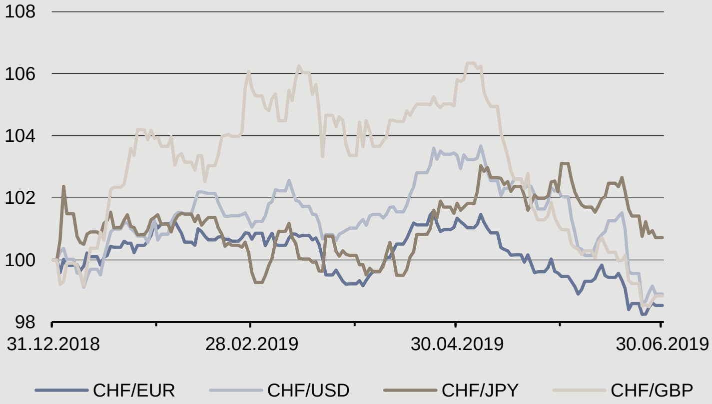
Half-yearly market report

30.06.2019

Central banks to the rescue

Announcements by key central banks indicating that they will support the economy with interest rates cuts, if needed, have made an impression on financial markets. Investor optimism has surged lately due to an easing of the US-China trade dispute. Even weak economic data are now considered positive because they increase the probability of further monetary policy measures. We have used rising equity and bond prices to selectively take profits and increase the defensive tilt in our portfolios. We see gold as an attractive alternative to cash. The risks to growth remain elevated, and it will likely take a great deal of patience until the hope for a fresh upswing becomes a reality towards the end of the year.

Exchange rates versus CHF (indexed since 31.12.2018)



Review: Hunt for yield continues

In recent weeks, equities have more than offset the sharp price declines suffered in May and, in some cases, equity indices have reached new record highs. Investors have taken heart, encouraged by the prospect of interest rate cuts by the US Federal Reserve and by hopes of progress in resolving the US-China trade dispute. The search for yield has intensified again in all asset classes. Equities as well as bonds recorded a pleasing performance in the first half of the year as a result of this.

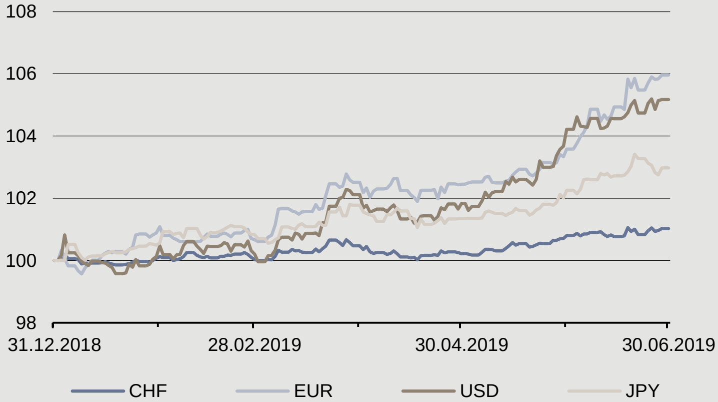
Macro: What comes after the record?

The USA has set a new growth record: in July, it entered its 11th consecutive year without economic recession. However, we need to put this in a global context. Other countries have avoided recession for a much longer period of time, such as Australia, which is now in its 28th straight year of economic growth. Between 1992 and 2008, the UK experienced a 17-year period without recession. Although business cycles do not die of old age, investors rightly question whether the cycle is coming to an end after so many years of growth. US economic growth remained robust in the first half of this year, but the latest leading indicators signal a significant weakening. The global economy already started to slow last year, and this weakening has now reached the US economy. Nevertheless, currently there is little evidence to suggest a recession is imminent. The trade dispute poses the biggest risk right now. The US president's erratic policy moves hang over investors' heads like the sword of Damocles because any escalation of the USA's trade dispute with China or an escalation of US-Iran tensions have the potential to usher in a global recession. But at least when it comes to the US-China trade conflict, the G20 summit meeting in Osaka between US President Donald Trump and China's Xi Jinping has helped to ease some concerns investors had. Details of the nego-tiated trade truce are, as usual, thin on the ground, but for now punitive tariffs will re-main in place, negotiations will resume and Huawei – China's flagship technology company – has regained access to American technology components. A sustained easing of trade war tensions would greatly improve the prospects for a continuation of the global business cycle and reacceleration of growth in 2020.

Bonds: US interest rate cuts ahead

Lately, global central banks have made every effort to signal that they are fully prepared to use further monetary policy measures. Mario Draghi, President of the European Central Bank (ECB), raised this issue in his speech last month at the ECB's annual Forum in Sintra, Portugal. Two years after Mario Draghi first laid out the blueprints for the ECB's interest rate normalization at the same ECB Forum in Sintra – when the Eurozone economy was recovering – Mr. Draghi has decided to leave this path. He stressed in this year's speech that additional stimulus would be needed if the economic outlook does not improve and inflation expectations do not increase. Also, he highlighted the possibility of reactivating the bond-buying program that ended two years ago. The US Federal Reserve (Fed) has also pledged that it will closely monitor economic developments and respond accordingly in order to sustain the economic expansion. According to Fed Chair Jerome Powell, measures that were considered unconventional monetary policy before the financial crisis have become part of the central bank's arsenal of traditional policy tools. This clear message opens the door to the first rate cut at the end of July. This is likely to be followed in September by interest rate cuts by the ECB and the Swiss National Bank.

Bond markets in local currency (indexed since 31.12.2018)



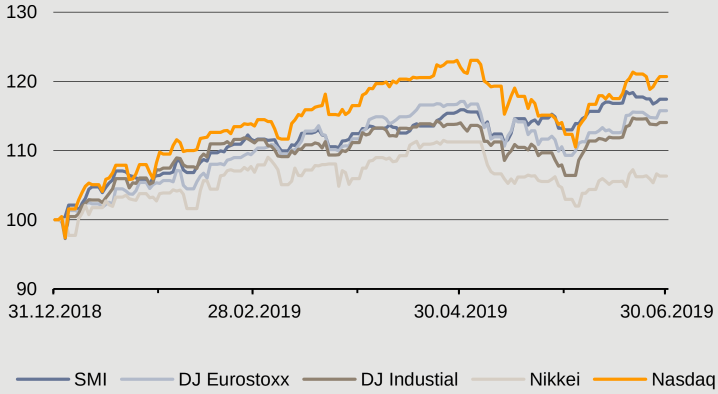
Last-minute panic in bond markets

Falling interest rate expectations across the globe have sparked strong demand for every type of bond. High-yield bonds have significantly profited from this situation. Credit spreads have decreased sharply and made a big contribution to annual performance. Capital gains are unlikely to continue, though coupon payments remain attractive, especially after the sharp drop in government bond yields. Emerging market bonds in local currencies have more return potential. The growth environment in emerging market regions is solid and is expected to improve in the second half of the year. Also, the US dollar could weaken further, and provide this asset class with another tailwind.

Equities: Cautious positioning

Investors were elated by the liquidity measures envisaged by global central banks and the deescalation of the trade policy dispute between the USA and China. The latter, in particular, has helped to improve market sentiment. However, the focus at index level should not override attention to detail. Cyclical index components indicate weaknesses. Banks, the transportation sector, as well as small and midcap stocks have not participated in the latest rally to the same extent as other areas. Despite the decline in several risk factors, investors remain cautious and as a consequence are defensively positioned. The economic cycle is the important factor. There are still too many signs that point to a continuing weakness in growth. This is likely to have an adverse effect on corporate earnings and on the outlook for companies in the upcoming reporting season. Upside potential in equity markets is limited in the absence of a clear turning point in leading indicators. This explains our cautious positioning.

Equity markets in local currency (indexed since 31.12.2018)



Asset Allocation: Defensive stance

The expected interest rate cuts have provided a strong tailwind for risky assets and should limit the risk of setbacks. Nevertheless, investors should keep in mind the adverse risk factors of another breakdown in the US-China trade talks and continuing weak growth in Europe and China. With this in mind, we believe the time has come for selective profit-taking. We have kept our position in high-quality bonds as a hedge against potential risks within a multi-asset portfolio. Gold has recently profited from the weaker US dollar and falling real interest rates, and now offers an attractive alternative to cash. The precious metal records a positive performance particularly in a late-cycle phase, and acts as a stable anchor for the portfolio in times of crisis.

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Overview of the investment groups

Traditional LPP life cycle	Equities bandwith	Strategic equities quota	Investment horizon
LPP Yield	10–20%	15%	min. 1 year
LPP Income	20–30%	25%	min. 5 years
LPP Growth	30–40%	35%	min. 10 years
LPP Future	40–50%	45%	min. 10 years
LPP Equities 80 – non-BVV2-compliant	50–95%	80%	min. 15 years

Sustainability LPP life cycle			
LPP Sustainability Income	10–35%	25%	min. 5 years
LPP Sustainability	25–50%	38%	min. 10 years