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»FischView

Monthly Update – February 2020

As at 29 January 2020

Summary

— **Our macro model scores for the equity and credit markets have weakened slightly in all regions due to lower short-term leading indicators, but remain positive.**
— **The general financial markets environment remains positive, from a global perspective, based on moderate growth, low inflation and loose monetary policy.**
— **However, the spread of the corona virus is an external shock that is difficult to assess, and has only limited negative effects thus far.**
— **The euphoric investor sentiment, which has been in place for some time, is inevitably susceptible to short-term disruptions.**
— **The trend signals for equity and credit remain positive. The valuation models show neutral to in some cases slightly expensive – yet not excessive – pricing levels.**

Highlights and key changes

— **Various short to medium-term leading economic indicators weakened in January.** In particular, meaningful indicators from the transport sector (Baltic Dry, Harpex container ships, ATA truck tonnage, etc.) were somewhat weaker, albeit after an extremely strong run last year.
— **This weakening has nothing to do with the uncertainties triggered by the corona virus,** but has been evident since the beginning of this year. Only the copper price, which is also very sensitive to economic trends, has reacted negatively to the virus issue as recently as the past few days.
— **However, other indicators still remain in very positive territory,** e.g. the US housing market and the share prices of consumer credit banks Capital One and American Express, all of which have remained very robust.
— **The overall picture for the economy and financial markets remains clearly positive globally,** thanks in particular to monetary support from most central banks. There is therefore still some potential for resilience to temporary disturbances relating to the corona virus. **However, the potential for further escalation is difficult to quantify at the moment.**
— In view of the existing economic slowdown trend and uncertainties, the trend in interest rates remains downward. However, the tide should turn quickly once the situation has calmed down.

- **Valuations of equity, credit and bond markets are in the neutral-to-slightly-expensive range.** However, no obvious exaggerations are visible. Owing to an expected flood of new issues, we consider credit markets in Europe to be somewhat less attractive than their US peers or the emerging markets.
- In terms of currencies, the US dollar is tending to strengthen again after a rather weaker trend until mid-January. However, this is probably also linked to the corona virus. Should the situation calm down, the weakening trend of the dollar could resume, which would even be positive for many emerging markets.

Topics “on the radar”

Have central banks reached the end in terms of their possibilities to act? Will traditional monetary policy (interest rate and money supply management and QE) become ineffective in the face of negative interest rates? The answer is clearly **No**, at least for the moment.

A closer analysis of historical monetary policy shows that traditional monetary tools still have a strong influence on markets and the economy. We have been observing a combination of the so-called **"Goldilocks scenario"** (= moderate global economic growth, low inflation and loose monetary policy) and the **"Wall of Worry"** (cautious investors without euphoria) for some time now. Historically, these two factors have always formed an unspectacular but solid foundation for financial markets, as positive fundamentals, monetary and market-technical influences interact. And they prove the effectiveness of monetary policy to date.

But when does this scenario become perilous? Either in the event of a recession, which could be exacerbated by the existence of around ten percent "zombie companies" worldwide. "Zombie firms" are unprofitable companies that can only survive by virtue of low interest rates. **On the other hand, there is a danger that central banks could become unable to pursue accommodative monetary policy.** This would invariably be the case if inflation suddenly and unexpectedly flared up.

A recession and "zombies" can still be averted by a further easing of monetary policy, perhaps **with the help of the additional option of "helicopter money"** (= direct state or consumer financing via the printing of currency). But this will only be possible should inflation remain benign.

Money multipliers and the gold price should serve as an early warning system. Historically, these have always been helpful anticipatory inflation indicators. We are currently seeing a rise here, but not yet to a dangerous extent. For the time being, the very loose global monetary policy should be able to do its work undisturbed.

Summary of *FischView* model outputs

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA
Equities	+	+	+	+	+ ↑	+
Government Bonds	+ ↑	+ ↑	+ ↑			
Credit IG	o	o		o ↓	+	+
Credit HY	o	o		o ↓	+	+ ↑
Convertibles	+	+	+	+		

Commodities	Energy:	o ↓	Prec. Met:	+	Indu. Met:	+

Key:

++	Strong positive
+	Positive
o	Neutral
-	Negative
--	Strong negative

Notes regarding the table: Changes from prior month are indicated with ↓ or ↑. i.e. "O ↓" means that the output has weakened from a prior value of + or ++.
The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained **here**.
Within government bonds, we consider the most important bonds for each region, e.g. German Bunds in Europe, and a representative group of countries for Latin America, Asia ex-Japan and CEEMEA (Central and Eastern Europe, Middle East and Africa).

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible bonds	– Industrials – Utilities – Technology	– Real estate
Global High Yield	– 'B' rating segment EUR – Telecoms	– 'CCC' rating segment – Asia – Banks
Emerging Market Corporates - Defensive	– Latin America – United Arab Emirates	– South Korea – Hong Kong
Emerging Market Corporates - Opportunistic	– Latin America – Brazil	– South Korea – Hong Kong
Global Corporates	– North America – Telecom, Media & Technology	– Pacific – Energy – Asia HY

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

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