Prime Partners

SINCE 1998

MARKET INSIGHT

MAY 2019

CITYWIRE TOP 50
INDEPENDENT ASSET MANAGER

Market Insight

May 2019

A new record high in New York!

The S&P 500 achieved a new all-time high in recent weeks, buoyed by a stabilisation of the global economy thanks to Chinese economic data and US GDP figures for Q1 2019, in particular. April's rise in risky assets was also helped by a satisfactory earnings season and political tensions – the results of the Spanish election for example – being largely kept in check.

Contrary to what Voltaire wrote in *Candide*, this does not necessarily mean that "all is for the best in the best of all possible worlds" though.

There are certain factors that should prompt us to keep a cautious eye on the rally in risky assets.

First of all, we should once again note that the stock market rise is taking place with a fall in bond yields, which may lead to question the investor's (potential) schizophrenic behaviour – unless you believe that we are in a Goldilocks scenario again. In this respect, we doubt that international growth will pick up significantly in the coming quarters.

Secondly, April saw renewed turmoil in emerging markets, in particular in Argentina and Turkey. Even though more satisfactory liquidity conditions then in 2018 mean we shouldn't exaggerate the potential for emerging market instability to have a knock-on effect on the developed world, it isn't something we should just overlook either.

The fall in the peso is a stark reminder of how challenging the Latin American economic conditions are. The situation in Turkey is no less worrying if we are to believe recent reports suggesting that the central bank manipulated foreign currency reserves.

Directly related to this, the third risk factor that may affect the durability of the market upturn is the generalised USD rebound on the forex market. It is hovering around 1.11 against the euro.

"We still believe that investors are pricing in the most optimistic economic and financial market scenario"

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

The strength of the greenback – and that's without taking into account any potential future appreciation – is bad news for the global recovery scenario, as it means lower international liquidity. We are therefore compelled to revise our targets for the euro / dollar exchange rate for end-2019 to 1.18 and for short-term fluctuation margins to 1.10–1.15. However, these changes do not affect our negative view on the dollar for the coming months.

The lack of convincing signs of an improvement in economic activity in Europe also urges caution. The view that Europe will remain the sick man of the global economy raises doubts about the likelihood of a Goldilocks economy settling in for a prolonged period.

All this might sound like doom and gloom and lead you to believe that we are in dangerous territory, but that's not the message we are trying to convey.

We merely want to highlight some of the more significant risks that should be taken into account when assessing the moderate improvement in the economy. As we had expected, the latter has begun to stabilise and this trend is being confirmed with each passing week. The real question is how strong the rebound will be between now and the end of 2019. This is a valid question given that risks still remain, and even more so because it is uncertain how long this rebound will last.

On the earnings front, it's fair to say that the reporting season has been generally positive, with results suggesting that the worst is behind us after two quarters of poor profit growth.

With regard to market behaviour since the start of the year, we must admit that our decision to adopt a more defensive positioning in March was premature, even though economic conditions were in line with our expectations.

Are we focusing too much on risk management (see above) in our allocation? One could be inclined to say so if it weren't for the fact that our allocations have actually performed well. Not only this, but we have also managed to significantly limit the volatility of our portfolios in recent months with our more defensive approach; in other words, profit-taking does not only have disadvantages!

We did not increase the overall risk in our portfolios in April due to a relatively unfavourable valuation of the risk assets, fuelled by the perhaps exaggerated view that nothing can prevent an extension of the economic and financial cycle.

We maintained our underweight in equities and developed market corporate bonds in favour of cash and liquid alternative products. We are sticking to our policy of positioning ourselves on uncorrelated assets in case financial markets take a turn for the worse.

In addition, given the change in medium-term monetary policy prospects in the G7 countries, we have reduced cash in favour of alternative strategies such as global macro or relative value, with a preference for fixed income assets.

After abandoning our quantitative long/short global equities strategy in March, we opened a position on a similar product for European equities, but with a more concentrated, discretionary style. Despite their disappointing performance over the past few months, we are still interested in liquid alternative equity vehicles.

Gold once again fell short of our expectations in recent weeks. We would still recommend buying into weakness, given our cautious scenario on the dollar and a favourable trend in the cost of capital.

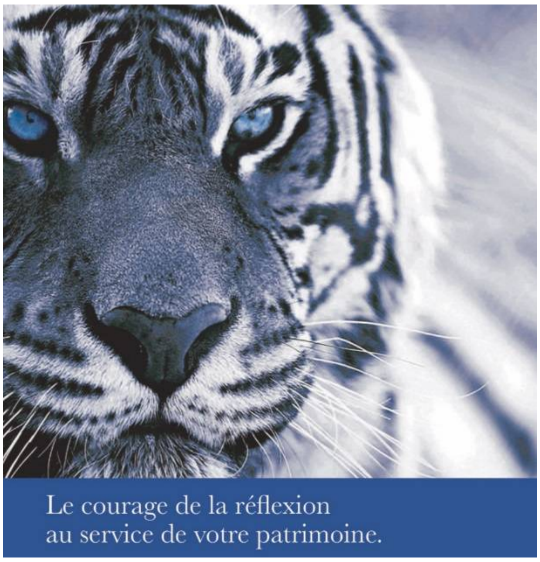
The financial markets always hold surprises, be they good ones as we've seen this year, or bad ones like last year. While navigating market extremes is certainly the most interesting side of asset allocation-based management, it also presents the greatest challenge.

As Euripides said: "To my mind, bravery is forethought". Taking the time to make a decision is just as, if not more, courageous than acting with haste.

This year, as we have done for the past 20 years, we have decided to stay the course we had set ourselves, as it is the one most in line with our view of the economic and financial environment.

On this note, please find enclosed our new publicity campaign marking our 20th anniversary in the business.

In our opinion, the bravery of forethought perfectly encapsulates our independent world view and our ability to explain the rationale behind our recommendations, with a view to being able to meet your performance expectations.

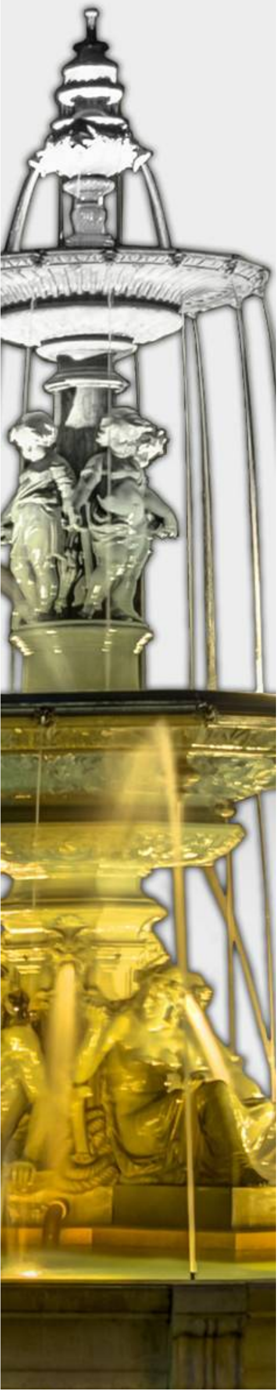


We hope to maintain your trust precisely because we have the courage to present our views on the markets month after month, in an effort to be as transparent as possible about our decisions.

We started 2019 with two strong convictions: the risk management and the need for a more tactical investment policy would be key! Despite the mistakes that we may have made, we hope we have proven that we do indeed act in accordance with our advises!

We see no reason to change these two convictions, especially as the decline in volatility (VIX index) seems overdone to us in light of the risks we mentioned in the introduction.

In conclusion, we still believe that investors are pricing in the most optimistic economic and financial market scenario, and that the accommodative tone of the central banks is fully reflected in asset prices.



As such, one shouldn't hesitate in taking profits or, at the very least, in finding sources of decorrelation in a diversified portfolio. This principle has been at the heart of our decisions over the past few months, and we will continue to stick by it. We would be pleased to see a consolidation in the recent gain of risk assets and we would take advantage of it to adjust our course if necessary.

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