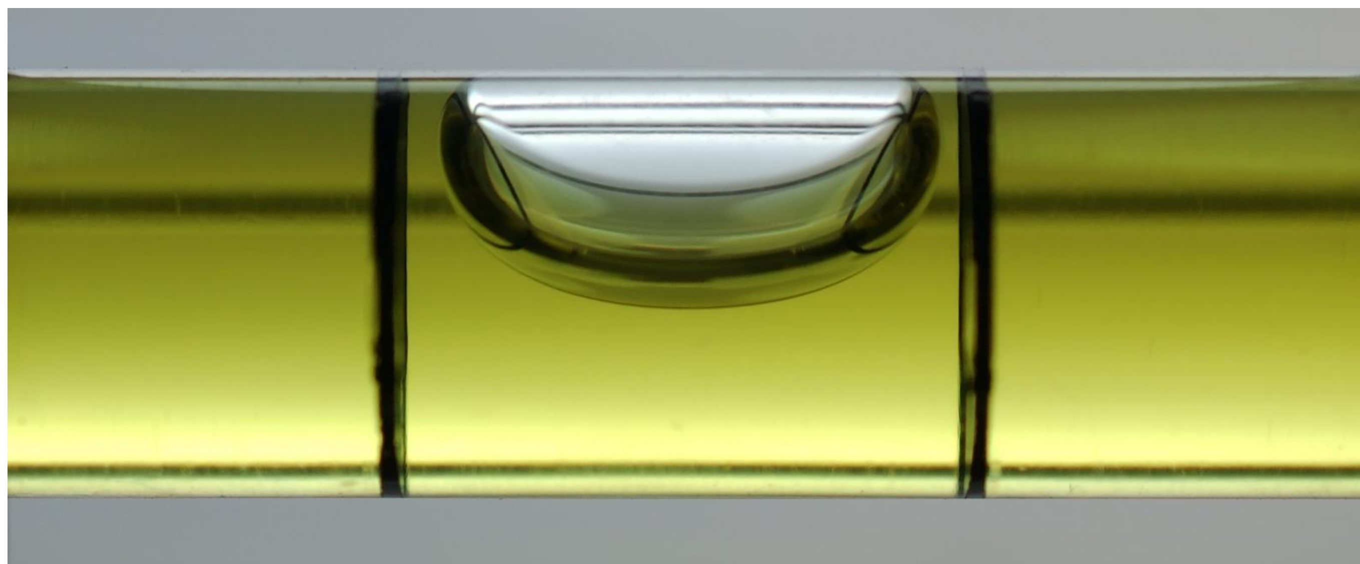
Monthly House Views



In balance

The drivers for continued global growth remain in place, thanks to robust consumer spending and a pick-up in business investment. The US has clearly received a short-term boost from tax cuts and has yet to see any fallout from the deterioration in the budget deficit. Although trade worries have emerged, the eurozone should grow above potential in 2018, while Brexit concerns have slowed foreign direct investments into the UK. China has eased policy settings to mitigate the impact of the trade war.

Inflationary pressures continue to build gradually. In the US, the central bank's preferred measure of price pressures was just below its 2% target in June, but wage rises and import tariffs should continue to push inflation higher. In the eurozone, underlying consumer price inflation reached a high for the year in July at 1.1% but the central bank remains confident that its target can be reached. A number of weaker emerging economies – e.g., Argentina or Turkey – continue to battle runaway price rises.

Recent statements to Congress suggest the Federal Reserve (Fed) is confident that it can proceed with two further hikes this year and four more next, while continuing to shrink its asset holdings. The European Central Bank (ECB) has set out its timetable for halting asset purchases – end-2018 – and for an initial rate hike – summer 2019. The Bank of Japan has eased its cap on 10-year yields – a modest boost to bank margins – but still holds the line on extremely easy policy settings.

The opposing forces in markets should cancel each other out. On one hand, trade concerns, the new Italian government and tensions with Iran will give investors pause. On the other, global growth is strengthening, corporate profits are rising at double-digit rates and valuations are less stretched than at the start of the year. Negligible or negative real yields on government bonds suggest a defensive stance remains appropriate. In all, markets should maintain a fragile balance.

More details inside...

2 to 3 – Our views summarized

4 to 7 – The longer read

In accordance with the applicable regulation, we inform the reader that this material is qualified as a marketing document.

Our views summarized

EQUITIES	BONDS	ALTERN.

Here, we present our VaMoS investment approach, combining economic, valuation, momentum and sentiment signals that help us fine-tune our views on asset classes for the coming period. The signals below reflect the latest conclusions of our Global Investment Committee. Here's how to read them:

Least preferred   Neutral   Most preferred   Upgrades in green, downgrades in red

EQUITIES		VA Valuation	VA Fundam.	VA Macro.	MO Momentum	MO Technicals	S Sentiment	S Risk
United States								
Eurozone								
UK								
Switzerland								
Japan								
Emerging								

BONDS – EUR	Global	VA	MO	S
Sovereign				
Inflation-linked				
Inv. Grade				
HY				
*Duration**	Short			

BONDS – USD	Global	VA	MO	S
Sovereign				
Inflation-linked				
Inv. Grade				
HY				
*Duration**	Short			

BONDS – GBP	Global	VA	MO	S
Sovereign				
Inflation-linked				
Inv. Grade				
HY				
*Duration**	Medium			

CURRENCIES	
EUR/USD	
GBP/USD	
USD/JPY	
EUR/CHF	
Emerging vs USD	

ALTERNATIVES	
Hedge funds	
Gold	
Oil	

Source: SG Private Banking, 03/08/2018, * Duration: short = 3 to 5 years, medium = 5 to 7 years, long = 7 to 10 years. HY = High Yield bonds (higher return but greater risks), Inv. Grade = Investment Grade bonds (higher quality but lower return)

In other words

Asset class	Category	View
EQUITIES*	United States	US equities will remain supported by strong corporate profit growth while the Fed will continue to hike rates only gradually. Political uncertainty remains elevated.
	Europe	Uncertainties about trade and European politics – notably Brexit – will remain a concern in coming months.
	Eurozone	The short-term outlook has brightened. After a soft H1, we expect growth to stabilise in coming months which, combined with a weaker euro, will support corporate profits. However, the market is cyclically-sensitive and may be penalised by softness in manufacturing and global trade concerns, warranting a Neutral stance.
	UK	Corporate profits are expected to firm on the back of high oil prices and weak sterling. However, we remain Neutral due to lingering uncertainties about Brexit negotiations.
	Switzerland	We stay Neutral as the market's bias toward high quality defensive stocks could prove useful if risk aversion returns.
	Japan	Softer global manufacturing activity and trade tensions have prompted analysts to slash earnings expectations. Moreover, last year's uncoupling from the yen did not last – a spike in the yen on a bout of risk aversion would be a negative for the equity market.
	Emerging	US-China trade disputes, higher global rates, strong dollar and slowing earnings growth are headwinds for emerging markets. Recent monetary and fiscal policy easing in China is supportive for this attractively valued market, but we prefer to keep a cautious stance for now as uncertainties around trade tensions remain high.
BONDS*	Sovereigns	The uptrend in yields has resumed and there may be more to come, which warrants a defensive stance in the US and Eurozone. Political risks may shake sovereign bonds in the euro zone periphery in the run-up to Italy's 2019 budget, calling for prudence.
	Duration**	With yields in EUR and USD set to rise, we still favour short duration. However, we expect GBP yields to increase less than in the US or core euro zone – Brexit negotiations could degenerate putting Bank of England tightening back on hold and so we suggest adding more duration in UK gilts.
	Inflation-linked	Inflation-linked bonds offer protection to bond investors.
	Investment Grade	We still prefer US Investment Grade to High Yield given the latter's weaker balance sheets and lower protection from covenants.
	High Yield	Euro zone high yield remains attractive from valuation and a carry perspective but high leverage in the US warrants a more defensive approach.
	Emerging debt (in € and $)	Rising US rates are draining liquidity from emerging debt markets.
CURRENCIES	EUR/USD	Range-bound trading as we see limited upside for the USD and supportive factors for a cheap euro.
	GBP/USD	We keep a neutral view on sterling – the recent slump looks overdone but Brexit uncertainty is set to linger.
	EUR/GBP	We expect directionless trading as both currencies should inch higher against the dollar.
	USD/JPY	Higher hedging costs and foreign capital repatriation could underpin the yen. We remain Neutral.
	EUR/CHF	The SNB is likely to remain even more dovish than the ECB – we still expect a gradual slide in the CHF as we see less safe-haven buying.
	Emerging	Emerging currencies have dropped but we see limited further downside as long as the trade war doesn't escalate.
ALTERNAT.	Hedge funds	Range-trading is challenging for macro traders but, with strong corporate earnings better recognised by investors, the backdrop for Equity Long/Short and Event Driven strategies is supportive.
	Gold	Demand for gold continues to slump but gold retains safe-haven characteristics – expect sideways trading.
	Oil	OPEC's supply increase and rising US output have pushed the market into oversupply and oil prices lower.

Source: SG Private Banking, 03/08/2018, EM = Emerging markets, hard currency = dollar & euro, *Relative views expressed in local currencies, ** Duration: short = 3-5yr, medium = 5-7yr, long = 7-10y

Economic focus

What would trade war do to growth?

- At first, tariffs could dampen activity but not derail growth.
- However, investors should beware possible second-round effects.
- Although escalation cannot be ruled out, we do not expect a full-blown trade war.

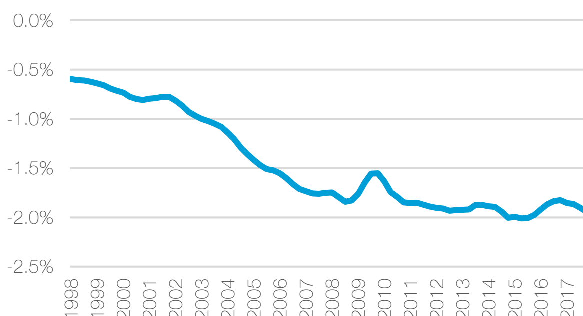
- As promised, President Trump has embarked on a war against major trade partners, hoping protectionism could help narrow the trade deficit, rejuvenate US industry and fight the Chinese high-tech boom.
- However, China will not remain passive and has weapons to retaliate. For example, it could draw closer to the EU to promote global free trade, stop upholding detente in the US-North Korea nuclear debate, devalue its currency sharply or restrict US investment in China.
- Neither country can afford a full-blown trade war but after the recent escalation both governments will be hard pressed to find a face-saving deal.

Bad news for growth?

- The measures' economic impact will depend on their scale, length, extent (number of targeted countries) and form (tariffs, restrictions on foreign direct investments, controls to cross-border mergers and acquisitions).
- Economic models suggest that, in our best case, tariffs would reduce Chinese GDP growth by 0.1-0.2 percentage points (pp) the first year. An intermediate scenario would likely trim growth by 0.3 to 0.4pp. In the worst case – i.e. a full-blown trade war – the hit would reach 0.8-1pp.

USA show a large trade deficit with China

US trade balance with China ($, % GDP)



Sources: SGPB, Bloomberg, Datastream, Q1 2018

- Since its economy is about half as open as China, the direct economic impact on the US could be about half China's or -0.1pp, -0.2pp and -0.5pp respectively. However, this does not take into account the financial feedback loop effect (uncertainty, risk premia, wealth effect…).
- Using a dynamic general equilibrium model, Banque de France economists found that a 10pp increase in world tariffs would reduce global GDP by 1pp after two years. However, there could also be second-round effects:

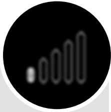
1. Higher import costs. Firms unable to find substitutes to Chinese imports would see production costs rise.
2. Lower global demand. Higher global tariffs mean weaker US exports, only partially offset by lower imports, and slower growth.
3. Rising growth uncertainty. This would likely prompt consumers and businesses to delay spending.
4. Tighter financial conditions. Uncertainty and higher tariffs would weigh on investor sentiment, pushing risk premia and financing costs higher.
5. Disruptions to global supply chains. As trade openness goes into reverse, manufacturers relying heavily on low-cost countries (e.g. China, Mexico…) would need to relocate – which would take time.
6. Lower productivity growth. Productivity growth has been boosted by open trade and foreign direct investment flows. Dismantling global supply chains would put this in reverse.

- The cumulative impact of these second-round effects would see global GDP growth fall 3pp after 2 years – a much more significant move.

Bottom line

- Although escalation cannot be ruled out, we deem a full-blown trade war rather unlikely. Still, lingering trade tensions and tariffs are set to weigh on business and investor sentiment, and hence on investment and growth.

Fixed Income



The risk remains higher rates

- Yields are back on the rise. We still recommend short duration in the US and eurozone and favour inflation-linkers.
- Italian politics could again be a concern this autumn. Prefer Spanish bonds among peripherals.
- Economic divergence between the US and the eurozone is reflected in credit spreads. In the US, we prefer Investment Grade (IG) to High Yield (HY) bonds, which are more expensive and more sensitive to risk aversion. In the eurozone, we expect HY to outperform IG as credit conditions ease further.
- We still like floating-rate notes – they are a good hedge against rising rates and help reduce portfolio duration.

Rates

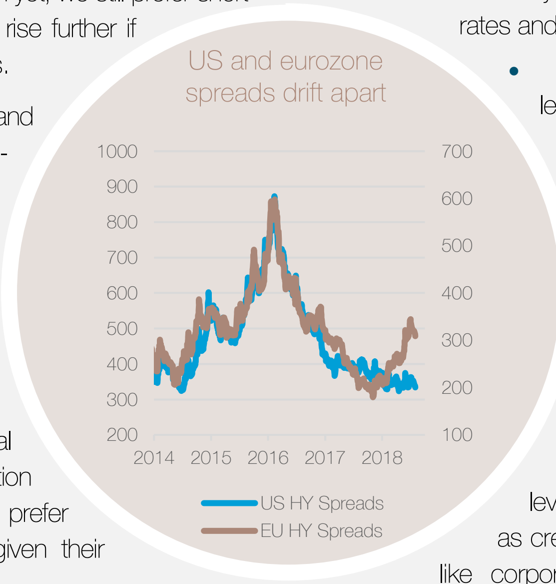
Bond yields on the rise

- United States. Market participants are eager to know if the ongoing trade war will encourage the Federal Open Market Committee (FOMC) to reconsider its appraisal of risks in September. We still expect two rate hikes this year – in September and December. The 10-year yield could rise from 3.00% now to around 3.25% by late 2018 in response to strong growth and a further rise in inflation. However, trade war escalation may cap long-term yields. The yield curve remains flat and, given we expect no inversion yet, we still prefer short maturities. Inflation breakevens may rise further if price pressures exceed expectations.
- Eurozone. Easing political concerns and stronger inflation have pushed 10-year German Bund yields up from 0.29% to 0.45%. We expect 10-year Bund yields to rise to 0.70% by year-end. The yield spread between Italy and Germany narrowed to 210bp in mid-July but has since widened again to 255bp. Italy is likely to see renewed political tension this autumn with the preparation of the 2019 budget and so we prefer Spanish bonds to Italian bonds, given their lower risk.
- United Kingdom. The 10-year Gilt yield has been stuck in a tight 35bp range (1.20-1.55%) since the beginning of the year. Brexit uncertainty will disrupt the economy, encouraging the Bank of England to stay accommodative a little longer. In the near term, UK yields seem to offer less upside than in the US or even the core eurozone. We prefer to move to longer maturities in the 7-10y sector in sovereign bond space.

Credit

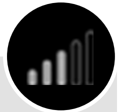
Divergence between US and eurozone spreads

- United States. Corporate yield spreads have narrowed as solid economic and profit growth kept default rates stable. High Yield (HY) is expensive compared to Investment Grade (IG) and the spread between the two bond segments is trading close to its lows. We still prefer IG to HY bonds, which are more sensitive to risk aversion and more correlated to equities. We still favour short maturities, expecting further rate hikes in the US. We also like floating-rate notes as they offer a good hedge against rising rates and help reduce portfolio risk.
- Eurozone. Credit spreads are less attractive than earlier this year because of lingering political uncertainty and softer economic momentum. HY spreads have widened more than IG year-to-date, leading to underperformance. However, the market is supported by healthy corporate balance sheets, the ongoing recovery and ECB asset purchases. At current levels, we expect HY to outperform IG as credit conditions ease further. We still like corporate hybrids bond and selected floating-rate notes, which offer appealing carry ahead of ECB rate hikes next year.



Sources: SGPB, Bloomberg, 03/08/2018. Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

Equities



Cautiously optimistic on global equities

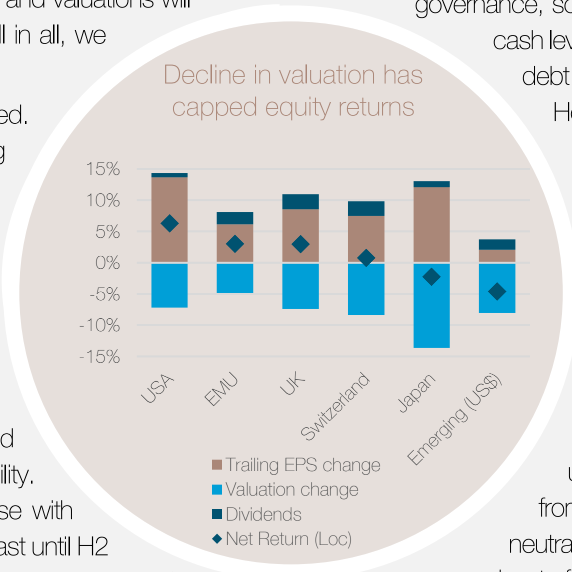
- Rate hikes and political uncertainties (trade war, Brexit, Italy) are likely to weigh on valuations in coming months.
- However, robust economic activity and easy funding in the G4 will keep corporate profit growth strong.
- Overall, we stay neutral given the downside risks.

Still neutral on global equities

Slight overweight on US equities on the back of strong profit growth

Keep a cautious stance on Emerging equities despite recent China policy easing

- USA. US equities should gain further ground in coming months. Corporate profit growth will be boosted by solid economic expansion, tax cuts, strong growth in top-line revenues and high margins. Furthermore, the rise in US interest rates remains too gradual for financial conditions to turn restrictive yet and recession is still a remote risk. However, the tax boost is now behind us and we could see higher wages and input prices weigh on margins in coming quarters. Also, political uncertainty may persist and valuations will remain pressured by higher rates. All in all, we keep a slight over-exposure.
- Eurozone. The outlook has brightened. Growth should stabilise in coming months after a soft H1. The US-EU trade deal has also reduced risks for eurozone firms, especially in the auto sector. Euro weakness should lead to further upgrades to corporate earnings forecasts. European firms have reduced their leverage since the financial crisis and increased their margins and profitability. Financing conditions will remain loose with the ECB policy accommodative at least until H2 2019. However, low rates for long is bad news for financials, the largest EuroStoxx sector (18.7%). In addition, the market is cyclically-sensitive and may be penalised by softness in manufacturing, lingering trade tensions and European political uncertainty in coming months. All in all, we stay neutral.
- Switzerland. Despite high valuation, downward revisions to earnings-per-share forecasts and expectations for slower profit growth, we stay neutral as the market's bias toward high-quality defensive stocks could prove useful if risk aversion returns.



- UK. Corporate profit growth is expected to firm on the back of high oil prices and weak sterling, two key supportive factors – large cap UK stocks generate around 70% of revenues abroad and 25% of the FTSE 100 is sensitive to energy. However, we remain neutral due to persistent Brexit uncertainty.
- Japan. In the long term, Japanese equities should benefit from structural economic reforms, improved corporate governance, sound corporate fundamentals (high cash levels, improved return-on-equity, low debt leverage) and attractive valuations. However, Japan is a cyclical market and sensitive to global trade and the yen. Softer global manufacturing activity and trade tensions have prompted analysts to slash EPS growth forecasts for the Topix. The IBES consensus is now for 4.1% this year and 9% next, after +22% last year. Moreover, last year's uncoupling of Tokyo stock markets from the yen did not last. We remain neutral USD/JPY but a spike in the yen on a bout of risk aversion would be negative for Japanese equities. All in all, we keep a neutral stance.
- Emerging markets. US-China trade disputes, higher global rates, strong dollar and slower profits growth remain headwinds for Emerging markets. Although Emerging equities could benefit from recent China efforts to fight the economic slowdown and from a weaker dollar in coming months, we would stay cautious for now – valuations are attractive but trade tensions will persist.

Sources: SGPB, Datastream, 03/08/2018, YTD 2018 performance decomposition, MSCI indices in local currencies. Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

Currencies

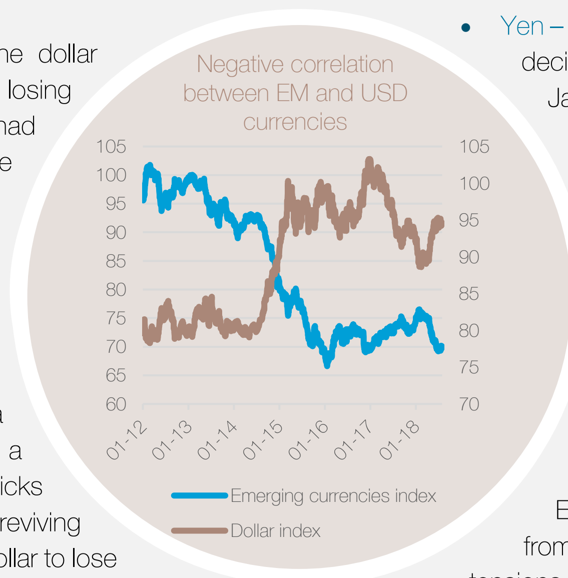
Trade war concerns hold sway

- Dollar rally is over.
- Euro to remain range-bound.
- Brexit uncertainty still key for sterling.
- Trade war to keep emerging currencies under pressure.

Euro stuck in a range

Political uncertainty takes centre stage

- Euro – Softer momentum. Political concerns, softer growth and cautious ECB talk have weighed on the euro. In the short run, we expect EUR/USD to stay range-bound with the dollar still underpinned by strong growth and a favourable yield gap versus the eurozone. Thereafter, the euro should recover gradually as investors stop trimming their long positions. Another source of support will be the recent batch of stronger-than-expected eurozone indicators.
- Dollar – short-lived recovery. The dollar bounce from last April is losing momentum – the market had become overly optimistic. In the near term, trade war escalation may benefit the dollar and weigh on emerging currencies. However, this is not our central scenario. Although the wide yield gap against other major currencies is still a support, a flatter yield curve will act as a headwind. Also, if US inflation picks up, risky assets could struggle, reviving volatility. All in all, we expect the dollar to lose ground in coming months.
- Sterling – Brexit risks. Since its 2017 surge, sterling has trended downwards, weakened by faltering growth, policy inertia at the Bank of England – until the early August hike – and the inability to strike a deal with the European Union. We stay neutral GBP/USD but expect a slight bounce from current oversold levels.



Trade war weighs on emerging currencies

Upside risks to the yen

- Swiss franc – resilience. Cautious ECB talk and revived political concerns in Italy have underpinned the franc. The Swiss central bank thinks its currency overvalued and will fight this appreciation. However, significant franc weakness would require a more bullish ECB stance and greater stability in Italy. The 1.20 EUR/CHF mark used as a floor by the central bank until January 2015 will remain a key resistance level.
- Yen – upside risks. The Bank of Japan's decision to raise the yield target for Japanese government bonds is likely to encourage domestic investors to stay at home rather than chasing returns overseas. However, monetary policy will remain ultra-loose with inflation failing to pick up. We stay neutral although risks are clearly to the upside.
- Emerging currencies – impacted by the trade war. Emerging currencies have suffered from the rise in US rates and trade tensions. Some countries have had to raise interest rates to fight inflation and capital outflows. The yuan has tumbled, in both political and economic riposte to US tariffs. However, the emerging currency index seems to have bottomed out, after falling steadily between March and July. Emerging currencies are cheap and remain supported by strong fundamentals and good growth prospects. However, trade war escalation has left investors wary and we believe it is too early to buy.

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Alternatives

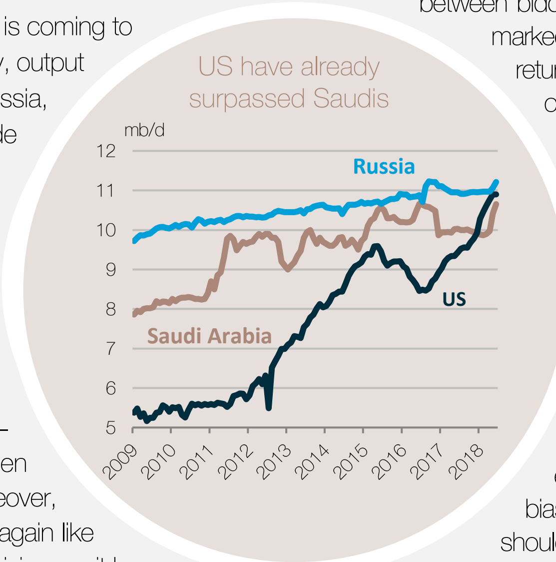
Diversification benefits

- Rising global oil output has pushed the market back into oversupply and we expect prices to ease lower.
- Rising rates and USD – a difficult environment for gold which should remain range-bound over the next 12 months.
- Markets remain below their January highs, despite strong corporate confidence and earnings. We prefer Event Driven funds to Long/Short strategies.
- The environment of rising rates and modest spread-widening is complicated for Credit and Distressed Debt funds. Range-trading likewise for Global Macro and CTAs.

Commodities

The US will surpass Russia as the world's largest producer of crude oil

- Crude oil. In July, Brent posted its largest monthly decline since 2016, down 6.5% to below $75 per barrel. This followed the late June summit when the Organisation of Petroleum-Exporting Countries (OPEC) agreed with Russia and some other producers to boost output by 800k barrels per day (b/d) to reach their target. This agreement comes ahead of November's reimposition of sanctions on Iran by the US which will markedly reduce its role in global supply – Iran's output is up by around 800k b/d since sanctions were lifted in July 2015. Additional supply is coming to the market from the US – in mid-July, output hit 11.0 million b/d, very close to Russia, the world's largest producer of crude oil. The market has moved back into oversupply, which should see Brent prices ease lower – we expect $75 per barrel on average in coming months and $70 by next summer.
- Gold. Assets producing no income stream – such as the gold bullion – tend to struggle in times like today when real bond yields are rising. Moreover, assets which are priced in dollars – again like gold – tend to fall when the dollar is rising, as it has over the past 6 months. Against this unfavorable backdrop, prices have moved lower, from $1,350 in January to $1,225. In addition, gold output has risen steadily over the past decade, from 2.3 million metric tonnes in 2008 to 3.2 million last year, while demand has been sluggish (the latest data from the World Gold Council for H1 2018 was the weakest since 2009). All in all, these factors should keep the ounce range-trading, around our 6-month and 1-year projections of $1,250 and $1,225 respectively. This notwithstanding, we continue to value gold's qualities for portfolio diversification.



Hedge funds

We await more visible trends before upgrading Global Macro and CTAs

- Equity Long/Short. Stock prices have reacted in line with recent earnings announcements, in contrast to previous quarters. This plays to the strengths of Long/Short stock pickers and their ability to identify winners and losers, especially in Europe and the US. However, portfolios have been scaled back as trade tensions have escalated, meaning that managers would not fully benefit from any summer rally. Stay Neutral.
- Event Driven. In recent months, the spreads in takeover deals between bidders and their targets have tightened markedly, which tends to reduce expected returns in Merger Arbitrage. Yet, high corporate sentiment should keep the pipeline of new deals full. Although there are few new Special Situations, managers are happy with the potential value creation from current campaigns. Stay Overweight.
- Credit/Distressed Debt. The context of rising rates and modest widening of credit spreads is challenging for Credit managers, especially those with a directional bias. Funds with a deep-value approach should do better. As highlighted for several quarters now, robust global growth has reduced the opportunity set for Distressed Debt funds. Given our macro outlook, more patience is required. Stay Underweight.
- Global Macro/CTAs. Global Macro trends show great diversification potential, given the variety of themes and issues faced by global economies and markets. Managers specializing in Emerging Markets, who tend to run a long bias, will struggle as worries about trade, the dollar and rates will continue to bite. Most markets continue to range-trade, a difficult environment for CTAs. We await more visible trends before upgrading this segment.

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