Investment Committee Meeting

September 2019

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Summary

Market Overview:

- Bonds and Equities have done quite well year to date despite trade war escalations; slowdown in global growth; Brexit uncertainty and endless tweets from President Trump
- We expect both bond and equity markets to generate lower returns with higher volatility in the next few quarters

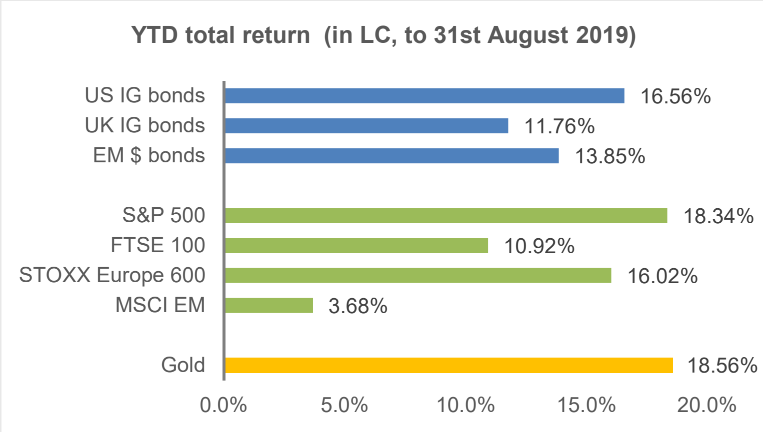
Positioning

- Overall, we are being defensive and aiming to take profit to lock in gains from the first part of the year where relevant
- Since we are in latter innings of an economic bull cycle, our equity positioning is defensive with focus on higher quality, secular growth and event names
- In the bond space, we continue to be underweight high yield and have increased our allocation to floating rate bonds

Market Update

Market performance

- **Equities:** Despite becoming more volatile predominantly as a result of worries about trade war escalations and potentially inadequate central bank policy response to a macroeconomic slowdown, equity market performance in most developed market regions remains strong YTD.
- **Bonds:** Bond yields across the curve have declined rapidly both in the US and Europe and are now at multi year lows. Following a 25bps benchmark rate cut by the Fed, the first cut in a decade, market participants focus on the next central bank policy move at the end of 2019 (expected to cut by another 50bps).
- **Commodities:** Gold continues to be in favour, advancing close to 19% YTD, on the back of global recession fears.
- **Currencies:** Continuous Brexit uncertainty keeps fuelling GBP volatility, while Fed actions have an ongoing impact on USD.



Key risks to watch

- The market has been experiencing more volatility throughout August on the back of President Trump's continuous exchange with China on higher and potentially more widespread tariffs
- Apart from trade war escalations, other key risks we are observing closely include: slowdown in global growth, central bank policy mistake and geopolitical risks

Key factor	Risk
Macro risks	Deteriorating global growth driven particularly by the US and Chinese economies
Trade war	Further tariffs imposed by the US/China/EU de-stabilising the already fragile global economy as well as financial markets
Central bank policy	Central banks around the world not responding to weaker growth adequately and in a timely manner, particularly the US FED
Geopolitics	Escalation of political unrest in the Middle East or Asia, upcoming elections, oil price volatility

Source: Bloomberg, VAR Capital Research

Factors Dominate: Momentum versus Value

Factor Basics

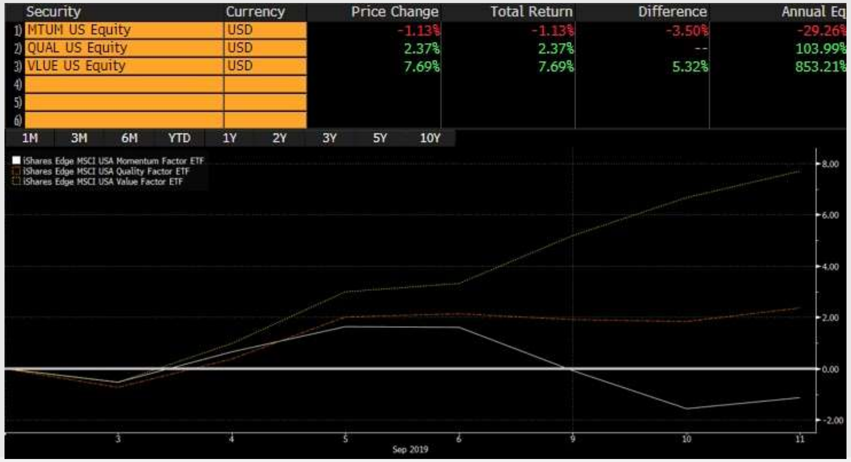
- One of the most striking features of this bull market has been the absolute dominance of the "momentum" factor versus the more traditional "value" factors. Banks, construction, autos, and chemicals now form the value bucket, trading at relatively low multiples. Momentum sectors now include tech, staples and pharma (plus biotech) and being overweight these sectors has been key to outperformance.

Momentum Dominates

- Any serious recovery in value stocks will require rates to rise, inflation expectations to rise, and confidence that economic growth is on a stable footing. Our portfolios remain well diversified, but even small changes in these expectations might cause big changes in the momentum/value divergence and we are watching this closely.

Momentum has outperformed Value by 38% in the last 10 years

MTD Value has outperformed Momentum by 9%. Start of a trend or a blip?



Source: Bloomberg, VAR Capital Research

Equity Outlook

Equities

Valuation & Earnings

- S&P 500 is currently trading on a c.16x 2020 earnings multiple which is in line with its 10 year average so equity valuations don't seem particularly stretched at the moment
- Expectations for 2Q corporate earnings were quite negative and while not shooting the lights out, companies overall surprised the market positively

Equity strategy

- In the face of slowing economic growth globally, companies capable of generating high revenue and earnings growth irrespective of the general macroeconomic environment will in our view continue outperforming the market; we are therefore selectively overweight certain high growth stocks in the tech space
- We also increased our exposure to high quality stocks which tend to perform better in periods of heightened volatility

Valuations in the US are near longer term averages/medians

Sources: JPMorgan

Earnings growth in the US still looks solid

Sources: Credit Suisse

Bond Outlook

Bonds

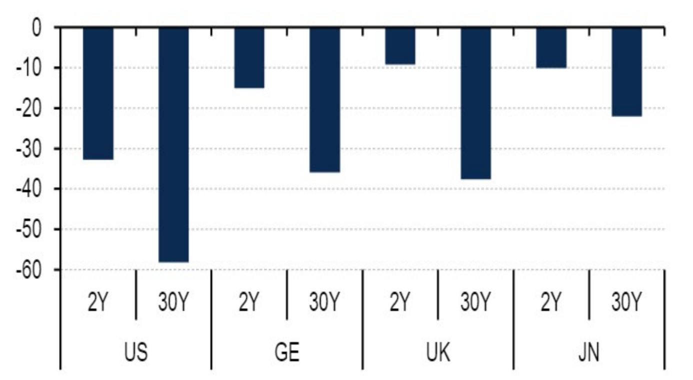
Yield curve

- After the US 10 year yield dropped more than half a percent from c.3.2% in the beginning of 2019, we expected yields to stay in the region of 2.3.-2.6%. However, they then subsequently declined even further across the entire yield curve and we believe at these levels dramatically increasing duration isn't justified
- Interestingly, US 30 year bond yields are at all time lows, suggesting the market is not particularly worried about inflation

Bond strategy

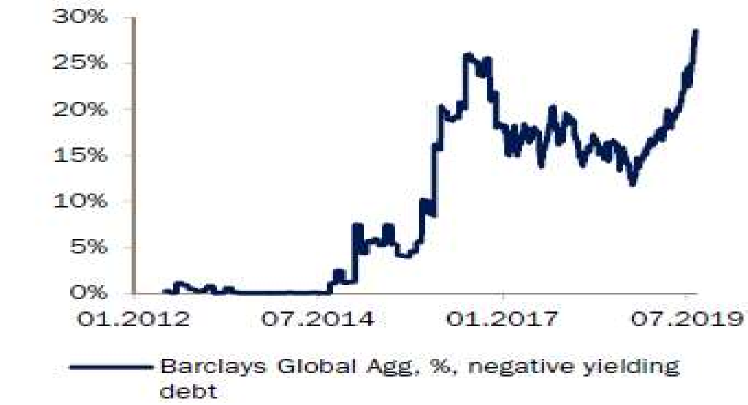
- We continue to be underweight high yield bonds, both in developed and emerging markets. We don't think credit spreads are attractive enough to sufficiently compensate for the risks
- We recently initiated some positions in floating rate bonds in order to partially hedge the portfolio in the event of fewer interest rate cuts than anticipated by the market

Global rate curves have flattened since the July FOMC (bps)



Source: BofA Merrill Lynch Global Research, Bloomberg

Almost 30% of the Barclays Global Bond index now has a negative yield



Source: Macrobond, J. Safra Sarasin, 15.08.2019

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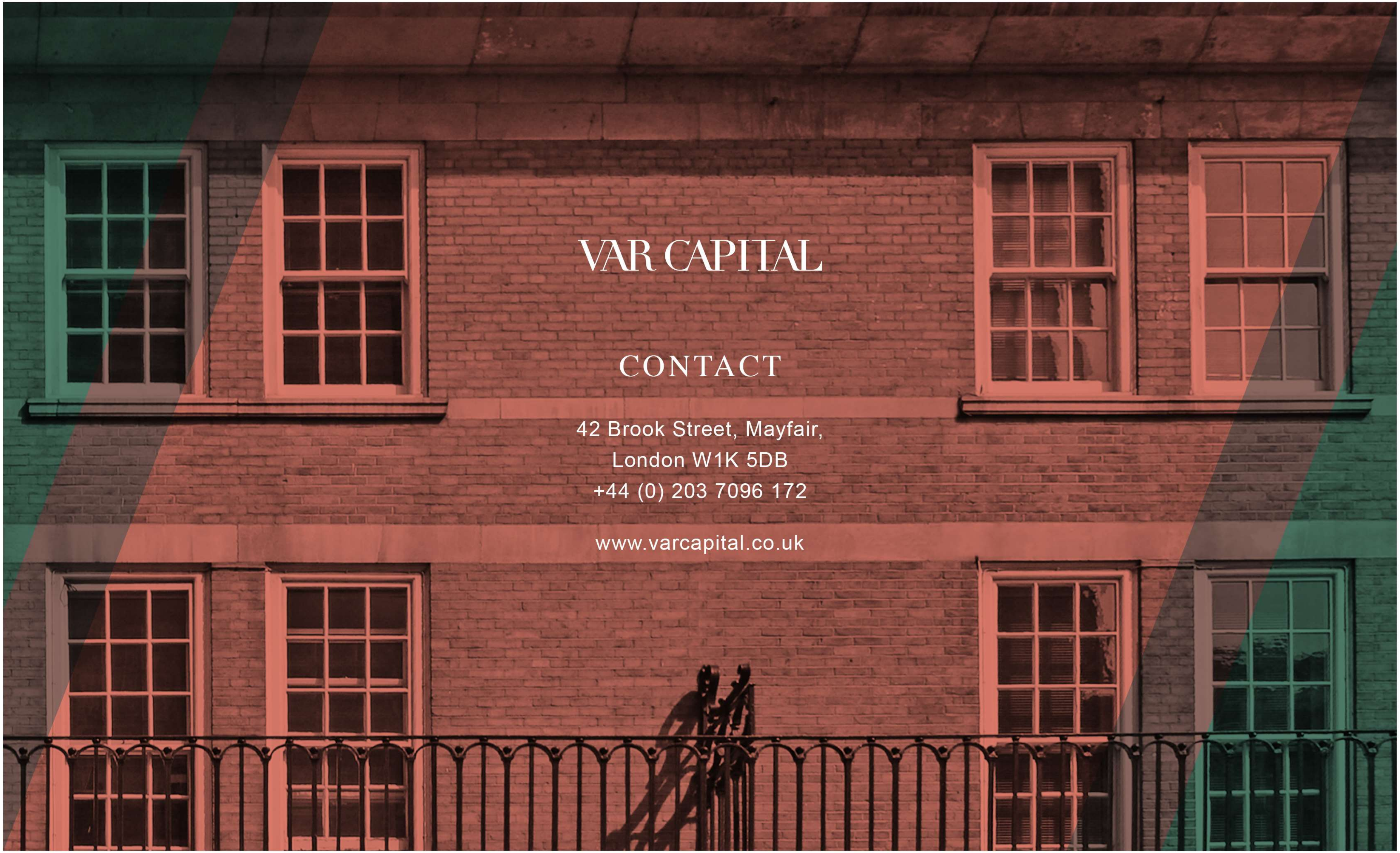

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