down to fresh lows, more than reversing the rebound which easing trade tensions and better political visibility had sparked since last summer. Until the epidemic wanes, it is unlikely we will see higher US sovereign yields, as investors will keep hoarding safe assets. Investor expectations for lower policy rates have also increased in recent days for the same reason. Although there is little fundamental reason to ease monetary policy today, we expect the Fed to be on high alert in case measures to stem the spread of the virus look like jeopardising their current projections for inflation and jobs.

Eurozone. While German yields are not yet back at their historic lows, the upward swing since last summer has been reversed by spreading coronavirus fears. In the near term, safe-haven flows should keep yields low but once the epidemic begins to come under control, we would expect rates to move higher again. Like in the US, the ECB is likely to hold its course for now and would only turn more accommodative if the epidemic worsens. Peripheral bonds should remain under pressure in the near term given heightened risk aversion and the virus containment measures in Italy, where growth prospects were already weak. By year-end however, we expect the mix of ECB purchases and low political risk to spark renewed appetite for peripheral bonds.

UK. The budget stimulus promised by the new Chancellor is not likely to drive rates higher – spending will likely be focused on infrastructure, which will take time to boost growth. On the contrary, the BoE should keep a dovish bias as uncertainty mounts around EU-UK trade agreement talks. However, with long-dated yields (at 0.47%) already well below base rates, we continue to prefer short maturities.

Covid-19 fears have pushed US yields to record low



Source: SGPB, Bloomberg, 28/02/2020

Credit

US. Credit spreads have started to widen again on investors' coronavirus fears. Moreover, as highlighted last month, underlying issuer fundamentals have deteriorated, especially for those with the weakest ratings. The trend in ratings (i.e. the ratio of upgrades to downgrades) remains negative, and a high proportion of Investment Grade (IG) issuers are only one notch above a speculative rating. The context warrants cautiousness and we suggest further trimming High Yield (HY) exposure.

Eurozone. From a fundamental perspective, the situation is better in Europe – funding rates are lower and the ECB provides significant support as a large buyer of corporate bonds. However, credit spreads for the weakest issuers remain vulnerable in the near term given the current risk-off environment. We propose a tactical shift in HY exposure to Neutral – better opportunities will emerge once the current bout of volatility is over.

UK. Sterling corporate bonds are likely to remain correlated to their USD and EUR peers. However, UK-EU trade talks are about to start and will merit close attention given the divergent stances on level playing field requirements.

Emerging Market (EM) debt

The continued slowing of new confirmed Covid-19 cases in China is reassuring and companies are gradually trying to restart production. Fundamentally, we see no change in the ability of EM debt markets to deliver positive returns, but of course much will depend on the length and depth of the current epidemic and its impact on global economic activity. For the moment we keep an Overweight view.

EQUITIES

Wuhan whiplash

The coronavirus epidemic has continued to depress market sentiment, especially once international contagion began to accelerate in the second half of February. China, long the epicentre of the epidemic, has seen more encouraging trends in recent days, with new cases slowing and factories ramping up output. Once the global outbreak begins to come under control, we expect markets to begin to recover.

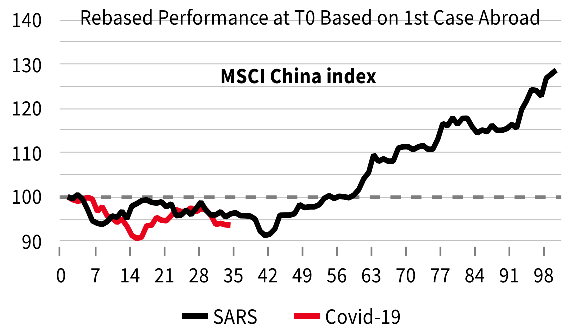
US. US equities have followed global markets lower as coronavirus contagion spread beyond China's borders, shedding around 12% from recent all-time highs. Such sell-offs are quite normal – in an average year, US stocks are likely to fall 5% on three occasions and once by 10% or more (data from 1949 to 2018). Moreover, equities had risen 44% since late 2018, leaving them vulnerable to selling pressure. During previous corrections sparked by virus scares, the sell-off tended to be intense but short-lived, followed by a recovery once the epidemic began to wane.

In our recent House Views reports, we have suggested a focus on defensive plays in US equities, such as the "Dividend Aristocrats", companies which have demonstrated the ability to grow their dividends consistently over time. In terms of sectors, the sharp slowdown we expect in the near term argues for continuing to avoid more cyclically-sensitive areas like Materials, Industrials or Consumer Discretionary.

Eurozone. Euro zone bourses have not been immune to the selling pressure, down 11% from recent highs. The coronavirus fears have overwhelmed both the improvement in various measures of business and consumer confidence and the pick-up in consensus expectations for 2020 earnings growth, up to 11% from 9.9% last month. We expect these forecasts to be revised lower, given the slowdown in global and regional growth we anticipate in the first part of this year, delaying the pick-up in earnings to the second half and 2021.

This change to the near-term growth outlook means that cyclically-sensitive sectors – which we have highlighted in recent months – are likely to face headwinds for now. Healthcare, a more defensive area, looks relatively attractive – valuations are only at a modest premium to the median over the last ten years while earnings forecasts have been ticking higher over the past 3 months.

In 2003, Chinese equities recovered quickly



Source: SGPB, Macrobond, 28/02/2020

UK. UK equities face cross-currents. On one hand, business and household confidence surveys have been bolstered by December's decisive election result, the ensuing clarity that Brexit would go ahead and the new government's fiscal stimulus plans. On the other, trade negotiations with the EU are likely to be extremely tense while the UK's relatively high exposure to Energy and Materials may penalise sentiment during the coronavirus epidemic. As elsewhere, recovery should follow and we remain Neutral.

Switzerland. As highlighted in February, the Swiss franc continues to attract safe-haven inflows, raising fears that international earnings might be penalised. Nonetheless, Swiss equities have proved somewhat more resilient than other markets, no doubt helped by their heavy exposure to high-quality global leaders in sectors like Consumer Staples and Healthcare. We suggest a Neutral stance for now.

Japan. The Japanese economy may well face an unwelcome recession – Q4 2019 saw GDP drop sharply in the wake of October's consumption tax hike while this quarter will be hit hard by the coronavirus-induced slump in Chinese demand. Moreover, this summer's Tokyo Olympics may be postponed on virus containment grounds, delaying the hoped-for boost to tourism revenues. Nonetheless, Japanese equities have some appeal – valuations look relatively attractive, earnings are set to recover after two years of falling profits and the market boasts a solid 2.4% dividend yield.

Emerging Markets. The gradual decline in new confirmed cases of Wuhan flu has encouraged Chinese authorities to ease travel restrictions and to permit factories to reopen, albeit at reduced capacity for now. This suggests that activity should start to pick-up in Q2 after a sharp drop in the first quarter. As a result, Chinese equities have demonstrated some resilience during the recent setback in developed markets. Moreover, emerging equity markets have underperformed developed-world bourses over the past decade and valuations now look attractive in comparison.

CURRENCIES

Dominated by safe-haven flows

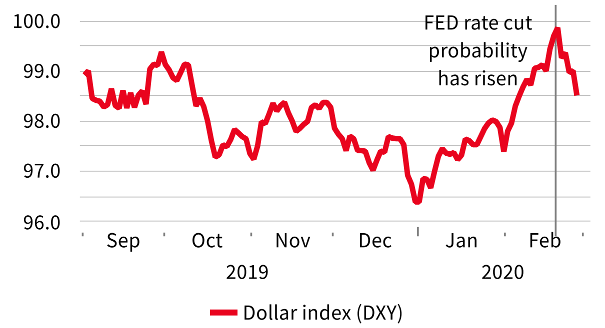
For now, the coronavirus epidemic is likely to dominate currency trading, with safe havens like the Swiss franc close to multi-year highs. Exchange rates are only likely to revert in line with fundamentals once the crisis is perceived as having come under control.

Dollar Index. The dollar has strengthened across the board for much of this year as virus concerns drove safe-haven flows – the US was perceived as relatively immune to the spread of the epidemic and US financial assets boast a deep pool of liquidity. In recent days however, the rise of confirmed cases internationally has prompted a reassessment of this view, pushing the dollar index lower again. Moreover, rising expectations of Fed rate cuts have served to weaken the perceived yield advantage of the dollar over other currencies. As the epidemic comes under control, we expect the dollar to trade lower later this year.

EUR/USD. Measures to contain the recent virus outbreak like those implemented in Italy are likely to slow European economies as we head into the second quarter of the year. However, we do not expect ECB to cut rates, but rather to use its other tools – asset purchases, refinancing operations and so on – to ease policy if necessary. The euro remains attractively valued against the dollar on a purchasing power parity basis and the zone's modest budget deficit and healthy balance of payments surplus stand in stark contrast to the sizeable twin deficits in the US. All in all, we expect modest upside in EUR/USD by year-end.

GBP/USD. Ever since the spectre of a "no-deal" exit from the EU faded last September, sterling has traded in a narrow band between $1.28 and $1.32, apart from a brief spike to $1.35 after the December election. Looking forward, GBP/USD is likely to remain volatile. On one hand, the government's fiscal stimulus plans should bolster medium-term growth prospects. On the other, trade negotiations with the EU and the US are likely to prove extremely difficult, raising renewed fears of a cliff-edge Brexit at year-end. Once it becomes clear that such fears are overblown, we expect sterling to rally back above $1.35.

Covid-19 spreading abroad has pushed the dollar lower



Source: SGPB, Macrobond, 28/02/2020

USD/JPY. Over the past two years, USD/JPY has traded sideways between ¥108 and ¥112 for much of the time. On one side, safe-haven flows often bolster the yen. On the other, weak economic data – such as the Q4 GDP report in mid-February which came in well below expectations on the back of October's consumption-tax hike – can penalise the currency. All in all, these factors should continue to keep USD/JPY range-bound this year.

EUR/CHF. The Swiss franc has strengthened since November when the Swiss National Bank (SNB) decided not to mimic the ECB's latest cut in deposit rates. More recently, it has gained momentum as safe-haven inflows have not been met with Swiss National Bank (SNB) purchase of foreign currencies. We expect the SNB to remain on the sidelines in the face of such inflows for now and would only expect an intervention if the Swiss economy shows sustained signs of weakness.

EM currencies. The coronavirus epidemic has pushed the dollar to all-time highs against emerging market (EM) currencies. Many EM central banks have taken advantage of falling inflation levels to ease policy, with others cutting rates to mitigate the impact of outbreaks of the virus, thereby reducing their yield advantage over the dollar. At current levels, EM currencies look undervalued and oversold. However, a recovery is unlikely before the epidemic comes under control and safe-haven buying of the dollar peters out.

USD/CNY. The yuan has fluctuated in a tight band around the 7-mark versus the US dollar since the return from the lunar new year holiday, well below the levels reached after the "phase one" trade deal with the US was signed in mid-January. This weakness reflects the negative impact on Chinese growth due to the prolonged shutdown, in addition to safe-haven buying of the greenback. With Chinese factories beginning to ramp up output, we would expect the yuan to strengthen back below 7 by the second quarter.

ALTERNATIVES

Rally potential in crude prices

Oil prices should recover by year-end and we suggest moving Overweight. Gold should continue to provide useful safe-haven benefits. Within hedge funds, Fixed Income Arbitrage should benefit from the bull run in rates while Event Driven is set to recover once the Wuhan flu scare abates.

Commodities

Oil

The coronavirus epidemic has continued to push oil prices lower – a combination of travel restrictions, temporary factory closures and slower growth have led specialists to slash their forecasts for 2020 demand growth. The International Energy Association has already cut its forecast from 1.2 million barrels per day (mb/d) to 825,000 mb/d and further cuts are likely. Moreover, US crude output remains at 13.0 mb/d, the highest level on record.

However, OPEC has called a meeting in early March with its allies, such as Russia, to discuss further production cuts. At present, the group – known as OPEC+ – has curbed output by 2.1 mb/d with a further 1.0 mb/d planned in an attempt to bring the market back into balance. Furthermore, with China beginning to reopen factories, we expect demand to recover to previous levels by the second half of the year.

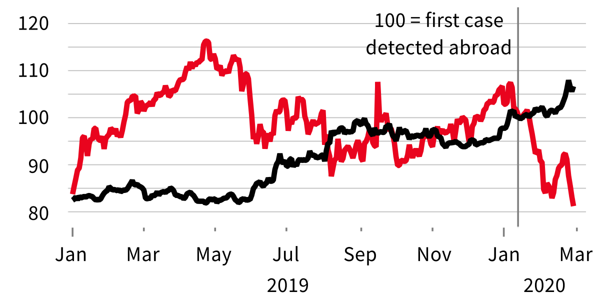
All in all, we see Brent prices back in a $60 and $70 per barrel range by year-end and suggest moving Overweight.

Gold

As worries about the global spread of Wuhan flu have skyrocketed, so has the gold price, again demonstrating bullion's value as a diversifier within balanced portfolios. Gold recently touched a 7-year high at $1659 per ounce, up from $1517 at year-end, as investors sought safe havens.

As a result, inflows to gold ETFs have remained strong, triggering purchases of almost 100 tonnes (t) in addition to the 400t bought last year. In addition, central bank purchases represented 16.3% of aggregate demand last year, up from an average 12% in the previous five years, as the emerging world seeks to diversify its reserves away from the US dollar. In Russia for example, the central bank's gold holding now amount to 19.9% of total reserves, just behind the 23.6% held in dollars.

Gold price still has room to climb amid Covid-19



Source: SGPB, Macrobond, 28/02/2020

As the number of new coronavirus cases in China has begun to slow, gold prices have slipped below recent highs. Nonetheless, output growth from gold mines will be negligible this year while demand from investors and central banks remains robust – we maintain our Overweight view.

Hedge funds

Long/Short (L/S) Equity

The rapid sell-off in global equity markets in recent weeks presents a challenge for L/S Equity managers – who tend to focus on corporate fundamentals – given its indiscriminate nature. However, their portfolios are of course systematically hedged with short positions, providing welcome downside protection in the current environment. We remain Neutral.

Event Driven

For now, corporate expansion plans via mergers and acquisitions are likely to go on hold, reducing deal flow for Merger Arbitrage specialists. Special Situations funds – which specialise in corporate transactions such as spin-offs – are more sensitive to market direction, leaving them vulnerable to sell-offs. However, both strategies should recover once the epidemic begins to come under control.

Fixed Income Arbitrage

As government bond yields have plumbed new depths in recent weeks, corporate bond spreads have widened as investors have begun to anticipate the risk of credit quality impairment for some highly-leveraged issuers. This environment should play to the strengths of L/S Credit managers while Fixed Income Arbitrage should benefit from the bull market in rates.

Global Macro / CTAs

The swift reversal in equity markets from February's all-time highs may prove challenging for trend-following managers (known as CTAs). However, the accompanying extension to the bull market in government bonds is likely to have provided some offset. The coronavirus outbreak creates an atypical risk environment for Global Macro funds and we suggest staying Neutral.

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