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MONTHLY PULSE FRIDAY, 30 NOVEMBER 2018

ECONOMIC OUTLOOK

November was full of risk events with flattish equity markets. Even though a Brexit agreement has been accomplished and Italy's Matteo did not force to confront the EU Commission – uncertainties are not over. The bumpy global markets and increased geopolitical risks mean investors should assume a more defensive posture in 2019.

Looking at the global picture, the growth is expected to slow down in 2019. However, with risks to the downside we still find attractive opportunities in markets with strong fundamentals. Hence, we continue to favour the US markets despite the end of the longest equity bull market in August. The combination of tax cuts, immediate expensing of capex, the mandatory repatriation of overseas profits and a broad deregulation push should incentivize further capex.

However, the inflation is still contained although we began to see some signs of improvements in wages. But let's be clear on this topic: it will remain a slow process. Energy prices have assumed to be an important part in evaluation of inflation for many years. Inflation for example has a positive correlation to oil prices. Usually inflation accelerates as oil prices recover. For next year, with growth facing challenges and oil prices drift sideways, we are expecting inflation not to accelerate remarkably. Thus, what does it mean for the FED?

Last month we were still expecting four interest rates hikes in 2019 but we cut our forecasts back to three. With advanced economies still growing, although at slower pace, and inflation contained, we expect to see a convergence of monetary policy next year. Central Banks are normalizing their balance sheets resulting in less global liquidity. Additionally, being in a late business cycle, higher interest rates will be rather challenging, and the FED continues to act data-dependent. FED's Powell hint of fewer rate hikes this week underpins its easing stance. And lastly, not to forget the ongoing tariffs dispute between US and China. Looks like a never-ending story as we do not see any positive outcome very soon.

For Fixed Income we look to the front end of the US yields curve. FED's stance is just below neutral with rates near a cyclical peak and the yield curve will continue to flatten as the US rates continue to rise – even though not at the same pace as markets anticipated so far.

On Equities we continue to favour US over Europe. Since Treasuries are yielding now more then the dividend yields on the S&P 500, we suggest to add flexibility to porfolios and diversify across regions and sectors. Tech is still the place to be in our opinion – Communication to a certain extent as well. We are still on hold for EM equites despite the pullback and prefer to have some reserves in the form of cash to play opportunistic.

Gold was mixed in November and moved inversely to the USD. Any upward moves were rather limited despite the financial markets and geopolitical risks. We stick to Gold as a strategic position in our portfolios. Oil dropped below USD 50 per barrel for the first time over a year due to oversupply. Its decline should not continue further at this pace but rather stablize around USD 50-60 for the coming weeks. EUR/USD was fairly under pressure but recovered the last days due to lower anticipation for USD rate hikes. However, geopolitical risks are still looming on this currency pair.

TACTICAL ASSET ALLOCATION

Liquidity	Neutral
Bonds	Underweight
Equities	**Overweight***
Alternative Investments	Neutral

EQUITY INDICATORS

Valuation	Attractive
Momentum	Negative
Seasonality	Attractive
Macro	Attractive

*compared to previous month Equites changed from Neutral to Overweight.

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 FRIDAY, 30 NOVEMBER 2018, 4:28 PM

FIXED INCOME

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	2.18	0.01	0.27	0.75
USD 1y Swap	2.91	0.01	0.25	1.01
USD 3y Swap	2.98	-0.13	0.11	0.81
USD 5y Swap	2.97	-0.15	0.09	0.73
USD 10y Swap	3.05	-0.16	0.12	0.66
EUR Overnight	-0.37	0.00	0.00	-0.02
EUR 1y Swap	-0.24	0.00	0.01	0.02
EUR 3y Swap	-0.02	-0.06	-0.01	-0.03
EUR 5y Swap	0.27	-0.08	-0.01	-0.04
EUR 10y Swap	0.88	-0.08	0.01	-0.01
CDX Xover 5y	3.86%	0.11%	0.56%	0.80%
iTraxx Xover 5y	3.30%	0.32%	0.30%	0.97%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.2%	0.5%	0.9%	0.9%
USD Aggregate 1-3y	0.3%	0.3%	0.7%	0.8%
USD Aggregate 3-5y	0.5%	0.0%	0.5%	-0.2%
USD Aggregate 5-7y	0.6%	-0.2%	0.4%	-0.7%
USD Aggregate 7-10y	0.8%	-0.8%	-0.1%	-1.9%
EUR Overnight	0.0%	-0.1%	-0.2%	-0.3%
EUR Aggregate 1-3y	0.0%	0.1%	0.1%	-0.3%
EUR Aggregate 3-5y	0.1%	0.1%	0.1%	-0.4%
EUR Aggregate 5-7y	0.2%	0.0%	0.1%	-0.6%
EUR Aggregate 7-10y	0.3%	-0.1%	0.2%	-0.3%
US Corp. HY	-0.9%	-1.9%	0.3%	0.0%
EUR HY	-1.9%	-2.8%	-1.7%	-2.9%

EQUITY

	Price	P/E	D. Yield	FCF yield
MSCI World	5,838	15.4	2.6%	5.5%
S&P 500	2,738	16.7	2.0%	5.1%
NASDAQ	6,892	19.1	1.1%	4.6%
Euro Stoxx 50	3,165	13.3	3.9%	5.9%
SMI	8,998	16.1	3.5%	5.4%
FTSE 100	6,990	12.4	4.8%	9.1%
DAX	11,232	12.5	3.5%	4.7%
MSCI Asia Pacific	154	12.6	2.9%	6.9%
FTSE China A50	11,001	9.1	3.6%	25.3%
MSCI Emerging Market	998	11.7	3.0%	6.1%
PH Semiconductor	1,221	12.8	2.1%	6.5%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	0.8%	-6.1%	-2.0%	-1.5%
S&P 500	1.0%	-5.6%	1.2%	2.4%
NASDAQ	-1.1%	-10.0%	-1.1%	7.8%
Euro Stoxx 50	-1.0%	-6.7%	-7.1%	-9.7%
SMI	-0.3%	0.3%	6.4%	-4.1%
FTSE 100	-1.9%	-6.0%	-9.0%	-9.1%
DAX	-1.9%	-9.2%	-10.9%	-13.0%
MSCI Asia Pacific	2.8%	-7.2%	-10.7%	-11.6%
FTSE China A50	-0.8%	-2.7%	-10.9%	-16.6%
MSCI Emerging Market	4.4%	-5.5%	-10.9%	-13.8%
PH Semiconductor	1.6%	-12.8%	-11.4%	-2.5%

COMMODITY

	Price	FCST 18	FCST 19	Δ Future
Gold	1,222	1270	1265	0.5%
Silver	14.33	15.8	16	1.8%
Platinum	811	887	910	1.3%
Palladium	1,167	996	1040.2	-3.9%
Crude Oil	50.66	67.0	68.78	3.2%
Brent Oil	58.84	73.7	75.5	1.8%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	0.6%	1.7%	-6.0%	-6.7%
Silver	-0.5%	-2.3%	-14.7%	-18.5%
Platinum	-3.7%	2.7%	-11.9%	-15.0%
Palladium	9.9%	21.2%	20.1%	11.7%
Crude Oil	-22.6%	-26.4%	-22.4%	-12.3%
Brent Oil	-21.6%	-23.7%	-22.4%	-7.1%

FOREIGN EXCHANGE

	Price	FCST 18	FCST 19	Δ Spot
EUR/USD	1.1373	1.1500	1.2000	5.4%
GBP/USD	1.2751	1.3000	1.3700	7.2%
USD/CHF	0.9978	1.0000	0.9700	-2.8%
USD/JPY	113.50	113.00	109	-4.0%
EUR/CHF	1.1348	1.1400	1.1800	3.9%
USD/RUB	66.90	66.66	67.00	0.1%
EUR/RUB	76.08	77.08	81.90	7.4%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	0.5%	-2.0%	-2.7%	-5.3%
GBP/USD	-0.1%	-1.6%	-4.1%	-5.6%
USD/CHF	1.1%	-2.9%	-1.2%	-2.4%
USD/JPY	-0.5%	-2.2%	-4.1%	-0.7%
EUR/CHF	0.5%	-0.9%	1.6%	3.1%
USD/RUB	-1.5%	1.0%	-6.7%	-13.9%
EUR/RUB	-2.0%	2.9%	-4.1%	-8.9%

Source: Clarus Capital Group, Bloomberg

THEME IN THE SPOTLIGHT: LEVERAGE

GLOBAL LEVERAGE – THE NEXT CRUNCH?

Despite the post financial crisis to reduce debt, the debt load has increased and could trigger the next crisis – far more painful than the previous one. Central banks are becoming more cautious: the FED for example has flagged leveraged loans as potential risk to financial stability. Additionally, BIS and the IMF are seeing global boom and deteriorating credit quality as a potential risk.

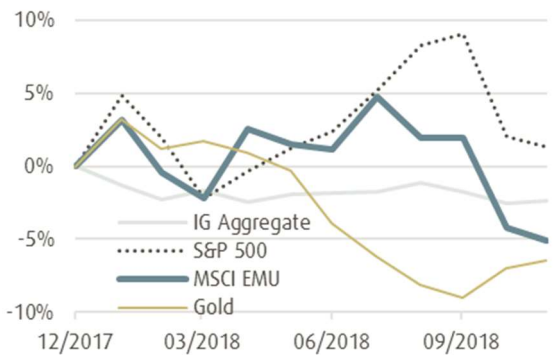
Countries can certainly grow out of high debt if their GDP growth is of a productive nature and the returns on investment exceed the cost of the debt. However, looking at China, the opposite happened in recent years. The GDP figures include inefficiency and bad decisions born out of central planning. Anecdotally, this is visible in the ghost cities, uninhabited housing stock and unutilized infrastructure. Hence debt sustainability is crucial. Not only in China but in the west as well. Debt to service ratios could get out of control in countries like Australia and Canada. Both commodity producing nations have a ballooning real estate market, fuelled by overseas investor money and low rates. Not to imagine what could happen when interest rates are increasing. Argentina and Turkey stared down economic collapse over the summer partly because the countries and its corporations owed too much debt – foreign currency debt. As USD has strengthened since February, emerging market currencies have weakened. As these local currencies fetched fewer USD, repaying their debts became a challenge. Should the FED accelerate its monetary policy, emerging markets could feel pinched sooner as investors are seeking more into HY and safer US assets. Another ticking bomb we see in the US, where highly leveraged deals make up about half of all corporate loans – higher than levels seen before the financial crisis.

We mostly agree that many asset prices have been elevated by policy and could be vulnerable. When interest rates rise the leverage could create stress disproportionately, leading to default, counterparty failure, fire sales and a contagious chain reaction through the system. We all have already seen it before. Hence, investors should remain cautious, focusing on defensive and quality credits in the US.

THEME IN THE SPOTLIGHT: DIVERSIFICATION

NOWHERE TO HIDE

2018 so far, has proved a challenging year with equity markets seeing highs of more than 7 percent in January just to be shuttered down in February to a -2 percent. Markets slowly climbed up to almost 12 percent gains until beginning of October. And October wiped out all the gains of the year. We are putting a high probability to a year-end rally and are therefore overweighting equities. However, the US market has been one of the best equity regions. European equity markets went down by -5 percent, Asia/Pacific by -12 percent and Emerging Markets more than -10 percent.



Source: Bloomberg, Clarus Capital Group

Therefore, let us have a look at the usual suspects for diversification. Normally bad equity markets are good for gold. But due to a stronger USD, Gold also lost more than 5 percent year-to-date. What happened to the other diversifier in a classical portfolio?

Bonds have been hit by the rising interest rate environment. Investing into USD Bonds led to a loss of -2 percent. EUR bonds showed similar losses. High yield markets performed slightly better. How does this translate into a balanced portfolio?

This sums up to the result that most of the competitors' balanced strategies lost between 4 and 6 percent in USD and 6 and 7 percent in EUR. Yield mandates were only slightly better off between -3 to 4 percent in USD and similar in EUR. Alternative weighting concepts than the traditional asset classes approach such as risk parity were even showing worse performance. As markets were developing sideward, it was difficult for quantitative concepts to grasp the correct positioning. Thanks to our conservative approach in terms of duration and our better positioning in equity markets we were able to outperform peers on average by more than 2 percent.

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IMPRESSUM

PUBLISHED BY CLARUS CAPITAL GROUP AG, GUTENBERGSTRASSE 10, CH-8002 ZURICH,
RESEARCH@CLARUSCAPITAL.CH, WWW.CLARUSCAPITAL.CH

EDITORS ROGER GANZ, HEAD ASSET MANAGEMENT, DEJAN RISTIC, ASSET MANAGEMENT