Prime Partners

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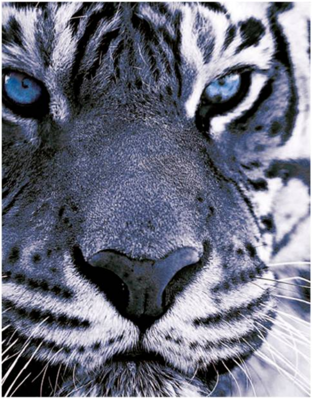
MARKET INSIGHT

JULY 2019

CITYWIRE TOP 50 INDEPENDENT ASSET MANAGER



Market Analysis

July 2019

Gone with the wind

At the end of a hectic May for the global financial markets, one could justifiably conclude that investors had grown more averse to risk, in the wake of growing economic uncertainty and unabating geopolitical tensions. In the past few months, we've been wary of market player sentiment – which tends to fluctuate sharply and often dramatically – and stated our intention to seize opportunities in risky assets (convertible bonds or equities) based on these developments and our overall market analysis.

Then came June, which showed the pressing need for investors to be more flexible, more tactical and quicker off the mark than ever in adjusting their exposure to financial assets. Wall Street perfectly illustrates our argument: the S&P 500 hit a new record in the past few weeks, rallying over 5% from the previous month.

Are we to assume then that the doubts that assailed market players and investors in May are – to quote Victor Fleming's 1939 epic – gone with the wind? Or better still, do the fundamentals now herald radiantly sunlit uplands for investors?

The truth is that economic indicators provide no justification for investors' renewed craze for risk, and risky equities in particular.

The fear of recession that haunted the markets in May might have been overblown, but global economic data are far from signalling that we can expect anything better than stabilisation in the coming months. According to the data available, the risks that overshadowed the economic cycle are not insignificant, on either the growth or the inflation front.

Cue the central banks, which (once again) intervened with measures that proved decisive for the markets. By changing tack and shifting away from policy normalisation, the big monetary authorities have bowed to pressure from markets panicked by political and economic uncertainty. In other words, hope has trumped facts for investors these last few weeks.

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FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

This includes the trade war and its impact on the global economy, beyond the theatrical resolution of the illegal immigration standoff between the US and Mexico.

Doubts about Beijing's and Washington's ability to come to a lasting trade agreement and the threat of escalating trade tensions between the US and Europe loom as large as ever.

To put it nicely, there's a distinct lack of peace and quiet in geopolitics right now. Take for instance the series of skirmishes in the Persian Gulf against the backdrop of tensions between Tehran and Washington.

In short, the world has changed. The new order bears little resemblance to the global conditions that prevailed during the development of globalisation in a climate of international cooperation just a few short years ago.

As geopolitical events generate uncertainty that is challenging to manage day-by-day, macroeconomics and the role of central banks gain in importance. Investors should stay flexible in this climate, and should maintain a strong emphasis on risk management in their investment policy.

Of this, we are more firmly convinced than ever, especially now that markets have priced in the optimum scenarios for support for risky assets by monetary authorities in the near future.

Looking at the actual measures we took in June, we've put our money where our mouth is. We increased exposure to convertible bonds in our portfolios at the start of the month, as we indicated in our last monthly report. We believe

these bonds are a good investment in current market conditions and their risk / return profile makes sense in a diversified asset allocation.

We also built up the weighting of equities across a number of themes, such as education and big data, and pared back the amount of cash we had accumulated in previous months. However, because stock markets rebounded quickly during the month, this adjustment was limited in scope. We remain convinced of the advantages of allocating a portion of our assets for management under a thematic investment policy.

We may still regret not having taken a more resolute approach to increasing our overall risk exposure – but if we've erred, it's on the side of caution. Given this and the satisfactory performance of our portfolios at the end of the first half, we don't think we'll have too many regrets.

Particularly when one remembers that our performance this year was achieved not only while limiting volatility, but also while remaining broadly in step with our own investment policy guidelines.

We're glad we kept our fondness for a significant allocation in gold. The value of our policy of buying when prices were low, reaffirmed several times in the last few quarters, was borne out by the precious metal's sharp rise in June. We reiterate our positive opinion on gold, in light of global uncertainty and our ongoing guarded view on the US dollar. What's more, the change to a more dovish stance signalled by the leading central banks will have consequences for fixed-income assets, which are generally seen as strong alternatives to gold. We expect gold to climb higher, to $1,450–$1,500 per ounce in the course of the next few quarters (considering that yields are now negative on over $12 trillion in government debt!).

It will thus be obvious why we haven't altered our advice to underweight government debt, which doesn't offer attractive returns.

The switch to more accommodative central bank policies should favour carry strategies in bond exposures. We remain heavily invested in emerging sovereign debt and, given recent developments, we're inclined to be less cautious about corporate debt in the most mature developed economies. We increased our positions in the developed corporate bond segment in our most conservative portfolios at the end of the period, focusing on the soundest issuers.

In the current interest rate environment, we continue to invest significantly in uncorrelated strategies to hedge against contradictory developments. The sheer range of uncertainty means such negative occurrences cannot be ruled out, even though we remain reasonably optimistic about the economic and financial outlook in the coming months.

In the wake of recent events (H2O and Woodford), we have stepped up our vigilance around the liquidity of the products we hold. Focusing on liquid alternatives thus remains a priority.

Taking all of the above into consideration, broadly in line with our policy of staying focused both on rigorous risk management and on maintaining a tactical management approach, we reviewed our equity exposure at the end of the month. The market rally was resounding, in terms of both scale and speed.

On reflection, two factors prompt us to reduce our equity exposure: i) there was little change in the global situation, and ii) our year-end targets on the major indices are still the same and account performance is good. We've therefore increased index hedgings on our holdings.

While we took the same approach across all our portfolios previously, this time we opted to tailor adjustments by management profile.

In conclusion, while the sun shines and markets are back up, it may be wisest to ride the current, and yield to the siren song of exuberant optimists. Yes, we must be able to listen and analyse, and be ready to react – but it's just as important to know when to hold steady. In *Gone with the Wind*, Scarlett O'Hara knew that sometimes it's best to leave discussion for another time. "Fiddle dee dee!" as she would say, "After all, tomorrow is another day". We've made Scarlett's saying our own in recent months, as it conveys so well the need to be flexible in 2019's investment universe.

We hope that our recent decisions will prove judicious and help us maintain performance. We will have no hesitation in revising these conclusions as developments unfold.

Have a great summer and we look forward to seeing you at the end of August.

Geneva, 26 June 2019

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