CITYWIRE / TOP 50
INDEPENDENT ASSET MANAGER

MONTHLY PULSE THURSDAY, 30 JANUARY 2020

ECONOMIC OUTLOOK

The announcement of a phase-one deal between the USA and China and the Tories' landslide victory in the UK led to a strong year-end rally in cyclical assets. No doubt: 2019 will go down in history as an exceptionally strong year, which is reflected in a very good performance. Supposedly one hoped that it would continue like this in January. Especially since, in retrospect, the quick saber rattling in Iran and the coronavirus were not on the radar.

There was little economic data released in the US last week. In addition to promising indicators from the US housing market, there were also cautious indicators supporting a further slowdown in US growth this year. However, we remain confident for both the housing market and the labour market. Purchasing managers' index showed a divergent development. While manufacturing PMI worsened surprisingly, the service PMI rose to its highest level since March 2019, with the PMI Composite rising from 52.7 to 53.1 points thanks to the improvement in the service sector. In contrast the outlook for the industrial sector remains difficult. However, the markets are cautiously optimistic. The question that arises is the extent of the coronavirus. Just imagine if hundreds of millions of people were quarantined and there was a break in the supply chain. You obviously going to get slower growth. In such a scenario, the FED would probably be forced to lower interest rates. Since the last ECB meeting, the economic data in the EZ was largely as expected and would be in favour of a continuation of the economic recovery, supported by growth. Due to the economic situation and the low inflation, an extremely expansive monetary policy is still necessary. However, higher growth would require support from fiscal policy and structural reforms.

As per Fixed Income, short-term yields should mainly move in line with monetary policies. Government bond valuations remain expensive and we expect the global cyclical recovery, led by the US, to drive long dated yields higher. Investment Grade credit is expecting modestly to further spread tightening into Q1. The High Yield market outperformed the higher graded ones, tightening spreads much more markedly. US rates showed a strong performance with UST10Y closing at 1.63 (-30bps in January), which is near the all-time low (1.38) seen in mid-2016. The main buy-impulse came from safe haven trades due to ME tensions and the coronavirus fears. The curve (2-10Y) flattened by about 20bps. Within credit, new issues have been in high demand and the search for yield continues. 70% of new supply traded tighter in the secondary market. Generally, return gains are likely to be moderate and we remain our neutral stance.

The Equity market was driven by US-Iran saber rattling and the coronavirus and is back on were we started this month. The stock market is a great indicator of risk sentiment. We see this setback more of a short-term nature and are still positive for both developed and emerging markets in Q1. In sectors, we prefer IT and Financials. Regionally speaking, we have a slight tendency to European over US equities for the time being. Hence, we stay neutral in Equities.

EUR/USD have depreciated slowly but steady this month as yield advantage continues to be USD supportive. JPY has largely profited as a safe haven but should fade away and gold has still room to the upside amid the negative risk sentiment.

TACTICAL ASSET ALLOCATION*

Liquidity	Neutral
Bonds	Neutral
Equities	Neutral
Alternative Investments	Neutral

EQUITY INDICATORS*

Valuation	Underweight
Momentum	Attractive
Seasonality	Attractive
Macro	Neutral

*no changes to previous month

Should you require further information or advise, please do not hesitate to contact your Clarus Capital relationship manager.

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MARKET OVERVIEW AS OF THURSDAY, 30 JANUARY 2020, 3:58 PM

FIXED INCOME

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	1.53	0.00	-0.27	-0.01
USD 1y Swap	1.61	-0.16	-0.13	-0.16
USD 3y Swap	1.40	-0.28	-0.21	-0.27
USD 5y Swap	1.38	-0.33	-0.21	-0.33
USD 10y Swap	1.51	-0.37	-0.20	-0.37
EUR Overnight	-0.45	0.01	0.01	-0.01
EUR 1y Swap	-0.36	-0.04	-0.01	-0.04
EUR 3y Swap	-0.34	-0.10	-0.02	-0.10
EUR 5y Swap	-0.27	-0.16	-0.04	-0.16
EUR 10y Swap	-0.02	-0.23	-0.09	-0.23
CDX Xover 5y	3.02%	0.24%	-0.30%	0.23%
iTraxx Xover 5y	2.30%	0.25%	-0.07%	0.23%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.2%	0.5%	0.9%	0.9%
USD Aggregate 1-3y	0.4%	0.8%	1.7%	0.4%
USD Aggregate 3-5y	0.9%	1.4%	2.6%	0.9%
USD Aggregate 5-7y	1.1%	1.6%	2.9%	1.1%
USD Aggregate 7-10y	2.3%	2.6%	5.1%	2.4%
EUR Overnight	0.0%	-0.1%	-0.2%	0.0%
EUR Aggregate 1-3y	0.1%	0.0%	-0.2%	0.1%
EUR Aggregate 3-5y	0.5%	0.2%	0.0%	0.5%
EUR Aggregate 5-7y	1.1%	0.5%	0.4%	1.1%
EUR Aggregate 7-10y	1.8%	0.7%	0.8%	1.8%
US Corp. HY	0.2%	2.4%	3.7%	0.2%
EUR HY	0.2%	2.1%	2.4%	0.2%

EQUITY

	Price	P/E	D. Yield	FCF yield
MSCI World	6,958	17.4	2.4%	4.2%
S&P 500	3,273	18.8	1.9%	3.8%
NASDAQ	9,102	23.5	1.0%	3.8%
Euro Stoxx 50	3,698	14.3	3.6%	6.8%
SMI	10,744	16.9	3.2%	4.0%
FTSE 100	7,417	13.3	4.6%	7.5%
DAX	13,199	14.3	3.1%	2.2%
MSCI Asia Pacific	169	14.4	2.7%	4.1%
FTSE China A50	13,791	9.7	3.3%	9.2%
MSCI Emerging Market	1,098	12.9	3.0%	5.2%
PH Semiconductor	1,859	20.8	1.7%	4.3%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	0.9%	6.4%	8.6%	0.7%
S&P 500	1.6%	7.4%	8.6%	1.3%
NASDAQ	4.5%	12.6%	14.5%	4.2%
Euro Stoxx 50	-1.3%	2.1%	6.8%	-1.3%
SMI	1.2%	4.8%	8.6%	1.2%
FTSE 100	-2.2%	1.2%	-3.0%	-1.7%
DAX	-0.4%	2.2%	8.7%	-0.4%
MSCI Asia Pacific	-1.2%	4.1%	6.0%	-1.0%
FTSE China A50	-2.1%	-0.8%	1.5%	-4.1%
MSCI Emerging Market	-1.9%	5.4%	5.2%	-1.5%
PH Semiconductor	0.8%	11.9%	16.6%	0.5%

COMMODITY

	Price	FCST 19	FCST 20	Δ Future
Gold	1,581	1387	1,500	-1.3%
Silver	17.70	16.2	17	-11.2%
Platinum	968	864	967	-13.0%
Palladium	2,188	1502	1,925	-23.4%
Crude Oil	52.42	57.0	59	-2.5%
Brent Oil	58.75	64.0	63	1.7%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	4.1%	5.6%	10.6%	3.8%
Silver	-1.7%	-1.8%	5.3%	-1.2%
Platinum	0.2%	3.3%	9.7%	-1.0%
Palladium	16.3%	22.5%	45.4%	14.6%
Crude Oil	-14.7%	-4.1%	-8.5%	-13.7%
Brent Oil	-11.9%	-0.5%	-6.6%	-11.0%

FOREIGN EXCHANGE

	Price	FCST 19	FCST 20	Δ Spot
EUR/USD	1.1017	1.1100	1.1600	5.2%
GBP/USD	1.2985	1.2900	1.3500	3.9%
USD/CHF	0.9711	0.9900	0.9700	-0.1%
USD/JPY	108.87	108.00	107	-1.7%
EUR/CHF	1.0698	1.1000	1.1200	4.6%
USD/RUB	63.05	64.10	63.70	1.0%
EUR/RUB	69.45	71.10	74.70	7.3%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	-1.7%	-0.9%	-1.2%	-1.9%
GBP/USD	-1.0%	0.9%	6.7%	-2.1%
USD/CHF	-0.3%	2.1%	2.0%	-0.5%
USD/JPY	0.0%	0.0%	-0.2%	-0.3%
EUR/CHF	1.5%	3.0%	3.3%	1.5%
USD/RUB	-1.7%	1.2%	0.7%	-1.7%
EUR/RUB	0.1%	2.4%	2.1%	0.3%

Source: Clarus Capital Group, Bloomberg

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SPECIAL TOPIC: THE ECB'S STRATEGIC REVIEW

ECB PRESIDENT LAGARDE ON THE TOUCHSTONE

The European Central Bank (ECB) has a new President. By the end of the year, it might also have a new strategy and a new set of objectives. This is because Christine Lagarde, shortly after beginning her tenure as ECB chief, has launched a sweeping review into how the ECB conducts monetary policy.

It has been over 16 years since the ECB undertook its last review. In 2003, the euro was only four years old and European economic conditions were significantly different to where they are now. Since 2003, there has been a Global Financial Crisis, a Eurozone Crisis, and a prolonged hangover in terms of reductions in underlying growth and inflation expectations.

These events have necessitated a systematic change in the way monetary policy is conducted. The ECB implemented negative interest rates and significantly expanded its balance sheet. When, since 2003, so much has changed, a review is, as Lagarde has put it, "overdue". The review is intended to be broad, but is likely to cover the ECB's inflation target and how it measures inflation, its use of 'unconventional' monetary policy and its communications strategy.

Interpreting 'Price Stability'

The ECB has a mandate to maintain price stability, established by Article 105(1) of the Maastricht Treaty. The ECB's original strategy, published in 1998, operationalised this mandate by defining price stability as a year-on-year price increase of below 2 percent. This established the ECB's inflation target, setting an upper bound on its inflation target but not an explicit floor (although price *increase* implies an aversion to deflation).

Benoît Cœuré, a former member of the ECB's Executive Board, has suggested the ECB should adopt an inflation target of *2 percent over the medium term*. While a subtle change, this would establish the ECB's inflation target as symmetrical. It would indicate the ECB was willing to accept inflation greater than 2 percent in the short run, so long as medium term inflation converged to 2 percent.

It would also bring the ECB in line with other central banks that have a 'tolerance band' around their 2 percent inflation target, such as the Bank of England and the US Federal Reserve. It may also help to raise inflation expectations if the public understood that the ECB was willing to let inflation rise above 2 percent in the short run in order to achieve inflation of 2 percent over the medium term.

A move to a symmetrical, medium term 2 percent inflation target also replicates some of the benefits of *price level targeting*. Under a price level target, the central bank attempts to keep the price level on a steady growth path, rising by 2 percent per year. The central bank is prepared to make up any shortfall in the growth in prices by allowing inflation to run above 2 percent in later periods. Under a narrow inflation target, periods of low inflation are not made up.

Ben Bernanke, former Federal Reserve Chair, has proposed *price level targeting* in place of inflation targeting when interest rates reach their effective lower bound. If the public believe that the central bank will compensate for periods of low inflation by keeping policy low even when inflation returns to 2 percent, thus allowing inflation to overshoot, this reduces real interest rates by raising inflation expectations. The ECB would thus have greater room to stimulate the economy in periods of stagnation if it were to move to a medium-term 2 percent inflation target.

Measuring Inflation

The ECB has also indicated it will consider how it measures inflation. The Harmonised Index of Consumer Prices (HICP) - its measure of inflation - includes volatile items such as food and energy prices. This can mean the ECB reacts too strongly to short term fluctuations even when core inflation remains subdued. An option would be for the ECB to base its monetary policy decision-making on HICP *excluding food and energy prices*, thus reducing the pressure to react to short term volatility.

The cost of housing enters the HICP only through changes in rents. No weight is given to owner-occupied housing despite the fact that over 65 percent of households across the euro area own their own home. There has been ongoing discussion about how to include a measure of home ownership in the HICP but the ECB has previously argued against including an element of asset price inflation in its headline inflation rate.

The Housing Price Index - a measure of the transaction price of homes - has exceeded the HICP in recent years. This suggests that including some measure of home ownership would boost inflation 'as measured'. It would also mean monetary policy was based more closely on the prices borne by households.

Unconventional Monetary Policy

The review will also need to consider the impact of the ECB's unconventional monetary policy. The ECB recently restarted its Asset Purchase Programme (APP), purchasing assets worth €20 billion per month. There is evidence to suggest previous APP rounds substantially eased financing conditions, complementing the introduction of negative rates. There is

also evidence that, in general, unconventional monetary policy has increased growth and inflation across the euro area.

However, there are questions about the side-effects of unconventional monetary policy, especially when it has been used for a prolonged period. There is debate about the effect on inequality, the profit margins of banks, and how the ECB might eventually begin to normalise policy. It has also been suggested that the ECB should announce that it will continue to provide liquidity via its fixed rate full allotment procedure in order to smooth market functioning.

ECB Communication

The ECB should also use the strategic review as an opportunity to become more transparent. Increased transparency improves forward guidance and central bank independence. Barry Eichengreen, professor at UC Berkeley, has argued that the ECB Governing Council should follow the Federal Reserve, the Bank of England and the Bank of Japan in publishing votes on monetary policy decisions. This would increase accountability and act as a form of forward guidance, indicating the future path of monetary policy.

The risk is, however, that national divisions become more pronounced, with national central bank governors incentivised to act in a way that is viewed as being in their national interest. However, while decisions are currently presented as representing consensus, in reality, divisions are already aired.

Conclusion

The ECB, under a new president, needs to take this opportunity to reflect on a period that has seen great changes in how monetary policy is conducted. The ECB's strategic review thus needs to examine how it continues to best meet its mandate of price stability. This means considering how it defines 'price stability' and the tools that it uses to meet this. But it also needs to make sure that monetary policy is prepared to meet the challenges of the next 13 years.

The ECB has indicated that it expects the review process to be concluded by the end of 2020. Lagarde has said she expects the outcome of the review to be communicated in either November or December 2020.

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IMPRESSUM

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