PICARD ANGST

Our Opinion

2019

The Tide Goes Out

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Introduction

In our outlook for 2018, we identified and assessed two possible development paths for the financial markets over the course of the year: Firstly, the continuation scenario of a late-cycle inflationary boom, and secondly, the reversal scenario of a slump in growth triggered by the onset of a cyclical economic downturn in China or the United States and reinforced by headwinds from structural factors. Looking back, 2018 did indeed turn out to be a year of change. Over the first half of the year, the much-vaunted globally synchronised growth upswing ran out of steam and macroeconomic headwinds and political concerns began to dominate, whether in the form of escalating trade disputes, capital flight from emerging markets, weakening growth in China or the renewed sense of crisis on the EU periphery. Recently, even the American equities market has begun to waver, despite continuing robust economic growth.

In the outlook for 2019, a much more challenging environment is emerging for investors than in recent years, which will be conducive when it comes to separating the wheat from the chaff. This is because the liquidity provided by monetary policy over the past decade in a globally coordinated form and to an almost unlimited extent is drying up. And, as Warren Buffet once aptly remarked: "Only when the tide goes out do you discover who has been swimming naked".

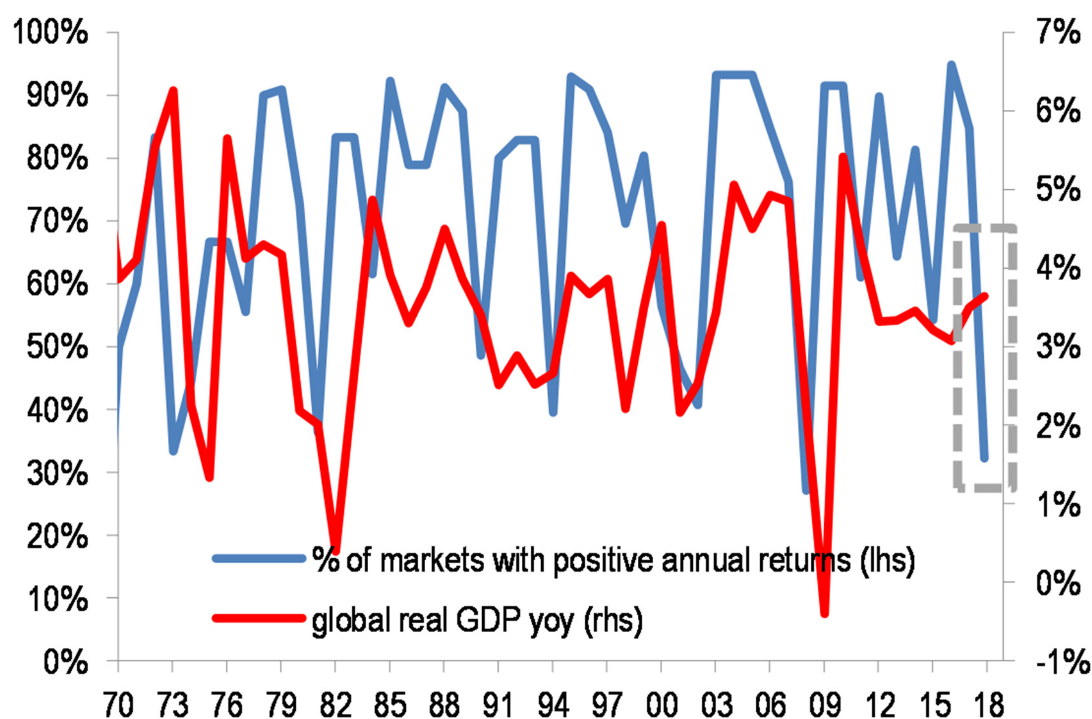
The return prospects for most asset classes is strongly reduced. A more active investment style and a high degree of selectivity will be required to achieve the targeted returns. In doing so, there is still no getting away from equities. Despite the fact that overall average valuations remain high, individual countries and sectors have already made significant corrections. In particular, the field of emerging markets, as well as one or another of Europe's equities markets, holds potential for recovery.

Macroeconomic Trends

Disappointing returns in almost all asset classes mask a still robust economic environment, which will however gradually continue to weaken in 2019

- Despite a brilliant start, last year ultimately saw losses in almost every asset class and style. Such a scenario has only occurred to a similar extent twice in the last fifty years, namely during the stagflation phase of the 1970s and the global financial crisis of 2008/9 (see Fig. 1).
- This is particularly astonishing given the sustained robust growth of the global economy, which the International Monetary Fund estimated to expand by 3.7% in 2018 despite a downward revision of expectations in recent months.
- Nevertheless, the much-vaunted, globally synchronised growth upswing already ran out of steam in the spring. Since then, with the exception of the United States, we have seen a gradual weakening of the leading sentiment indicators. The global average of the manufacturing sector's Purchasing Managers' Indexes fell to 52 at the end of the year.
- The signs for the coming year thus point to weaker but still robust growth in the global economy. The average growth expectations for global gross domestic product are only slightly lower than in the previous year at 3.5%. This means that the global economy is likely to expand above trend for the third year in succession.

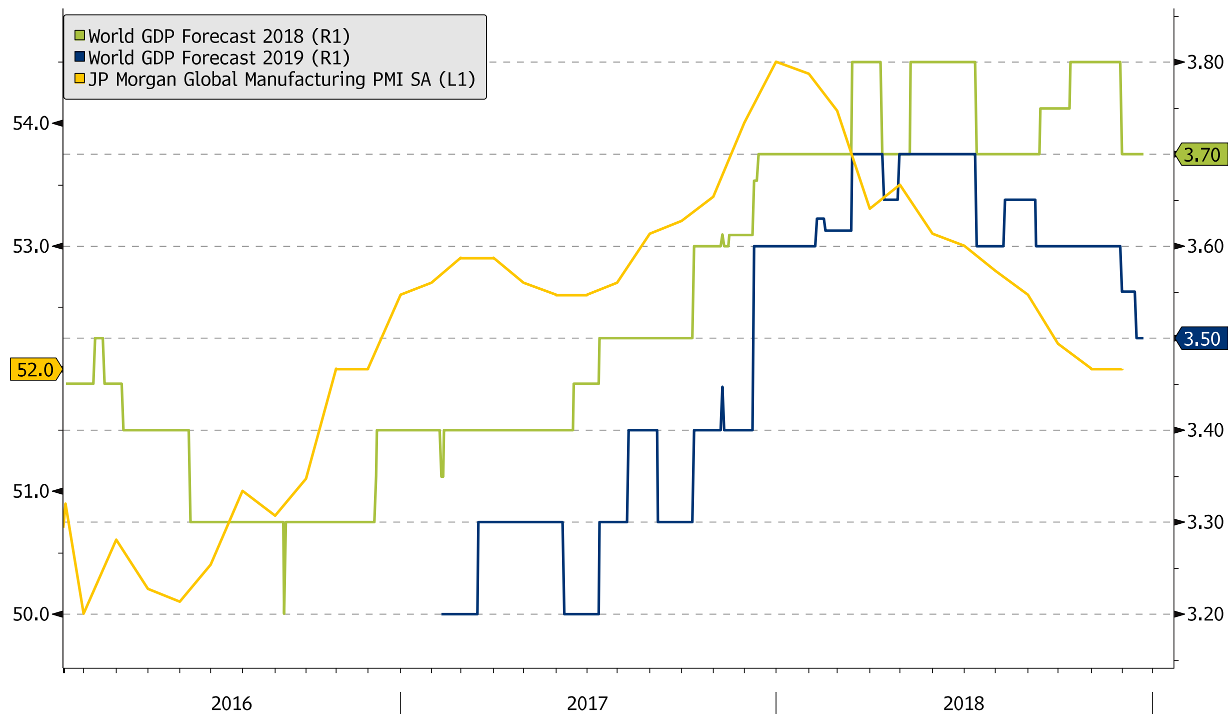
Fig. 1: Proportion of share classes with negative annual return in comparison with the growth of global GDP



Source: J.P. Morgan, 2018

- In the developed countries, however, declining support on the fiscal front and from monetary policy will reduce the growth of the US economy. Japan and Europe will have to step into the breach for this.
- This poses particular challenges for Europe. The improved economic situation of recent years has done little to curb populist political movements. Recent events in Italy, for example, mean that the Eurozone is facing a return of the debt crisis, with far-reaching effects on the bond markets (see also the chapter "Sovereign Bonds, Money Markets and Credit"); in France, hard-earned fiscal leeway is again being squandered to appease the "Gilets Jaunes" protest movement. However, the greatest downward economic potential is presented by Britain's unregulated withdrawal from the European Union by – a scenario that can be ruled out less and less in view of the never-ending political scramble over the withdrawal modalities.
- As in the previous year, the emerging markets will remain the growth engine in 2019. But their contribution will be slightly reduced. The extensive fiscal and monetary stimulus measures initiated by China in recent months should soon take effect and ensure that the growth path of the Chinese economy stabilises above 6%. The greatest growth risk for the export-driven emerging markets is an escalation of the smouldering trade conflict between China and the United States, since much of the growth is dependent on world trade.
- Despite the overall constructiveness of the available data, the sustainability and longevity of the upswing are increasingly coming into question. Potential growth estimates for the developed economies have been declining for years. Due to the combination of demographic factors and sustained declining productivity growth, future real growth rates of barely more than 1% p.a. can be expected for the United States. A similar trend can be observed in Europe. At the same time, the debt-equity ratio of both private and public budgets in Western economies has increased massively. That this has not led to any serious problems is solely due to the fact that interest rates have remained low thus far and the contributions to debt servicing have even fallen as a result.

Fig. 2: Constructive growth picture of the global economy despite slowing momentum

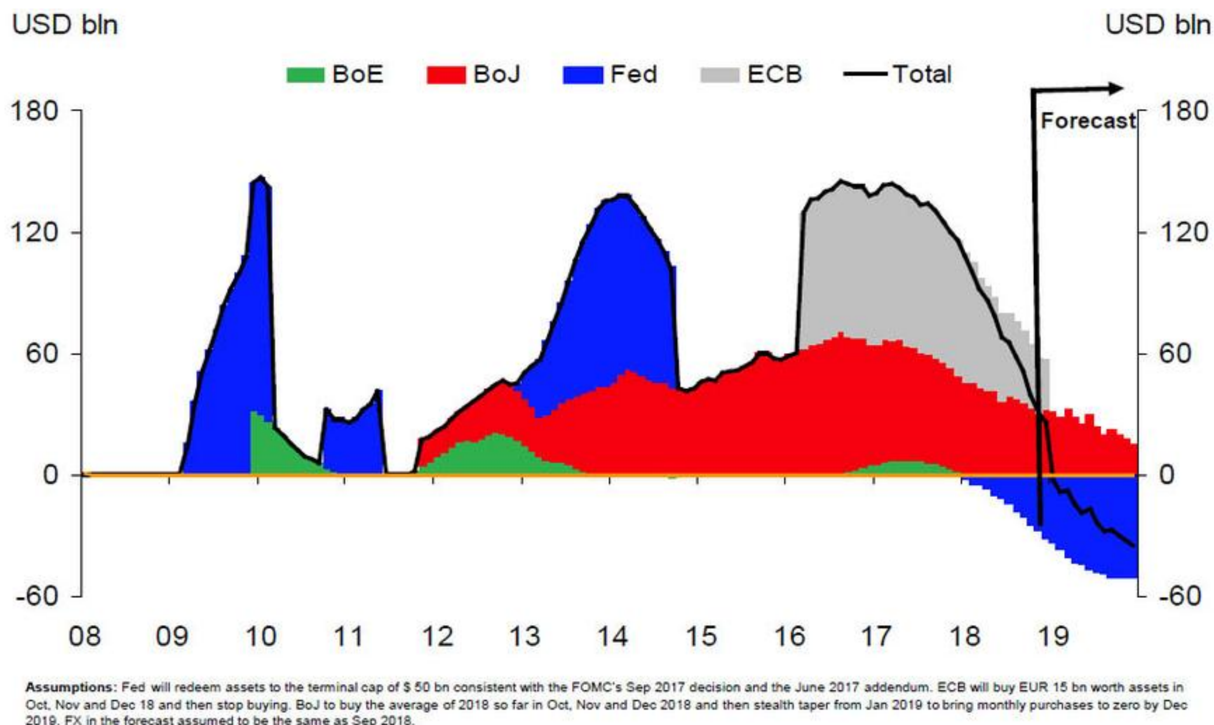


Source: Bloomberg LP, 2018

With the progressive reduction of inflated central bank balance sheets, there is headwind for high-risk asset classes and the global economy

- The flood of liquidity from the central banks' printing presses, which has helped to raise the valuations of risky asset classes to ever higher, and sometimes even dizzying, levels over the past decade, will definitely pave the way for a recession from next year.
- Most recently, the European Central Bank (ECB) announced that all purchasing programmes will be discontinued at the end of 2018. Although proceeds from maturing issues will be reinvested for the time being, the ECB's balance sheet total has peaked. Even if we have to wait until summer for interest rate hikes, this means a substantial decline in monetary support, which unfortunately also coincides with a weakening of the European economy.
- In the United States, on the other hand, a reduction in the Federal Reserve's balance sheet has been in progress for some time now and has accelerated over the course of the year. The inflated balance sheet is now being reduced by USD 50 bn. per month.
- In addition, base rates in the United States have also been rising for some time and have now reached a level of 2.5%. The extent of this rise meant that 2018 saw a significant tightening of financing conditions, unlike in previous years. However, a certain easing could be provided by the Federal Reserve's recently signalling that, contrary to its earlier announcements, base rates are no longer moving far from the neutral rate in its opinion. Market expectations for further interest rate hikes in the coming year have consequently been reduced to less than two.
- The only remaining net liquidity provider is the Bank of Japan. This means that the combined central bank balances of the G4 will shrink at an accelerated rate in 2019 (see Fig. 3).

Fig. 3: Smoothed monthly transaction flows of G4 central banks from QE programmes (12-month moving averages)



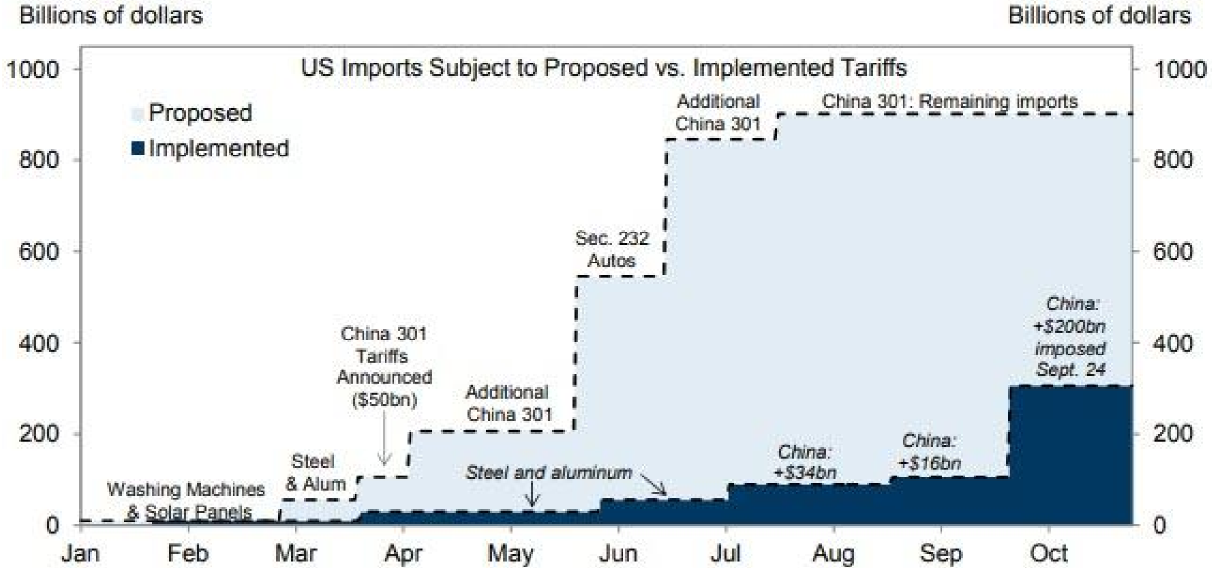
Source: Deutsche Bank, 2018

The further development of the trade war between the United States and China is of critical importance for the world economy

- Tensions between the United States and the rest of the world over the shaping of bilateral trade relations have gradually increased over the past year. Following the imposition of tariffs on aluminium and steel from a large number of trading partners, subsequent steps taken by the United States were directed primarily against China.
- It is certainly true that, to begin with, the Trump administration's main gripe with China was the trade deficit. It should not be forgotten, however, that this conflict has a much wider dimension and meaning. Ultimately, the United States is concerned with keeping an emerging competitor for global economic and military supremacy in check. This explains its increasing focus on the technology transfer forced by China, the danger posed by China's monitoring of foreign companies and President Xi's 'Made in China 2025' plan, which directly threatens the USA's technological dominance.
- Contrary to the expectations of some economists, the trade war is showing hardly any negative effects on the United States' reported economic figures thus far. This is largely due to the fact that imports were significantly brought forward in anticipation of new and higher tariffs, which artificially increased the activity data. In China, on the other hand, signs of declining economic activity and export demand cannot be ignored.
- A further escalation was averted for the time being in talks between China and the United States at the G20 meeting at the end of November. This secured a three-month suspension of the already-announced expansion and increase of all customs duties on Chinese export goods to 25%.
- In view of the considerable remaining potential for escalation (see Fig. 4), it is essential that this respite can be used to reach a long-term agreement, in order to ensure continued expansion of the world economy in the coming year. It is not so much the insurmountable differences in the

matter itself that stand in the way of this, but rather the confrontational negotiation style practiced by the US government, and in particular by the president himself, with its repeated tendency to make threats. This makes it extremely difficult for the Chinese side to attempt a compromise without losing face with its own people.

Fig. 4: Trade war between USA and China: there remains considerable potential for escalation over the coming year

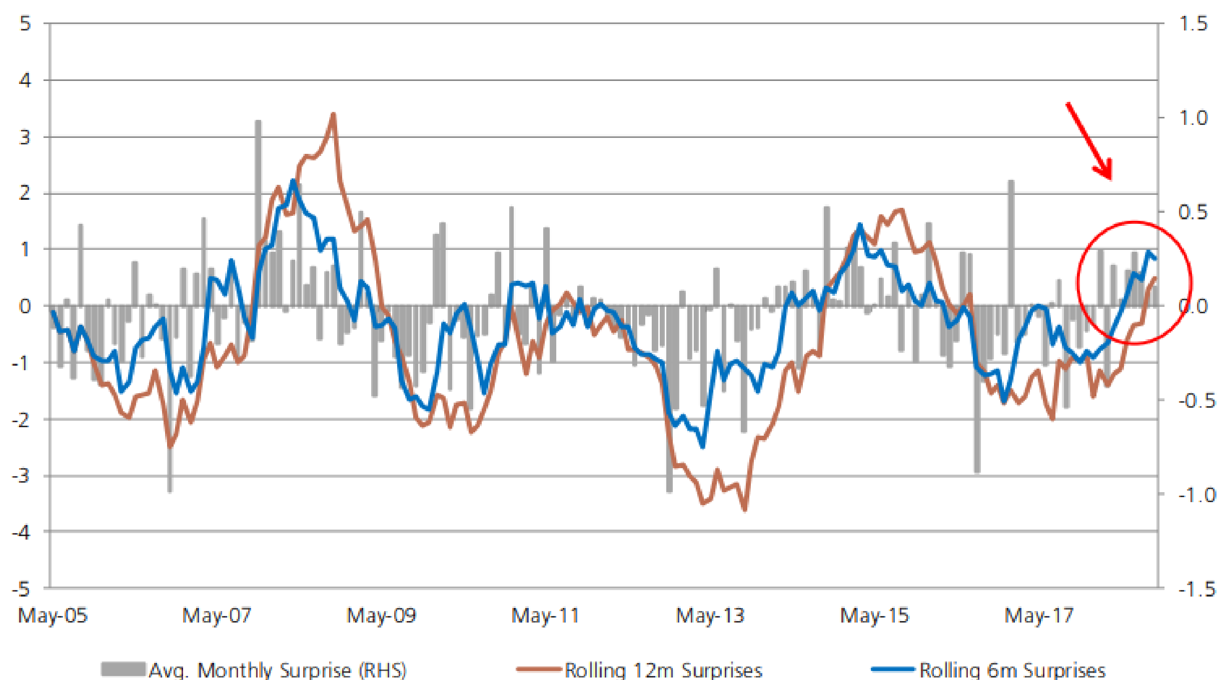


Source: Deutsche Bank, 2018

In view of increasing employment, inflation trends continue to point upward, despite the dampening effect of falling energy prices.

- A sharp drop in oil prices towards the end of the year put inflation expectations under pressure in the form of break-even inflation rates. This effect is also likely to be reflected in spot inflation rates in the coming months.
- However, core inflation continues to indicate an upward trend in the face of falling spare capacity and increasing employment. With a few exceptions such as Japan and Switzerland, consumer price indexes are already above target in most developed countries, and surprises in reported inflation data are at their highest level for three years worldwide (see Fig. 5).
- A further escalation of the trade war would also have an inflationary effect.

Fig. 5: Global inflationary pressure remains intact: surprises in inflation data are at their highest level for three years worldwide



Taking into account data from 18 countries: US, Japan, UK, Germany, Italy, France, Spain, Denmark, Switzerland, Norway, Sweden, Canada, China, South Korea, Russia, Chile, Mexico, Colombia. Source: UBS Knowledge Network, 2018

The US dollar is likely to weaken gradually, while EM currencies have bottomed out

- Last year was marked by the continued strength of the US dollar against the currencies of most developed countries, but even more so against those of emerging markets (see Fig. 6). Since its last relative low in 2011, the nominal, broadly trade-weighted exchange rate of the US currency has appreciated by around 35%.
- We do not expect this trend to continue in the coming year. For one thing, the singular effect caused by the large-scale repatriation of US companies' overseas liquidity stocks as a result of the corporate tax reform is already a thing of the past, and the associated growth impulses are weakening. For another, the US Federal Reserve has announced a foreseeable end to the rise in base rates, while an accelerating upward trend in base rates can be expected for the rest of the world on average. We therefore assume that the US dollar will gradually weaken over the course of the year.
- While an analysis of the Euro's purchasing power parity continues to assume a certain undervaluation against the dollar – which is confirmed by fundamental equilibrium models (FEER) for the trade-weighted Euro – the fate of the EUR exchange rate over the short and medium term will primarily be determined by continuing events surrounding the political crises in Italy and France and the forthcoming Brexit. If these can be overcome, key ECB base rate hikes planned for the second half of the year could give new impetus to the single currency.
- Given the effective link between Swiss monetary policy and the Eurozone, the Swiss franc should also benefit from a renewed convergence of interest rates between Europe and the United States in the second half of the year. However, substantial appreciation potential for the Swiss franc will likely only arise in market phases that are shaped by pronounced risk aversion and which activate the currency's safe-haven characteristics.

- The continued increase in interest rate differentials against the US dollar is especially problematic for investors with the Swiss Franc or Euro as their home currency who hedge their foreign currency exposure from US investments. These hedging costs have now risen to significantly more than 3% p.a. (see Fig. 7).

Fig. 6: Distinct divergences on the FX markets as a result of US monetary policy: Broad and narrow trade-weighted US Dollar vs. emerging currencies

Source: Bloomberg LP, 2018

Fig. 7: Comparison of FX hedging costs between major currencies over the year

			1y Hedging Cost Back into:				
			USD	EUR	JPY	GBP	CHF
USD	*Equities*	5.6	-	3.3%	3.2%	1.8%	3.7%
	Govt	2.9					
EUR	*Equities*	7.5	-3.2%	-	0.0%	-1.4%	0.4%
	Govt	0.3					
JPY	*Equities*	8.1	-3.1%	0.0%	-	-1.4%	0.5%
	Govt	0.1					
GBP	*Equities*	6.5	-1.8%	1.4%	1.4%	-	1.9%
	Govt	1.2					
MSCI AC World Equities (Weighted)		6.5	-0.8%	2.9%	2.8%	2.8%	3.4%
MSCI EM Equities (Weighted)		8.7	1.2%	4.7%	4.5%	3.0%	5.0%
EM Local Rates (Weighted)		0.0	3.2%	6.5%	6.4%	4.7%	7.0%

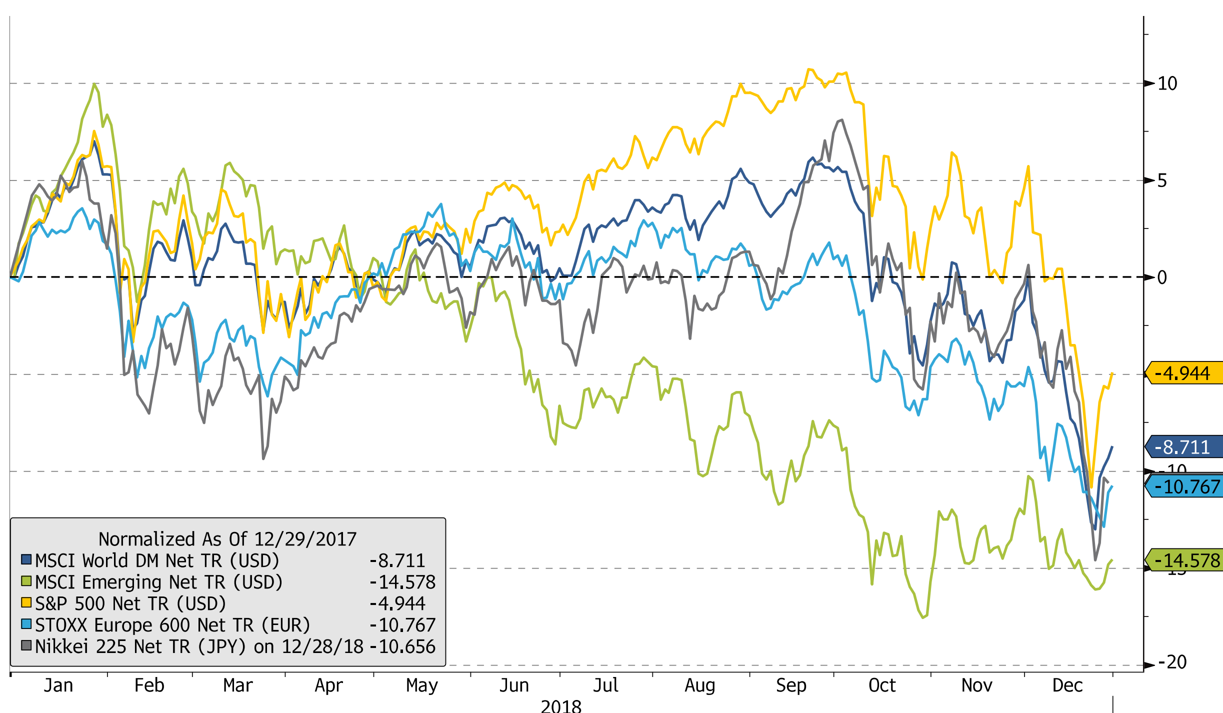
Source: Bloomberg LP, Citi Research, 2018

Equities

Global equities markets are reversing trends as corporate earnings have passed their peak and macroeconomic and geopolitical prospects become increasingly uncertain

- The equities markets had an excellent start in 2018, but on a global average they had already run out of steam by end of January. The immediate trigger was a liquidation shock which originated in the markets for volatility derivatives and heralded the end of the artificially low volatility regime on the equities markets.
- In the longer term, however, the gradual slowdown in growth momentum and the corresponding steady weakening of leading economic indicators were decisive factors. In the course of the second quarter, this was increasingly reflected in downgrades of corporate earnings expectations.
- One exception was the US equity market, where, driven by a generous reduction in corporate taxation, average growth in corporate earnings was well over 20%. Accordingly, US equities succeeded in decoupling themselves from the rest of the world and reached new highs over the summer. But this high-flying lasted only a short time. In the United States, too, the outlook for the second half of the year was clouded by the imminent expiry of the tax reform's singular effect.
- By the end of the year, the equity markets in all regions of the world were showing double-digit percentage losses from their 2018 peaks (see Fig. 8). Emerging markets suffered particularly badly, being hit by capital outflows due to the steady rise in interest rates in the United States and the continued strength of the dollar.

Fig. 8: Development of selected equity markets in 2018



Time series indexed at 100 as at 29.12.17. Source: Bloomberg LP, 2018

- A look at the economic indicators, most of which remain robust, gives the impression that investors were excessively pessimistic with regard to the sell-off in the equities markets at the end of

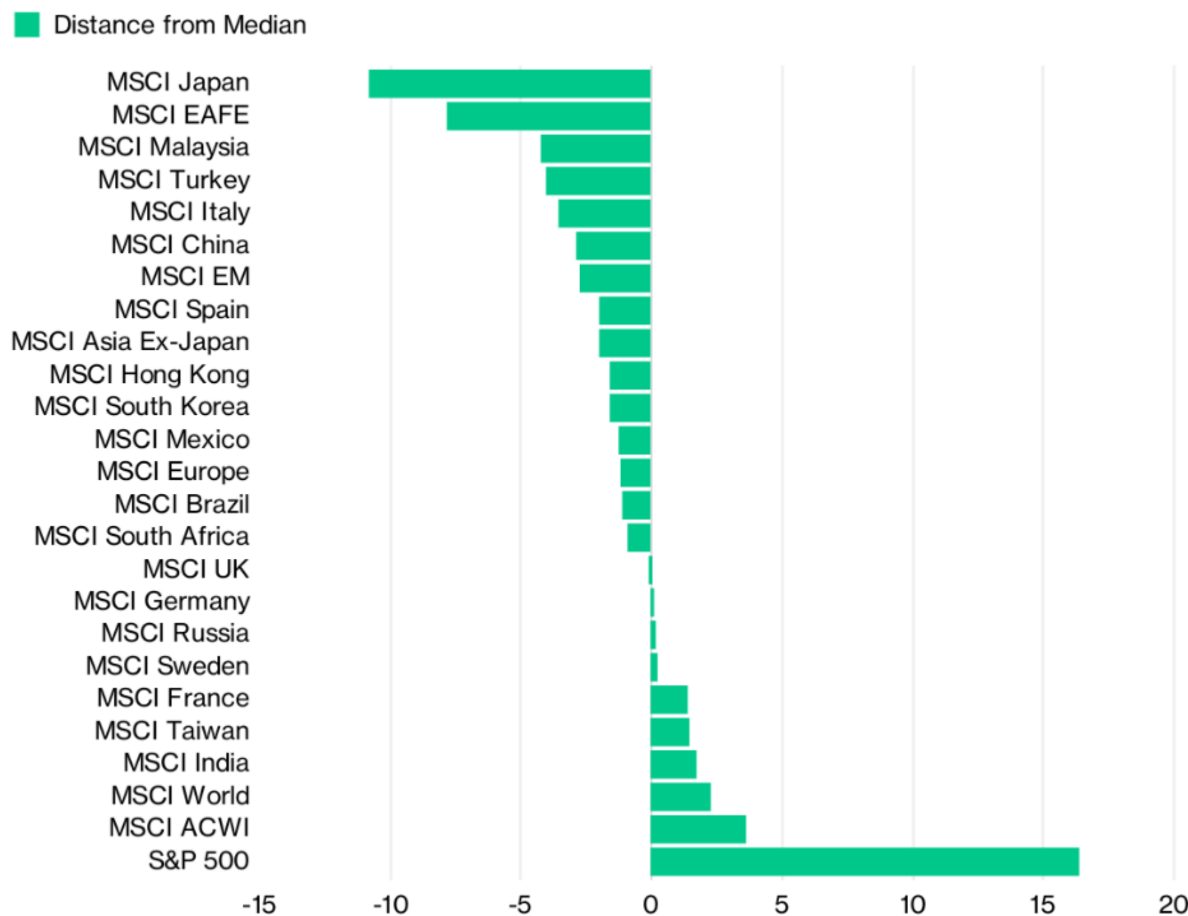
the year. Fears of recession appear premature. This opens up the prospect of a potentially more pleasing start to the new year.

- Overall, however, 2019 promises to be a challenging year for shareholders. The tailwind of monetary policy, which has helped to lift share valuations to sometimes undreamt-of heights over the past decade by injecting liquidity, has reversed. Increasing risk aversion is putting valuations back into the minds of investors and displacing the view promoted by the investment crisis that there is no alternative to equity investments. In fact, the losses of recent months have suddenly made even cash attractive again as an alternative, not only in view of rising interest rates (at least in the United States).
- The outlook for corporate earnings is unlikely to change anything in this regard. Companies in all industries have seen the largest number of downward earnings corrections in two years. Global corporate earnings growth is expected to halve from 13% this year to 7% next year.
- Furthermore, the Damocles sword of escalating trade disputes and a general increase in uncertainty regarding the macroeconomic and geopolitical outlook for the markets still hangs. The volatility regime is therefore likely to remain elevated but will settle at an annual average of between 17% and 20%, below current levels but significantly above levels seen in recent years. Investment strategies that cleverly incorporate the sale of volatility will benefit from this.

Distinct valuation divergences between regions and countries call for selectivity but also create opportunities

- Over the course of the year, a heightened awareness of valuations will contribute to a greater dispersion of returns between regions and countries than in the past.
- Taking a valuation yardstick such as the cyclically-adjusted price-to-earnings ratio (commonly referred to as the Shiller P/E ratio) as a basis – which has proven its worth with regard to its forecasting power over longer time horizons – a picture emerges of an unusually high spread in valuations, not only between developed and emerging countries but also within the block of OECD countries. This becomes particularly clear when analysing the differences between the valuations of the individual markets and their long-term historical median (see Fig. 9).
- From this perspective, Japan proves to be our favourite. Even though the economy is suffering from a slowdown of exports, equity valuations not only remain attractive on a relative basis, but also on an absolute basis. Of all the developed countries, Japanese equities are by far the most favourably valued. The low indebtedness of Japanese companies is another argument: on average, the ratio of net debt to EBITDA is 1.48%, which is lower than in the other developed countries. Moreover, in contrast to the Federal Reserve and the ECB, the Japanese central bank will continue to pump money into the market – albeit to a lesser extent than before.
- Europe disappointed in 2018: the first full year of rising corporate profits in 2017 after six lean years now threatens be a flash in the pan. Although the region's economy has improved slightly and equity valuations are generally not overpriced, there are a range of economic and political challenges (Brexit, Italy, France) and monetary support has dried up. This calls for an overall neutral attitude and selectivity.
- If Italy were to adopt a sustainable solution to its debt situation, this would greatly enhance the attractiveness of the country's listed companies, especially as no other European country has such low company valuations. Other austerity-struck Southern European markets, such as Spain, also offer opportunities. France, on the other hand, is particularly to be avoided. Although the Swiss equities market is among those valued comparatively highly, it is nevertheless likely to perform better than the European average in the coming year given its defensive qualities.

Fig. 9 Extreme overvaluation in the United States, but enticing bargains in emerging markets and parts of Europe



Distance of the current cyclically adjusted P/E (CAPE) from the historical median. Source: Research Affiliates, Bloomberg LP, 2018

- After the sharp price drop suffered over the past year, emerging market equities appear particularly attractive. Thanks mainly to China, economic activity in the emerging markets is developing better than in the developed countries. The significant valuation discount compared with the developed equity markets also count in their favour; this now prices in a good portion of risks posed by trade conflicts, to which the emerging markets are particularly exposed due to their export-driven nature.
- The currencies of the emerging markets have lost a lot of ground, but have been showing signs of bottoming out for some months now and are trading significantly below value. Prospectively, they should benefit from the fact that the US Federal Reserve is increasingly expected to slow the pace of its monetary tightening in the coming year, which would weaken the dollar and reduce incentives for capital flight. Emerging market equities should also benefit from the recovery in commodity prices that we expect (see also chapter "Commodities").
- In addition, many investors are still cautious when it comes to emerging markets as a whole. In our view, this should be seen as a contrarian-indicator that suggests upward potential.
- The most important contributor and driver for the emerging markets is and remains China, in both a positive and negative sense. Much will depend on the success of China's recently intensified efforts to set reflation impulses with fiscal and monetary policy measures. However, other Asian markets such as Malaysia also appear attractive from a valuation point of view.

Defensive sectors should be given preference over cyclical industries

- Since the fears of a global slowdown in growth last emerged in 2016, cyclical sectors have consistently outperformed defensive equities. This came to an end in the midst of last summer (see Fig. 10. However, the ratio remains outside the long-term historical range. In view of significant valuation differences, we therefore assume that defensive sectors will prospectively perform better under the scenario of a gradual economic slowdown.

Fig. 10: The prolonged outperformance of cyclical equities has come to an end, but the correction and relative recovery of defensive equities is only just beginning

Source: Bloomberg LP, 2018

- Cyclical consumer goods and technology stocks are particularly highly valued; consumer staples, telecommunications, utilities and the healthcare and pharmaceutical sectors seem preferable
- However, there are also regional differences here. For example, high valuations in the United States reduce the attractiveness of listed utility companies and some healthcare shares. The pharmaceutical sector could also be threatened by the regulatory uncertainty in the United States. Although it would be an exception, Democrats and Republicans could agree on the issue of drug prices in an otherwise divided Congress.
- Restraint is also expedient in the financial sector. In Europe, banks are exposed to the risk of the approaching Brexit, as well as a potentially resurgent debt crisis triggered by Italy. In the United States, on the other hand, the earnings outlook for the sector is becoming increasingly gloomy. Despite the acceleration of economic growth over the past year, credit growth slowed noticeably and the yield curve flattened significantly towards the end of the year, even inverting in some cases. As a result, the US financial sector has already largely stopped outperforming the market as a whole as it had been since the 2016 presidential election.

Rarely have US equities seemed so unattractive

- The prolonged outperformance of the US equities market with regard to the rest of the world – especially compared with Europe for over a decade – has led to a situation characterised by a spread in valuations, which has reached a level seldom seen before (see Fig. 9).

- The impressive 23% jump in corporate profits last year was largely due to singular effects. With the anniversary of the corporate tax reform, they will cease at the turn of the year. It can therefore be expected that corporate earnings growth in the United States will fall to 7% in 2019 – the largest loser of all major regions.

Fig. 11: Valuation premium of the US equity market: P/E difference largely explained by the technology heavyweights of the FAANG Group

Source: MSCI, Thomson Reuters, Blackrock Investment Institute, 2018

- For years, analyses of the composition of net inflows into the US equities market have underscored the importance of companies buying their own shares. Last year, US equities benefited from a particularly strong increase in share buyback programmes to a volume of almost USD 800 bn. This was mainly thanks to the repatriation of large overseas liquidity reserves as part of the tax reform. This source is unlikely to effervesce as strongly in the coming year. The same applies to buy-backs financed by borrowing in view of significantly tighter financing conditions on the credit markets.
- Almost twenty years after the internet bubble, technology equities have again become the driving force behind the US equities market. Their share of market capitalisation now stands at over 25% – a level crossed only once before for a short time in 2000, before the speculative bubble burst. The dependence of the broad equities market on the fate of the technology sector is thus currently higher than ever before.
- In addition, the technology sector itself has an extremely concentrated structure. Most of the market capitalisation is now concentrated in five companies that are commonly known by the acronyms FANG or FAANG (Facebook, Amazon.com, Apple, Netflix, Google/Alphabet). It is significant that these five companies alone explain the largest part of the valuation difference between the American and European equities markets; this is highlighted by comparing the prospective P/E ratio over 12 months of the MSCI Europe benchmarks with the MSCI US index that has been reduced by the FAANG components (see Fig. 11).
- The risk represented by the technology sector for the broad equities market is by no means limited to a potential clouding of the course of business. The high sector concentration is particularly the result of the strong positive network effects that characterise many of the business models;

the positive externalities promote a winner-takes-all dynamic whose natural end result is the establishment of monopolies. Although the interpretation of antitrust law in the United States has become much more cautious since the Reagan era, the fact that the reach of advertising and social media platforms has now entered the political sphere and even influenced the outcome of elections has provoked a potentially far-reaching political reaction. Even if the destruction of monopolistic structures were to be halted, alone the introduction and enforcement of more stringent regulation to protect private data sovereignty and privacy could severely affect the technology giants' business models. For companies such as Facebook, these concerns have already been clearly reflected in the share price over the past few months.

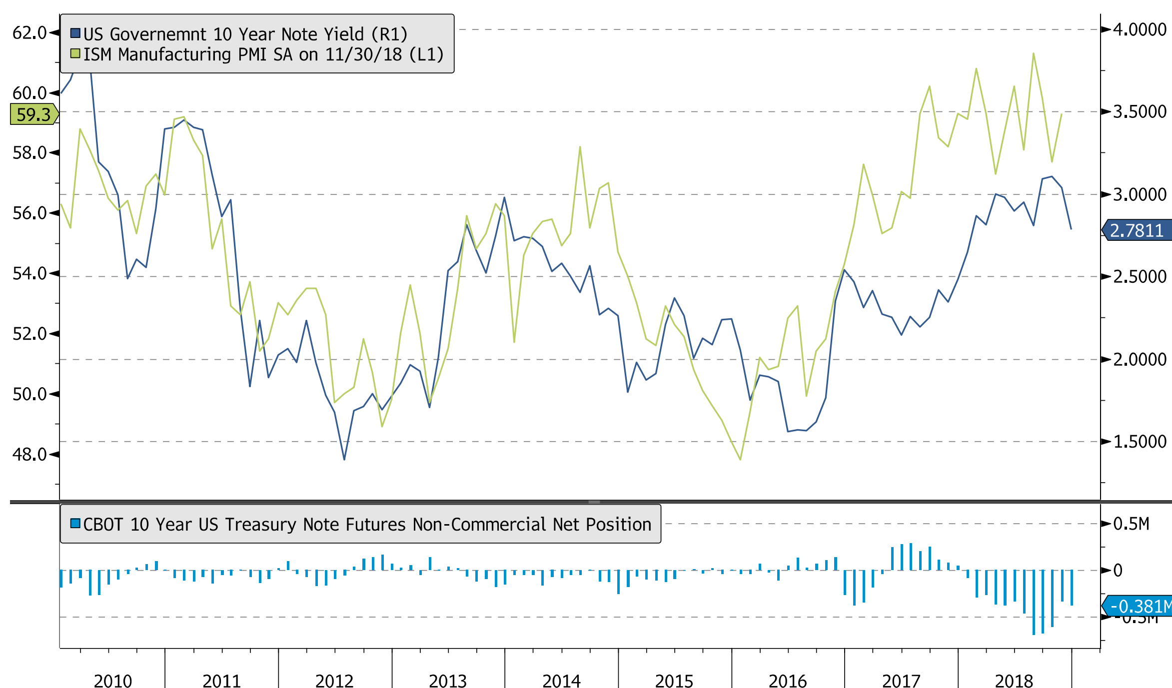
- With regard to portfolio positioning, this indicates a significant underweighting, if not elimination, of the exposure to US equities. The extent of the valuation divergences also makes currency-neutral, market-neutral long-short combinations appear attractive, especially with regard to Japan, the emerging markets and Europe.

Sovereign Bonds, Money Markets and Credit

Signs of a peak in long-term interest rates in view of declining economic expectations for the world economy

- In the wake of robust leading indicators in the United States, which have so far successfully resisted the downward trend in the rest of the world, US 10-year sovereign bond yields significantly broke through the 3% market over the summer. This breakthrough did not last long, however. As economic expectations deteriorated in the second half of the year, yields on sovereign bonds worldwide fell towards the end of the year.
- A compression of inflation premiums in view of the significant slump in energy prices in the fourth quarter also made a significant contribution to this.
- This means that interest rate-dampening structural factors threaten to regain the upper hand at the long end of the yield curves, as long-term real interest rates are closely linked to the potential growth of an economy. Given the steady decline in potential growth for developed economies over the past decade, it is likely that real interest equilibrium rates will remain close to their current low levels. The contributing structural factors include accelerated demographic change, the high indebtedness of both public and private budgets and the resulting lack of propensity to consume and invest.

Fig. 12: US sovereign bonds signal pessimism against rosy indicators of leading economic indicators



Source: Bloomberg LP, 2018

- Nevertheless, the positioning data of the futures exchanges indicate that, in view of persistently high net-short positions, the majority of investors continue to assume that yields will tend to rise at the long end of the curve (see Fig. 12).
- One of the factors that could drive interest over the coming year is the massive increase in the US Treasury's financing requirements. Last year's tax reform has left deep holes in the treasury’s pockets and the budget deficit threatens to break through the trillion dollar mark in 2019.

- In addition, the gradually accelerating shrinking of the bloated US Federal Reserve balance sheet is likely to have an increasingly noticeable effect. In view of the discontinuation of the ECB's QE programmes at the end of 2018, increasing refinancing pressure on the bond markets is also to be expected in Europe.
- At present, however, sovereign bonds are again dominated by sceptical signals regarding the longevity of economic expansion. The flattening of the yield curves in the market for U.S. Treasuries intensified towards the end of the year. Individual segments of the curve, e.g. between two and five years, have already inverted (see Fig. 13). In the past, the inversion of the yield curve has proven to be a reliable harbinger of an economic downturn and has preceded the last seven US recessions. However, its use as a timing signal is limited. In the past, the period up to the actual onset of a recession has lasted from a few months to more than two years.
- In order to benefit as an investor from such a scenario, it makes sense to bet on a continuation of the yield curve's inversion trend, for example, by means of flattener structures on the segment between two and ten years.

Fig. 13: The inversion of the yield curve has proven to be an indicator of an imminent recession in the United States in the past.

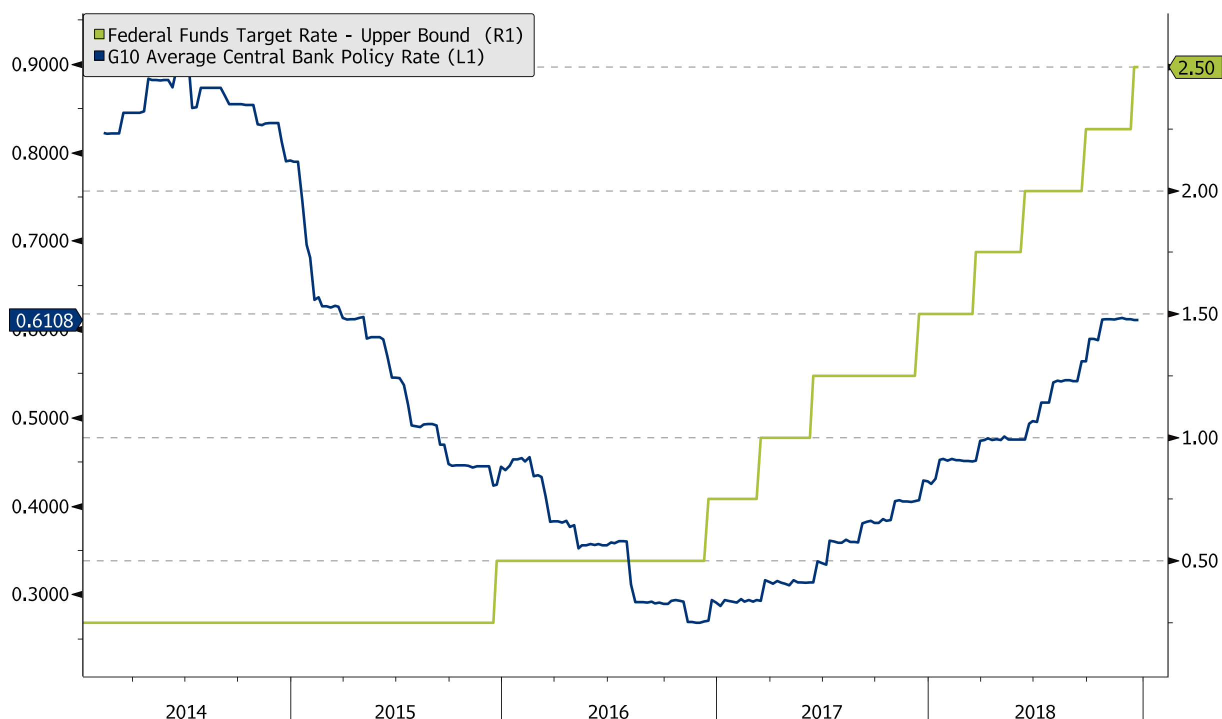
Source: Bloomberg LP, 2018

Variable interest investments in US dollars remain first choice, but the long end of the curve has also gained in appeal

- The US Federal Reserve recently reigned in its ambitions regarding further increases in base rates and, according to its own forecast for 2019, is expecting only two further interest rate hikes. These make money market investments with variable interest rates increasingly attractive. The Libor USD 3M has risen by almost 113 bp to 2.82% since the beginning of 2018.
- In the rest of the world, however, efforts to normalise monetary policy are still in the early stages but should pick up speed over the course of the year. In the second half of the year, the ECB and, in its wake, the Swiss National Bank (SNB) are expected to take the first steps to curb the prevailing regime of negative money market interest rates.

- At the same time, growth worries, if not deflationary fears, are spreading again at the long end. This implies declining yields to maturity, opening up opportunities for market gains in long-term bonds over the short term, despite the fact that long-term return prospects remain unattractive.
- Hence a 'barbell strategy', which combines money market commitments and other variable-interest investments (especially in the dollar zone) with a selection of long-term bonds, is preferable to a portfolio strategy that continues to focus purely on shortening portfolio duration.

Fig. 14: Timid approaches to a normalisation of monetary policy worldwide: US base rates vs. average key interest rates in the G10 countries

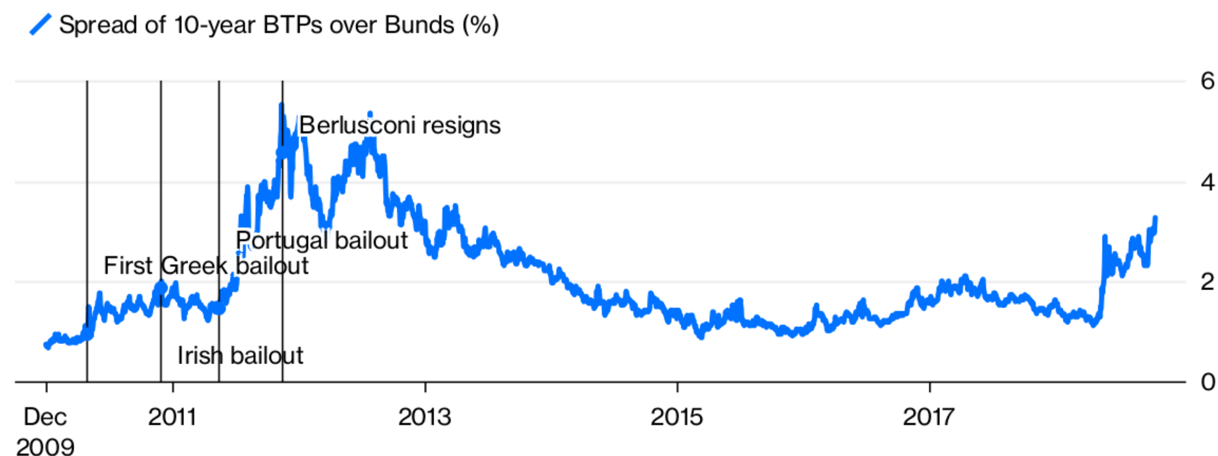


Source: Bloomberg LP, 2018

Italy could tip the scales in the Eurozone

- In Europe, the past year was marked above all by the return of divergence between the bond markets of the core Eurozone countries and those on the periphery. The trigger for this was the budget adopted by the new populist government in Italy, which violated EU directives and sparked a conflict with the EU Commission. As a result, spreads on Italian BTPs against government bonds rose rapidly, recalling the Euro crisis of 2011/12 (see Fig. 15).

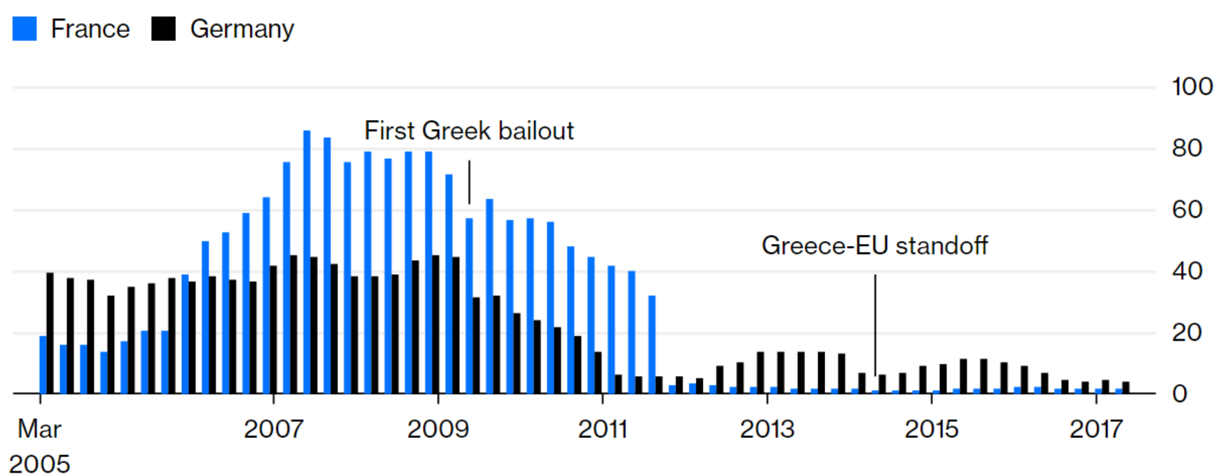
Fig. 15: Investors demand the highest risk premiums for Italian bonds since the 2011 Eurozone crisis



Source: Bloomberg LP, 2018

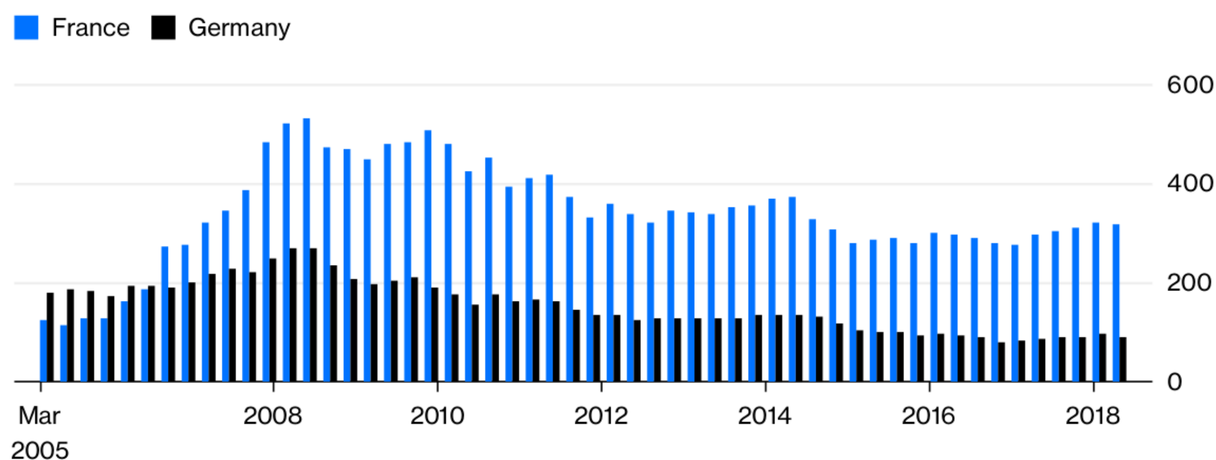
- We expect the BTP market to set the tone for all spreads of EU peripheral issuers over the coming year. However, we consider it unlikely that the BTP Bund spread will widen significantly beyond the current level and do not believe that comparisons drawn everywhere with the escalation of the conflict between Greece and the EU/ECB serve as a blueprint.
- Altogether, Italy faces three problems in this context:
  1) *Conflict with EU Commission over violation of budget rules*
     Essentially, this is a purely political problem. In view of Italy's crucial importance for the Eurozone, the likelihood of the Commission allowing this to escalate, as it did in the case of Greece, is practically non-existent. In contrast to Greece, from whose economy foreign banks largely withdrew after several bailout rounds at the time of the escalation, the exposure of the wider EU banking sector to Italy has decreased only slightly (see Fig. 16 and Fig. 17).
  2) *The question of whether the public debt burden of more than 130% of GDP is sustainable in the long term*
     The fact that Italy has not succeeded in producing robust growth even under the favourable macroeconomic and monetary conditions of recent years is indeed a cause for concern in this regard. Over the shorter term, however, this is unlikely to jeopardise the refinancing of public debt and market access. Italy has a primary budget surplus and a positive current account. In addition, private households have high savings balances and the fact that most of the bonds are in domestic hands greatly reduces the likelihood of capital flight.
  3) *Dependency relationship between the Italian State and the banking sector ('doom loop')*
     A direct problem is posed by the prominent role played by BTPs in the balance sheets of Italian banks and the regulatory incentives that strengthen this position. This opens up a transmission path through which bond price losses are directly reflected in bank balance sheets as capital losses. However, thanks to the unbundling and the trend towards re-nationalisation of the European banking system since the debt crisis, the risk of contagion and the potential systemic fallout have been substantially reduced.
- All this suggests that, although a sustainable solution to the problem is a long way off, an expansion into an acute crisis, which once again focuses on convertibility risks and the continued existence of the Euro, is equally unlikely in the coming year.

Fig. 16: Exposure of European banks to Greece



Source: Bloomberg LP, 2018

Fig. 17: Exposure of European banks to Italy



Source: Bloomberg LP, 2018

Disappointing year for inflation-protected bonds presents opportunities for 2019

- There was much to suggest that 2018 would be a good year for inflation-protected bonds. Many of the heavyweights among the developed countries and leading issuers of this type of bond, such as the United States, Great Britain and Germany, report full employment and rising wage agreements. Nevertheless, the break-even rates of inflation are at year-end lows (see Fig. 18). Inflation linkers were therefore unable to keep pace with their conventional counterparts across the board and lagged the latter by more than 2.5% over the year (FTSE World Government Bond Index vs. Bloomberg Barclays World Inflation-Linked Index).
- This was primarily due to the unexpectedly sharp drop in oil prices in the fourth quarter. However, structural developments such as declining productivity gains, accentuation of income inequality and wealth distribution and declining organisation – and thus bargaining power on the part of employees – are also increasingly weakening the link between the labour market and inflation postulated by the Philips curve.
- However, the late-cycle economic momentum should still be good for one or two inflationary surprises in the coming year. We are also of the opinion that the decline in energy prices to this extent will not be permanent (see also the chapter "Commodities"). It would also be a mistake to

ignore the inflationary potential of the smouldering trade conflicts in the event of a further escalation. The low break-even rates currently offer a favourable and low-risk entry opportunity for these scenarios.

- In this context, the biggest question mark for next year is the path of inflation in the UK. A hard Brexit without transitional arrangements with the EU could trigger a price shock, partly because of the expected impact on the pound, but also because of shortages of food and basic necessities. On the other hand, in the event of an orderly withdrawal or even remaining in the Union, currency-driven inflation expectations could be expected to fall. The recent winning strategy of combining long positions in index-linked Gilts with short positions in conventional Gilts is thus at a crossroads.

Fig. 18: The unexpectedly sharp drop in oil prices has put significant pressure on inflation break-even rates

Source: Bloomberg LP, 2018

Emerging market bonds: light at the end of the tunnel

- After an attractive start to the year, at least for local-currency bonds, emerging market bond markets came under abrupt and significant selling pressure from April. The trigger for this was the broad-based devaluation of the EM-FX complex against the backdrop of steadily rising interest rates in the United States and the associated appreciation pressure on the US dollar. In many emerging markets, this fuelled fears of uncontrolled capital flight, forced central banks to raise interest rates and dampened the economic outlook. Added to this was the threat of trade conflicts for export-dependent emerging-market economies.
- As expected, EM bonds issued as hard-currency liabilities (mostly US dollars) displayed greater resilience against this backdrop, but nevertheless fell by around 5% over the year (JP Morgen EMBI Global Index). Bonds issued in local currency had a difficult time and lost around 8% in USD terms according to the JP Morgan GBI-EM Diversified Index.
- Over the course of the fourth quarter, emerging market bonds showed the first signs of recovery. It is no coincidence that this coincided with a bottoming out of many EM currencies (see also the chapter "Macroeconomic Trends"). Moderate statements by US Federal Reserve Chairman Powell suggest that the Federal Reserve will hold back on tightening its monetary policy in the coming

months. This should support emerging market bonds in local currency, especially if it slows down and eventually reverses the appreciation of the US dollar.

Fig. 19: Hard times for emerging market bonds in 2018 , but prospects have brightened markedly

Source: Bloomberg LP, 2018

- While emerging markets face a number of challenges and risks in the face of the global trend towards a gradual normalisation of monetary policy, as shown by the experience of tapering in 2013 with similar facts, these should not be overestimated. The current account balances of the emerging markets have improved considerably since 2013. Overall, the current account surplus of the emerging markets grew from 0.1% to 0.8% of GDP during this period. Even in the emerging markets with deficits, the gap has narrowed and now stands at only 1.7% of GDP, compared with around 4% at the time of the fear of throttling.
- In addition, inflation in emerging markets is still well below its long-term average and continues to fall. Prices are currently rising at around 3% per year, almost two percentage points below the average rate of the last twenty years. The average inflation rate in the emerging markets has fallen with almost no interruption since 2012.
- Even the claim that companies in emerging markets are overindebted does not stand up to scrutiny. Credit creation in recent years has been concentrated in China. Taking this out of consideration, the picture of corporate debt as a percentage of GDP shows a decline from over 100% to just under 48% – just three percentage points more than five years ago. For comparison: In contrast, it is 72% of GDP in the United States, 100% in the Eurozone and 103% in Japan.
- It is also encouraging that borrowing in the emerging markets is slowing. Measured as a percentage of GDP, the credit gap, i.e. the gap between current and trend rates in private debt growth, is shrinking in all major economies. In China, the difference has fallen from a peak of 27% of GDP to 17%. In Brazil, India and Russia, the gap is now even negative.
- All this makes emerging market bonds with an average yield on local and hard currency bonds of 6.5% to 7% look cheap and attractive; they open up the prospect for 2019 of an environment that allows the asset class to make up at least a large part of last year's losses.

Credit markets: hoard of instability

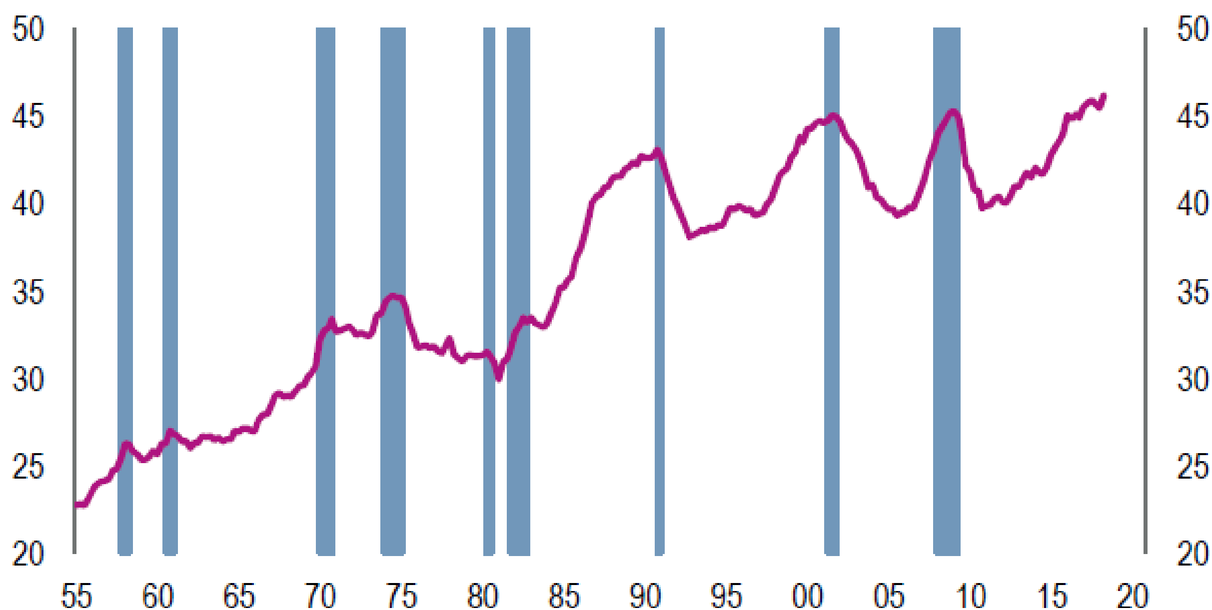
- On the credit markets, the first half of 2018 was marked by an unusual divergence between investment grade and high-yield bond yields in the USD area. While the yield premiums for the former widened markedly as financing conditions tightened, the latter followed the relaxed market sentiment on the US equity markets and recorded new lows. All this changed abruptly in autumn with the turnaround in US equities markets. However, spreads are still trading considerably lower than at the peak of the last phase of growth anxiety in 2016 (see Fig. 20).

Fig. 20: Compression phase completed: Credit spreads in investment grade and high yield sector expected to continue widening in 2019

Source: Bloomberg LP, 2018

- It is becoming increasingly clear that the credit markets are probably the weakest link in the chain of global risk sources. In a market environment characterised by increasing risk aversion, we believe that the trend towards widening credit spreads in both the US dollar and the Eurozone will continue over the coming year. There are a number of reasons for this:
- The era of cheap money and unlimited liquidity over the past decade, combined with a subdued economic environment that offered only limited organic growth opportunities, has given companies incentives to leverage their balance sheets to an unprecedented extent. Hence corporate debt relative to gross domestic product has hit a record level beyond that reached before recent recessions (see Fig. 21). In a weaker economic environment or only under tighter financing conditions, towards which monetary policy is working, this will inevitably lead to a significant increase in default rates.

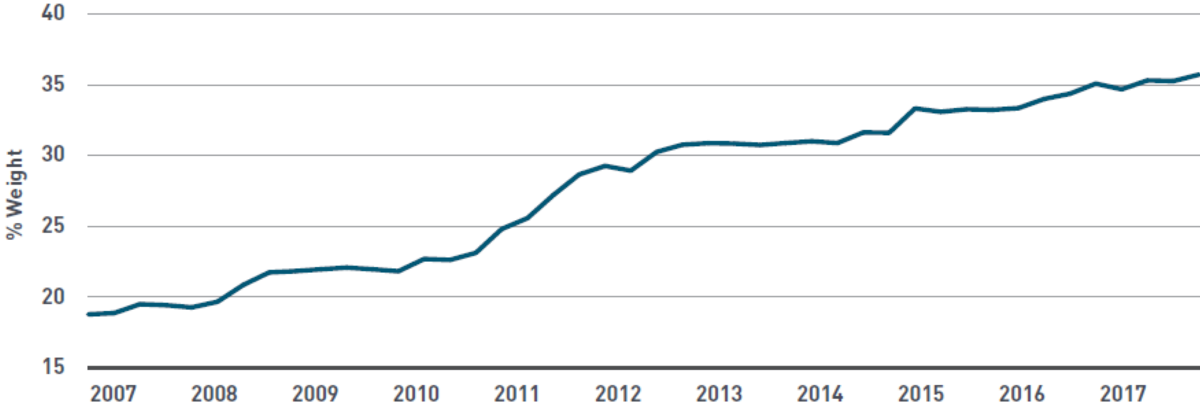
Fig. 21: Corporate debt in relation to gross domestic product at record level beyond pre-recession levels



Source: FRB, BEA, Haver Analytics, NATIXIS, 2018

- Corporate bonds have an inherently asymmetrical yield profile to the detriment of investors, i.e. they are characterised by a higher downward than upward potential. This is all the more true at the end of this cycle, as the current historically low yields mean that investors will have to forgo many years of coupon income when a company is downgraded or financially restructured.
- Against this backdrop, it is worrying that the proportion of bonds issued by companies with marginal balance sheet quality and a BBB rating in the indexes for investment-grade corporate bonds has risen steadily over the past decade (see Fig. 22. In the event of an economic downturn, they are particularly susceptible to downgrades, and in this case generally suffer from especially pronounced price losses due to their falling out of the investment-grade universe. Worldwide, BBB bonds now account for more than 35 percent of investment-grade indexes (in the United States even 50 percent), whereas ten years ago it was still significantly less than 20 percent. The volume of US BBB bonds alone increased from less than USD 700 bn. to USD 2.5 tr. during this period.
- Specific factors that will likely contribute to higher spreads over the coming year include a slowdown in corporate revenue growth and pressure on profit margins. Negative macro influences result from increasingly tightened monetary policy and flattening yield curves, which weaken the earnings potential of the financial sector. The US high-yield sector in particular is threatened by a crowding out of demand due to a continued rise in US base rates. A decline in issuing activity and less M&A activity could provide mitigating influences.
- The outlook for Europe is particularly bleak. Valuations on the European credit markets have improved over the past year. However, with the discontinuation of the ECB's CSPP corporate bond purchase programme, which has been an essential source of demand over the past two and a half years, buyers at the current spread level are likely to remain scarce. The high-yield sector in particular is suffering from the easing of the investment crisis. In addition, investment funds have already experienced strong outflows of between 7% and 8% of their funds in the past year – a trend that is likely to continue in 2019. Furthermore, the net issuance volume is likely to rise sharply in the coming year due to substantial financing requirements from the banking sector. In Europe, too, the BBB segment is increasingly coming to the fore as a source of risk, and its volume has quintupled to EUR 960 bn.

Fig. 22: Growth in the proportion of BBB-rated corporate bonds in the Bloomberg Barclays Global Credit Index



Source: MFS Investment Management, Barclays, 2018

Commodities

A disappointing year overshadowed by geopolitical influences and macro-factors on the commodity markets

- On the commodity markets, 2018 was disappointing for investors overall. Unlike in previous years, commodities as an asset class have failed to live up to their reputation for not only outperforming traditional asset classes in relative terms during the late expansion phase of the economic cycle, but also for delivering outright attractive yields. Commodities were therefore unable to fulfil their role as portfolio diversifiers last year.
- However, this was not attributable to a lack of constructive fundamental data in the individual commodity sectors. Strong global economic growth was reflected in robust overall demand growth and led to higher production costs in view of full employment and capacity shortages. Constantly falling inventory turnover rates could be observed for metals in particular; this was also true for cereals and, in the first half of the year, in the energy section. Declining availability was reflected in forward curves, which generally flattened out and even inverted in the energy sector and for base metals. This contributed to an overall positive development in the first half of the year.
- Over the summer, however, geopolitical factors prevailed as the trade conflict between the United States and China escalated. The agricultural sector and industrial metals were hit particularly hard. Concerns about a possible consequential weakening of the Chinese economy created additional pressure, despite rapid fiscal and monetary stimulus measures taken by the Chinese government.

Fig. 23: Picard Angst Commodity TR versus Benchmark Indices 2018

Source: Bloomberg LP, 2018

- As the last remaining positive commodities sector, energy prices also suffered a sharp slump towards the end of the year (see Fig. 24). Expectations of a substantial supply gap due to the rein-

troduction of US export sanctions against Iran were not fulfilled, and production increases initiated by Saudi Arabia and Russia as an anticipatory countermeasure for the former resulted in renewed oversupply of the oil market.

- Over the course of the year as a whole, the headwind for the asset class was also felt in the form of the continued appreciation of the US dollar, which was boosted by the US Federal Reserve's continued interest rate hikes. This particularly affected precious metals, which were unable to profit as a safe haven despite increased political risks and rising risk aversion on the equities markets.
- Against this backdrop, all the broad commodities benchmarks closed the year with significant losses of more than 10 percentage points each (see Fig. 23). Although particularly cyclically exposed representatives with a high proportion of energy, such as the S&P GSCI Commodity TR Index, had reported strong gains until autumn, these melted away rapidly by the end of the year. Unlike the previous three years, our broadly diversified, in-house Picard Angst Commodity TR Strategy 2018 failed to outperform the Bloomberg Commodity TR benchmark.
- In contrast, strategies with a cyclical focus that exclude agricultural commodities from their investment universe and thus exhibit a concentrated exposure to energy commodities and metals recorded significantly positive returns until the autumn. However, the rapid fall in prices in the energy sector in the fourth quarter meant that these investment approaches, including our in-house Picard Angst Energy & Metals TR strategy, were weaker than the broad benchmarks.

Fig. 24: Development of the commodity sectors in 2018

Source: Bloomberg LP, 2018

The tailwind from the ongoing late-cycle expansion of the global economy underpins expectations of a rebound in commodity markets over the coming year

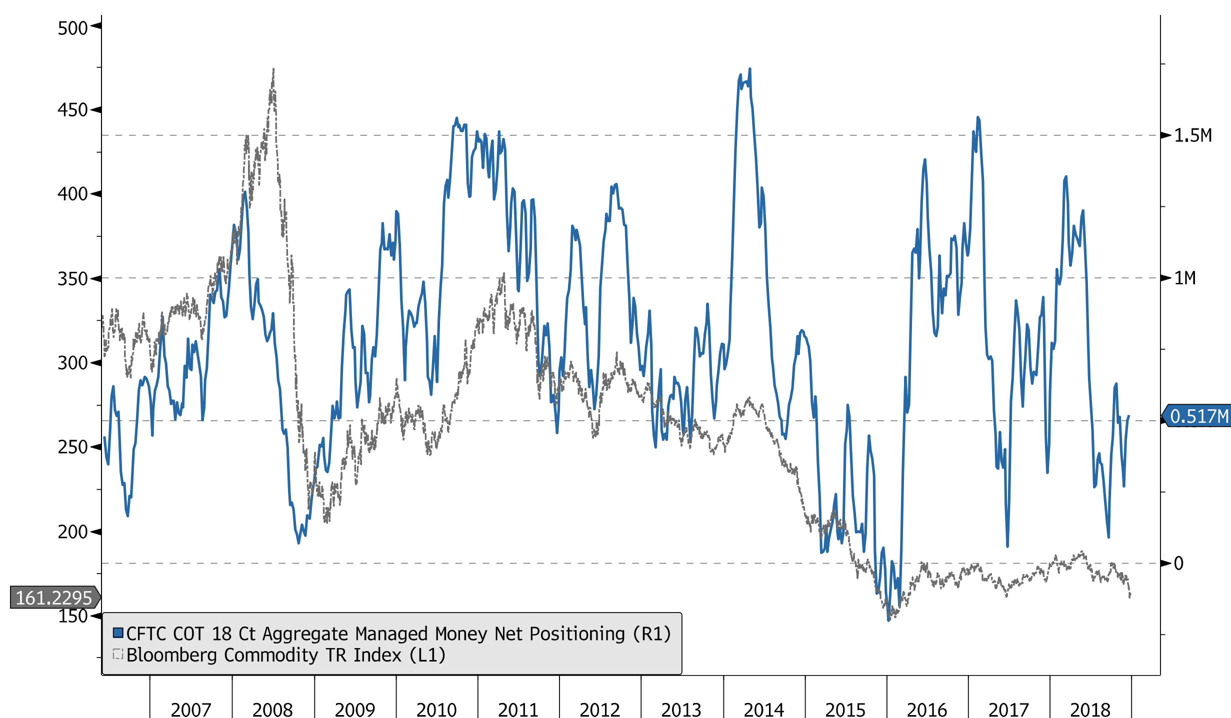
- In the past, commodity prices experienced the biggest appreciation and outperformed other asset classes when the economic cycle had already peaked, resource shortages were felt and central banks began to hit the brakes. In particular, the pronounced outperformance in the late cyclical expansion phase can be explained by the fact that commodity prices are determined by the supply and demand situation on the spot market – unlike financial equities such as shares, which

discount future growth and cash flows. Prices thus rise when the current level of demand exceeds available supply.

- Despite weaker commodity prices over the past year, the robust and once again accelerated growth of the global economy has left reserve capacities further exhausted, and global demand for commodities has again grown. Core inflation rates have also risen as employment rates and wage pressures have increased and are likely to continue to rise in 2019, although broad consumer price indices will weaken over the coming months as a result of the sharp fall in energy prices.
- At first glance, the slowdown in growth expected for 2019 appears to be a negative factor. However, this ignores the fact that commodity prices are primarily determined by the level of activity and not just by growth. As long as demand outweighs supply, positive returns can generally be expected.
- Against the backdrop of the sharp correction in spot prices in recent months, there are good prospects for a substantial recovery in commodity prices in 2019. However, this presupposes that the dispute over the structuring of world trade does not escalate any further and that an amicable settlement will soon be reached, especially between the United States and China. Under such favourable conditions, we expect our in-house commodity investment strategies to generate overall returns of between 10 and 15 percent.
- Specifically, the following factors in particular are expected to support commodity markets in 2019:
  - sustained employment growth and the closing of output gaps are driving the wage spiral and an accelerating rise in core inflation. Of all asset classes, commodities have the highest sensitivity to changes in inflation and are therefore particularly suitable for hedging portfolios against inflation.
  - The sharp decline in capital expenditures and investments in new production capacities since the global financial crisis is increasingly becoming a limiting factor in meeting rising demand.
  - The majority of the most traded commodities now have declining inventory turnover rates and thus supply deficits. The reduced availability of commodities also has an impact on the maturity structure. The forward curves, especially for base metals and individual agricultural commodities, have flattened out recently and in some cases inverted. The roll yield profile for investors is thus materially improved.
  - Commodities generally benefit from monetary policy tightening its reigns. Just as demand, which exceeds available supply capacities, leads to upward pressure on commodity prices, this usually provokes a defensive reaction from central banks. On average, the cyclical industrial metals and energy sectors are benefiting in particular.
  - The US Federal Reserve's leading role in the normalisation of monetary policy was reflected last year in a substantial appreciation of the US dollar on a trade-weighted basis. Meanwhile, however, there are increasing signs that the US interest rate cycle is approaching its peak, while other central banks will step up their tightening efforts. A gradual weakening of the dollar is therefore to be expected for the coming year, which will have a tailwind effect on the commodity markets.
  - With the deterioration in sentiment, investor exposure to the commodity markets has also declined significantly. Substantial capital outflows in the second half of the year have brought the net positioning of financial investors to the lower end of the historical range (see Fig. 25). In the past, this investor positioning data has proven to be a useful counter-indicator, as extreme values have often preceded trend reversals.
  - Over the past year, interest rates for collateral yield on commodity investments have recovered appreciably by more than one percentage point and should reach a level above 3% in 2019 in view of foreseeable further interest rate hikes.
  - Over the past year, commodities in a mixed portfolio have not had the expected diversifying effect. However, should political factors recede into the background, it is to be expected

that they will re-establish the regime of low correlation of previous years with equities and bonds. The correlations between the individual commodity sectors continue to move towards zero.

Fig. 25: Investor exposure to commodity markets has fallen back to the lower end of the historical range



Source: Bloomberg LP, 2018

- Among the risks that could jeopardise our positive scenario for the commodity markets are the following:
  - The escalation of the smouldering trade dispute between the United States, China and the EU into an all-out trade war could torpedo the growth of the world economy and severely affect demand for commodities. On the other hand, should the impact of new tariff barriers be limited, the resulting friction and increased production costs will tend to be reflected in rising commodity prices.
  - Economic momentum in China has been much more severely affected by the consequences of the trade conflict than the US economy. A significant further cooling of the Chinese economy would have far-reaching effects on the energy, metal and agricultural markets. However, China has already introduced far-reaching fiscal and monetary policy measures to stimulate the economy. Their effect should become increasingly apparent over the coming months and – if successful – keep growth above the six percent mark in 2019.

Energy

The development of energy prices in 2018 resembled a roller coaster ride. In the first half of the year, prices for oil and petroleum products continued to recover. The decisive factor for this was the disciplined adherence of OPEC and Russia to the agreed production restrictions. Given the extremely robust demand growth driven by emerging markets, the objective of normalising global inventory turnover rates earlier than hoped was achieved in the spring; this was reflected in a pronounced backwardation and high annualised roll yields of more than ten percent.

The unilateral withdrawal of the United States from the nuclear agreement with Iran and the announcement of the reintroduction of sanctions on oil exports fuelled fears of a shortage on the world market, prompting Saudi Arabia and Russia to increase production again over the summer. Nevertheless, as the sanctions on Iran came into force, the price of oil erupted once again, reaching almost USD 90 per barrel on a Brent basis. As a result, however, generous exemptions for a number of importing countries and an acceleration in the growth of shale oil production in the United States encouraged by high prices caused the market to tilt. Rapidly rising inventory turnover rates were accompanied by an equally rapid decline in oil prices in the fourth quarter.

It was only at a ministerial meeting in early December that OPEC and Russia were able to agree to change course and settle on a reduction in production quotas of 1.2 million barrels per day. Nevertheless, Brent quotations below USD 54 per barrel at the end of the year can hardly be reconciled with a global economy that remains in robust shape and is expected to grow by more than 3% in 2019. In addition, with WTI prices trading at a significant discount of USD 45 per barrel, the economic viability of a good portion of shale oil production in the United States will again come under pressure. Therefore, if OPEC and Russia consistently adhere to the quotas, the objective of a renewed normalisation of inventory turnover rates should soon be achieved. In this case, a return of the backwardation and a gradual recovery of the Brent price against USD 70 per barrel can be expected.

Industrial metals

In 2018, industrial metals did not succeed in matching the previous year's outstanding total return of over 30%. On the contrary, the important representatives of the sector recorded significant price losses across the board. In addition to the strong US dollar, the price trend was above all dominated by political influences such as the threatened escalation of the trade conflict between China – the largest consumer and producer of industrial metals – and the United States, while friendly and improving fundamental data for the individual metals became a thing of the past.

Sector-wide robust growth in demand contributed to a gradual reduction in inventory turnover rates on the futures exchanges. This was increasingly reflected in the forward curves in the second half of the year. Alongside zinc, copper has thus turned into backwardation, and the term structure of aluminium, lead and nickel has flattened out. Production costs have also risen in various ways, for example in the case of aluminium, where the input factor of alumina has become significantly more expensive due to a shortage of supply. Nickel is increasingly becoming the focus of attention due to its potential for the production of batteries for electric vehicles. According to analyst estimates, the amount of nickel required for battery production will increase tenfold over the next eight years.

However, all of this did not provide any lasting positive impetus for spot price formation in 2018. By now, however, the concerns of the market at the macro level – which range from the growth slowdown in China to the strength of the dollar and the trade conflict – are likely to be reflected in base metal prices and the overall positive fundamentals should come to the fore again in 2019.

Furthermore, it can be assumed that the prospects for the individual metals will diverge significantly in terms of their supply dynamics. The decisive factor here is whether the supply cycle is dominated by long-term or short-term factors. The outlook for copper remains extremely positive, as the slump in capital investments since 2013 has brought the supply growth phase to an end and the development of new production capacities is subject to long lead times. In contrast, the aluminium market is likely to face a headwind. The availability of raw materials and the input factor of energy is not limited. However, the supply-side reforms and new environmental requirements in China have cemented higher cost structures, which will prevent prices from falling back to 2016 levels.

The long-term prospects for base metals remain extremely positive. The mining industry is only slowly moving away from a record low in profit margins, which fell to their lowest level since 1998 in 2016. In the past, they proved to be a reliable indicator for the development of the market balance with a delay of about two years. This suggests that the sector will continue to recover in the coming years as supply deficits increase.

Precious metals

2018 also turned out to be a disappointing year for precious metals. What was particularly significant and worrying for many investors was the apparent lack of sustained demand for gold as a safe haven. This could be largely attributed to a divergent perception of risk in the various regions of the world. For a US investor focused on the booming US economy and equities market, the threat of the trade war must have been much smaller than it was for Asian and European market participants. Historical parallels can also be found here, such as the Asian financial crisis in 1997/98.

Gold also suffered from the continued rise in interest rates in the dollar area, which not only manifested itself at the short end via key interest rates but also at the long end of the curve with bond yields well above three percent. In view of rising interest rate differentials, this was accompanied by a steady appreciation of the US dollar. Muted rising inflation in the first half of the year still dampened the rise in real interest rates, but the collapse in energy prices at the end of the year created additional headwinds.

Against this backdrop, investor sentiment not only took an extreme turn away from gold but also from other monetary precious metals such as silver and platinum. In the course of the price correction below USD 1,200 per troy ounce, the number of short positions in the futures markets for gold – i.e. bets on falling prices – reached record levels, while long positions betting on rising prices reached a multi-year low.

But extremes in investor sentiment and positioning are often harbingers of a turning point for the trend. This reinforces our positive outlook for the sector and for gold in particular. In the wake of rising risk aversion due to falling equity markets, the recovery of the gold price to over USD 1,280 at the end of the year has reminded investors of the value of the precious metal as risk protection, which is likely to initiate a normalisation of investor positioning and in turn provide further revaluation impulses.

The fundamental picture is also changing in favour of gold. As a result, the US Federal Reserve is nearing the end of its cycle of interest rate hikes, which will lead to a gradual depreciation of the dollar. Moreover, there is continuing pressure on the core inflation rates, whose moderating influence on real interest rates should reduce the opportunity costs of holding gold and thus further stimulate investor demand. We therefore expect gold prices to exceed USD 1,400 per troy ounce in 2019.

Agriculture

In addition to base metals, agricultural commodities have felt the effects of the ongoing trade conflict between China and the United States most severely. The result was a noticeable decline in participation in the futures markets for agricultural goods. US soya beans were hit hardest in the price formation, with China reducing a previously used export share of more than 60% to zero. However, the prices of other major US futures contracts on cereals and soft commodities such as cotton also suffered significantly. This development is particularly lamentable for financial investors, who, due to liquidity and market access requirements, are dependent on the contracts of the major US futures exchanges and are generally unable to switch to local markets that are not affected or are benefiting from the situation, for example, for soy beans in South America.

For the time being, the US government is attempting to counter this problem with subsidy payments to its own farmers. However, this delays a market-based solution and reorganisation of production and trade relations. From a purely fundamental perspective, the coming year is expected to bring robust growth in demand. In view of the fact that the past harvest year did not bring any new record yields, stocks and stock-to-use ratios are therefore expected to fall for most cereals. In the case of soft commodities, high surpluses of raw sugar and Arabica coffee are continuing cause for concern. However, a weaker US dollar could help to find a price floor. This further exacerbates the sector's pronounced asymmetric risk profile, as investors are holding on to high net short positions in view of the mainly negative technical momentum signals.

The biggest risk factor and source of hope for a sustained recovery in the sector remains an amicable settlement of the Sino-US trade dispute in the near future. In addition, however, developments on the

weather front are not to be ignored. Global climate models, for example, agree on a return of the El Niño weather phenomenon over the winter, which has already been responsible for pronounced price turbulence on agricultural markets in the past – although its impact on crop yields is extremely difficult to predict in advance.

Picard Angst Funds – Performance 2018

Data as per 31 December 2018

Commodities – Enhanced Beta Strategies

All Commodity Tracker Plus		
Net Assets	USD 115 million	
Performance	Q4 2018	2018
Share Class P (USD)	-6.90%	-10.35%
Benchmark BCOM TR Index	-9.41%	-11.25%

Energy & Metals		
Net Assets	USD 123 million	
Performance	Q4 2018	2018
Share Class P (USD)	-17.11%	-15.47%
Benchmark BCOM ex-Ag ex-LS TR Index	-14.59%	-12.52%

All Commodity Fund (UCITS)		
Net Assets	USD 4 million	
Performance	Q4 2018	2018
Share Class Ca (USD)	-7.64%	-14.47%
Benchmark BCOM TR Index	-9.41%	-11.25%

Commodities – Systematic Long-Short Risk Premia Strategies

Systematic Commodity Alpha		
Net Assets	USD 26 million	
Performance	Q4 2018	2018
Share Class P (USD)	-5.69%	+0.90%

Equities

Picard Angst Systematic Equity Switzerland		
Net Assets	CHF 19 million	
Performance	Q4 2018	2018
Share Class 1 (CHF)	-9.63%	-11.37%

Picard Angst Padma India Fund (UCITS)		
Net Assets	USD 18 million	
Performance	Q4 2018	2018
Share Class I (USD)	+4.92%	-25.18%
Benchmark NSE Nifty 50 Index (USD)	+3.16%	-5.65%

Picard Angst Stabilized European Dividend Income (UCITS)		
Net Assets	EUR 8 million	
Performance	Q4 2018	2018
Share Class P (EUR)	-13.56%	-15.66%
Benchmark Euro STOXX 50 TR Index	-11.91%	-12.46%

Important notice

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