SYZ ASSET MANAGEMENT

MONTHLY **STRATEGY MEETING**

BY THE **INVESTMENT STRATEGY GROUP**

For professional, qualified and institutional investors only

26 June 2019

MONTHLY STRATEGY MEETING

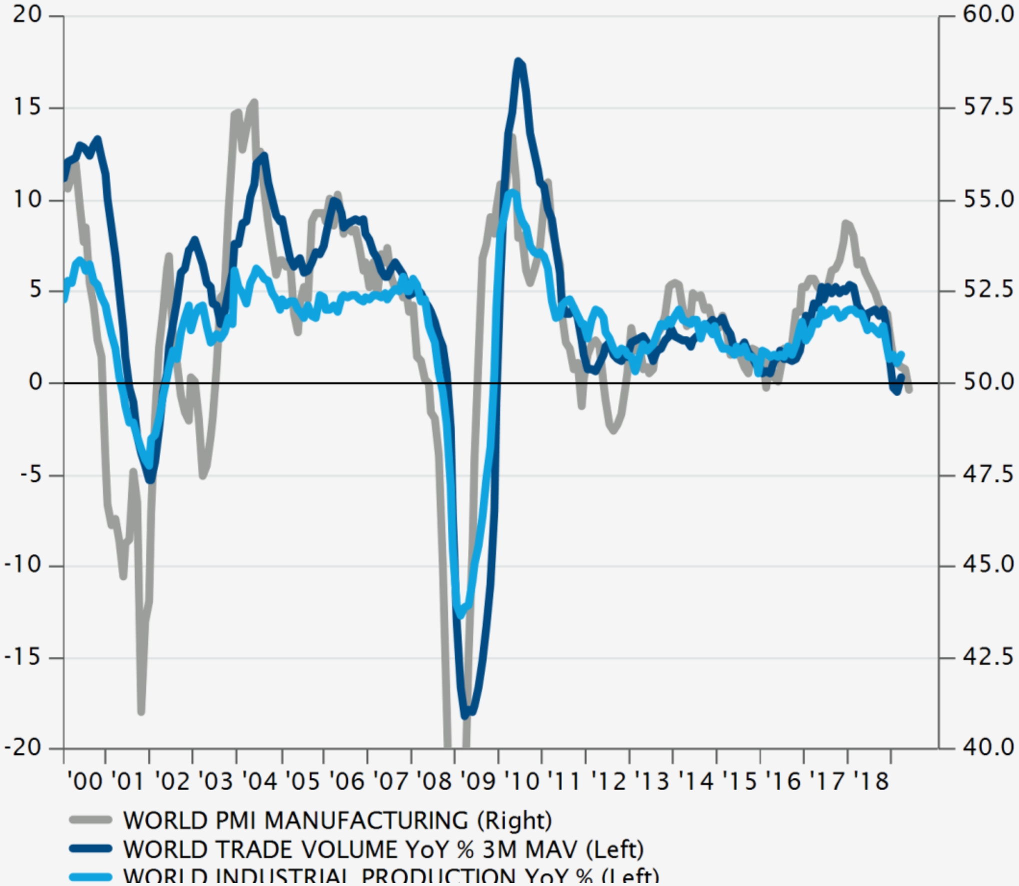
AGENDA

ECONOMIC CYCLE ANALYSIS

GLOBAL GROWTH **STABILIZATION** AT LOW LEVEL … BUT **NO SIGN OF PICK-UP**

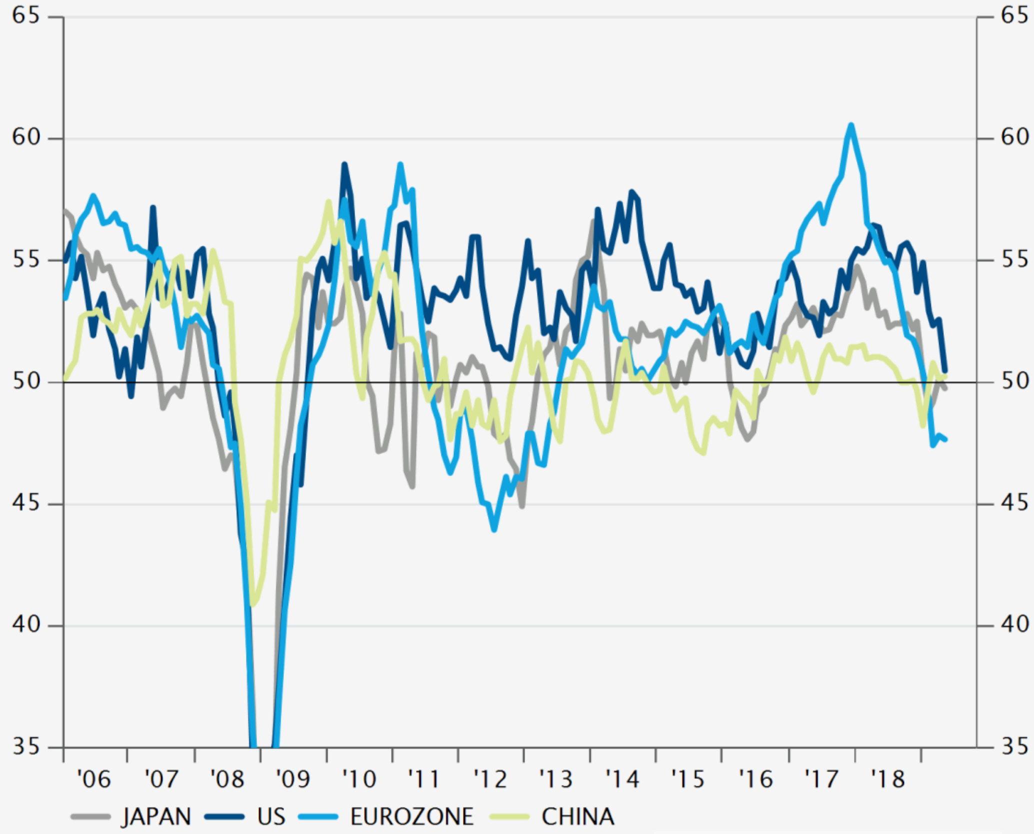
World Economy

Global PMI Manufacturing, Trade Volume and Industrial Production



PMI Manufacturing

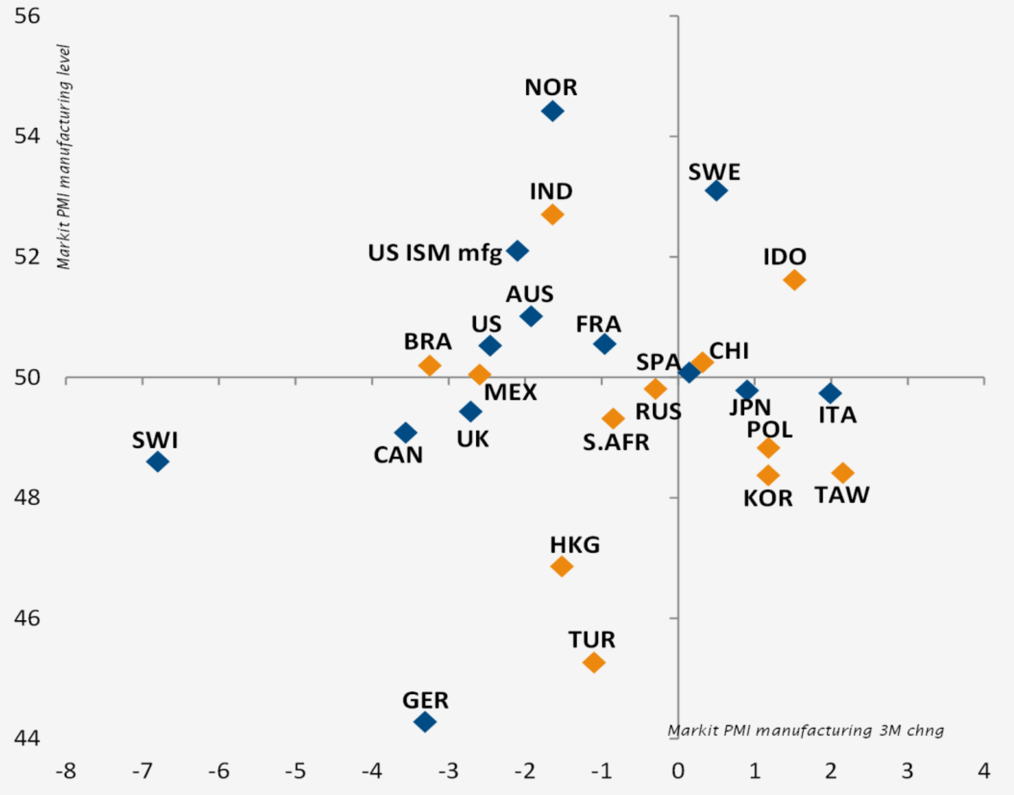
Four Larger Economic Areas



Sources: SYZ Asset Management, FactSet Research Systems, data as at 19.06.2019.

WEAK GLOBAL BUSINESS AND INFLATION DYNAMIC

PMI manufacturing by country
Level and 3-month trend

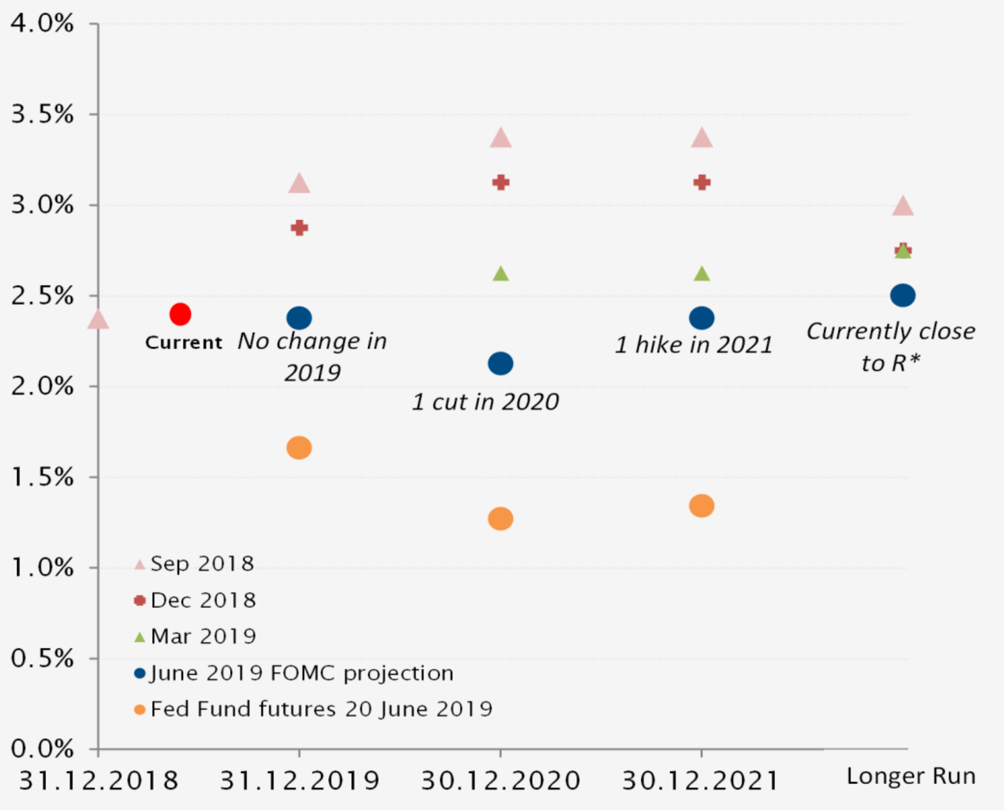


Medium-term market based inflation expectations
US & Eurozone

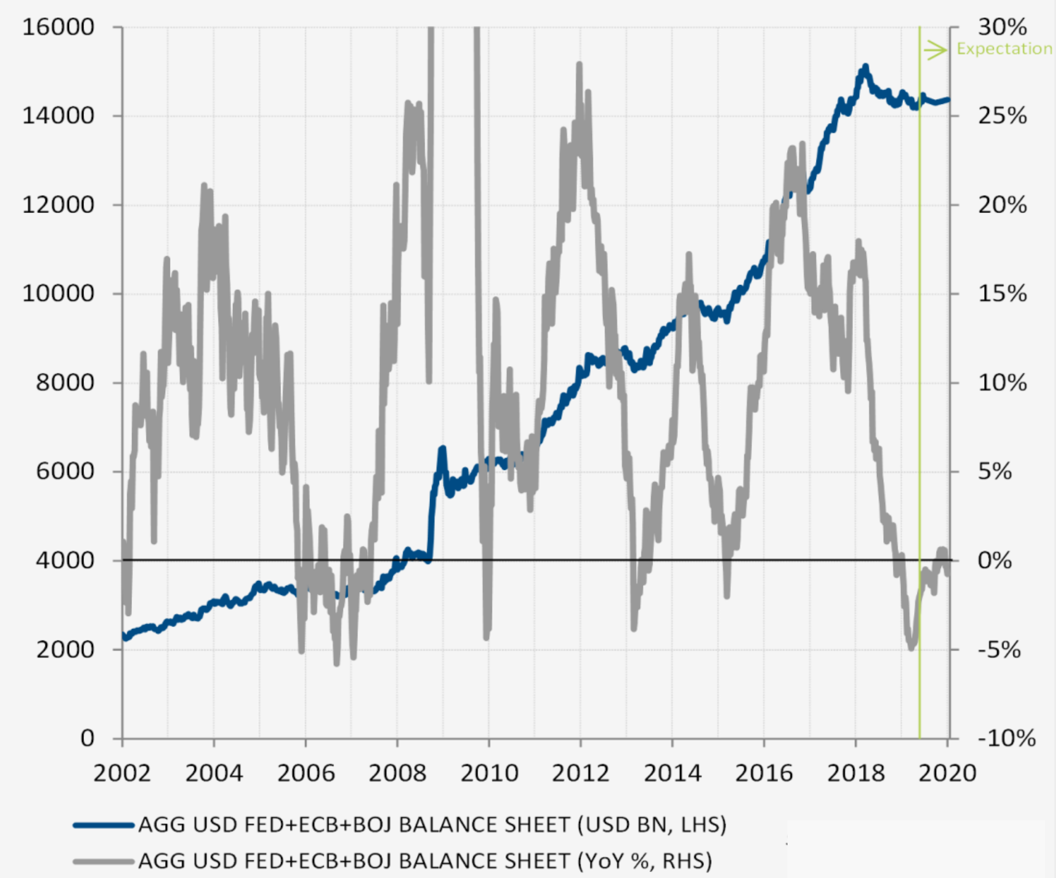
Sources: SYZ Asset Management, Markit, Bloomberg LPP, data as at 19.06.2019.

FED & ECB RATE CUTS IN SIGHT + THE POSSIBLE RESUMPTION OF **LIQUIDITY INJECTIONS**

FOMC expected path for the Fed Fund rate and market-implied expectations



Aggregated balance sheet size Fed+ECB+BoJ and YoY % change



Sources: SYZ Asset Management ,Federal Reserve, Bloomberg, data as at 19.06.2019.

OUR THREE **KEY QUESTIONS** FOR **2019**

United States

Will the Fed keep hiking and amplify the Monetary Policy Divergence with the Rest of the World?

- Mixed macro-economic data continue to point to GDP growth at or above 2%
- Dovish Fed communication confirmed and reinforced, with rate cuts expected and likely.
- Return of trade uncertainties raises back the risk of negative sentiment weighting on cyclical momentum

Eco fundamental & coming monetary policy easing supportive for risk assets. Trade war a potential headwind on sentiment

Europe

Will economic growth finally stabilize at a level still above potential?

- Economic indicators show tentative signs of stabilization but no clear pickup dynamic
- ECB has moved explicitly into the dovish side and is likely to provide accommodation soon
- Return of trade uncertainties raises back the risk of negative sentiment weighting on cyclical momentum

Still no clear sign of inflexion in the negative trend of 2018, domestic demand supports growth for the moment

China

Will fiscal and monetary stimulus succeed in stabilizing growth in the Trade War context?

- Lack of clear confirmation in growth pickup recently
- Ongoing economic policy easing to be continued if needed, but don't expect massive stimulus
- Return of trade uncertainties raises back the risk of negative sentiment weighting on cyclical momentum

Mixed recent economic data picture a stabilization but no confirmation of the pickup. Trade war risk

Source: SYZ Asset Management, data as at 19.06.2019.

TRADE WAR RISKS RAISE BACK HEADWINDS

BUSINESS CYCLE +

Softer but positive **global growth**

Stabilization in **European** and **Chinese growth** dynamics

US growth slows but remains above-potential level

EM growth supported by easing pressures from trade and USD

Expected 2019 GDP growth

US	Eurozone	Japan	China
+2.0%	+1.0%	+1.0%	+6.0%

INFLATION =

Potential short-term **inflationary pressures** from upward pressures on wages in the US and in Europe, and from oil prices

Medium-to-long term: **structural headwinds** (demographic, technology, debt) limit the upside potential

Expected «core» inflation

US	Eurozone	Japan	China
+1.8%	+1.2%	+1.0%	+2.0%

MONETARY POLICY

No more **normalization** in the **US**

ECB leaning again on the dovish side, no rate hike in sight (forcing the SNB to stay on hold)

BoE dependent on Brexit outcome

China further easing if economy keeps slowing down

Expectations for end of 2019

US	Eurozone	Switzerland	UK
+2.00% *(two FED cuts)*	-0.6% *(Deposit rate)*	-0.75% *(Deposit rate)*	+0.75% *(Base rate)*

65% "MAKE"

30% "BREAK" - Closer to the edge

Further loss of cyclical momentum due to:

Trade War, China and Europe stagnation and lack of pickup, Crash Brexit, European political uncertainty, slowing US growth, China-related EM crisis…

Central banks switch further into "damage control" mode

SCENARIO PROBABILITY

5% - Stronger growth

Suppression of U.S. tariffs and Brexit agreement and growth and political stabilization in Europe and USD softening allow for a synchronized rebound in global growth

Acceleration in global inflation and broad-based monetary policy normalization

Source: SYZ Asset Management, data as at 19.06.2019.

ASSET VALUATION ANALYSIS

ASSET VALUATION ANALYSIS

IN A NUTSHELL

GOVERNMENT BONDS

- Overall there is **more value** in **index linked bonds compared to nominal bonds**
- **Nominal bonds:** the segment is still scored **"expensive"** to **"very expensive"**
- **US/Canada** and **Germany/France/Spain** were respectively downgraded to **"expensive"** and **"very expensive"**
- **Linkers:** we downgraded the **US, Canada** to **"mildly expensive"** and the **UK** to **"very expensive"**
- **EM debt** denominated in hard currency still remains a **better value proposal** compared to local currency

CREDIT

- **Credit valuation** saw some **improvement** in May with **spreads widening** (not enough to trigger an upgrade in terms of valuation)
- **European credit** (both IG and HY) still looks **better valued than US credit**

CASH

- In **developed economies**, only the **US offers some value**, but less than before (downgrade to **"mildly cheap"**) while there are undeniably **appealing cash yields in EM** (Mexico, Russia)

FOREX

- The **USD** on a **valuation** perspective remains "**mildly expensive**" against other currencies while the **JPY** is one of the **cheapest** developed currency
- **Gold valuation** is still "**mildly cheap**"

EQUITIES

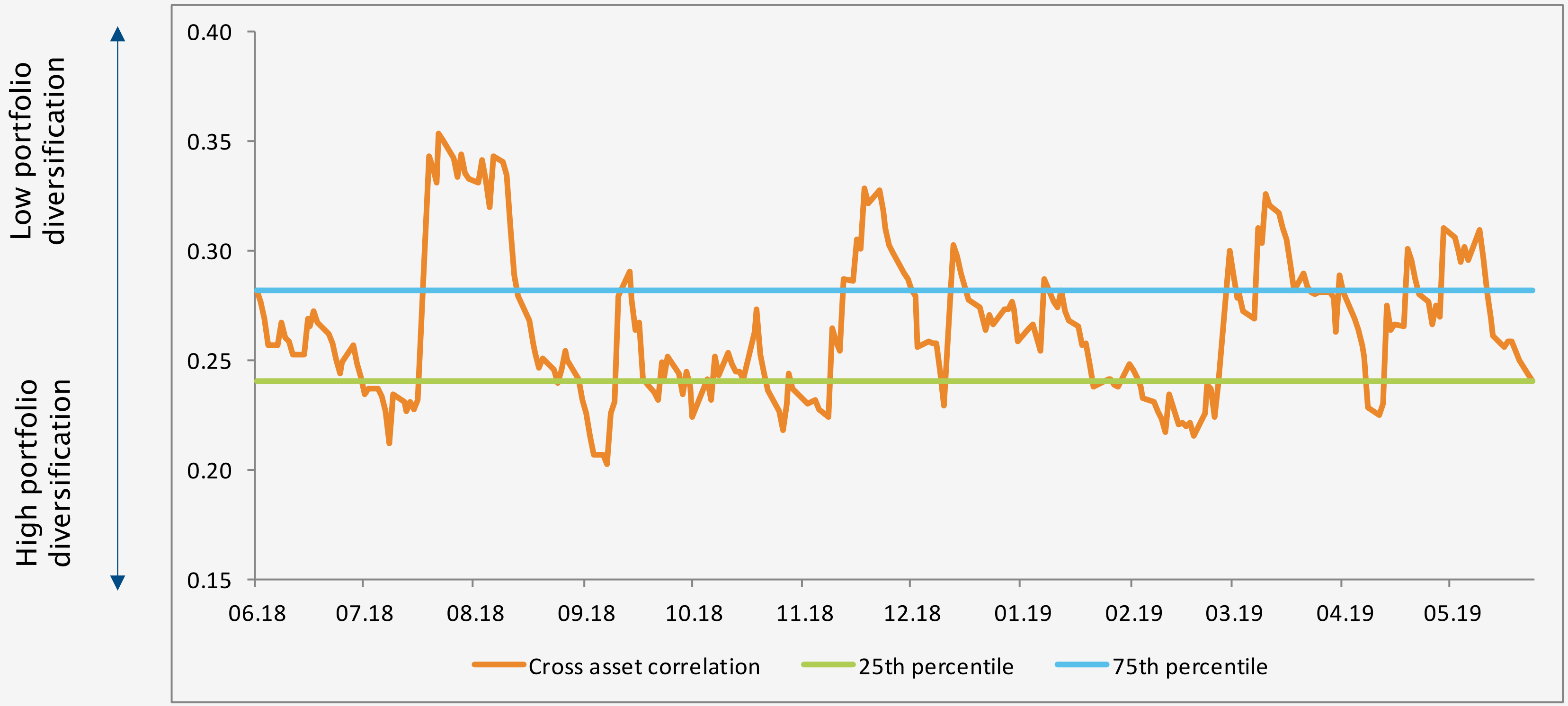
- **US equities valuation** (looking at the ERP) **improved** last month and was **upgraded** to **"mildly cheap"** while **Canada was upgraded to "cheap"**
- **Eurozone equities** (Germany, France, Spain, Italy) got also **cheaper** in the **risk off environment** prevailing last month and were **upgraded** to **"cheap"** while **Swiss equities** are now **"mildly expensive"**
- In **EM**, **"very cheap"** equity markets as **Russia** and **Poland** were **downgraded** to **"cheap"**
- **Trade war tensions** were **reflected** in **equity prices** and **valuation** in **China** was **upgraded** to **"cheap"**

The above commentaries are the views of the SYZ AM Asset Valuation Analysis, data as at 31.05.2019.

RISK BALANCING ANALYSIS

DISPERSION ANALYSIS

Cross asset correlation over the last 12 months



Following the change in the FED policy stance, **cross-asset correlations** have **fallen to very low levels**

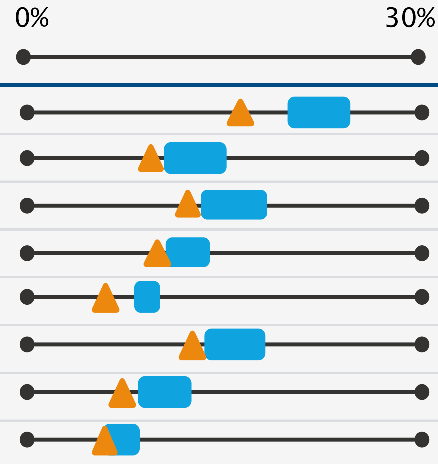
Sources: SYZ Asset Management, Bloomberg.
The above commentaries are the views of the Risk Balancing Analysis as at 18.06.2019.

VOLATILITY ANALYSIS

Current volatility compared to trailing 12 months levels

The current volatility levels ( ) of the ISG asset classes whose volatility level lies outside their 25th/75th percentile range ( )

Assets	Current	Low	Low date	High	High date	Expectation
Latam Equities	16.7%	16.7%	13.06.19	28.4%	08.10.18	↑
Russia Local Ccy Debt	8.0%	8.0%	13.06.19	21.2%	19.08.18	↑
Brazil Local Ccy Debt	12.2%	11.8%	28.01.19	26.3%	09.10.18	↑
UK Equities	9.1%	7.7%	02.05.19	20.4%	12.12.18	↑
AUD	5.9%	5.5%	09.06.19	10.0%	06.02.19	↑
Italian Equities	12.5%	7.8%	01.05.19	21.9%	12.12.18	↑
Turkey Hard Ccy Debt	6.5%	5.0%	20.03.19	33.9%	16.08.18	↑
GBP	5.7%	5.3%	13.06.19	12.0%	15.11.18	↑

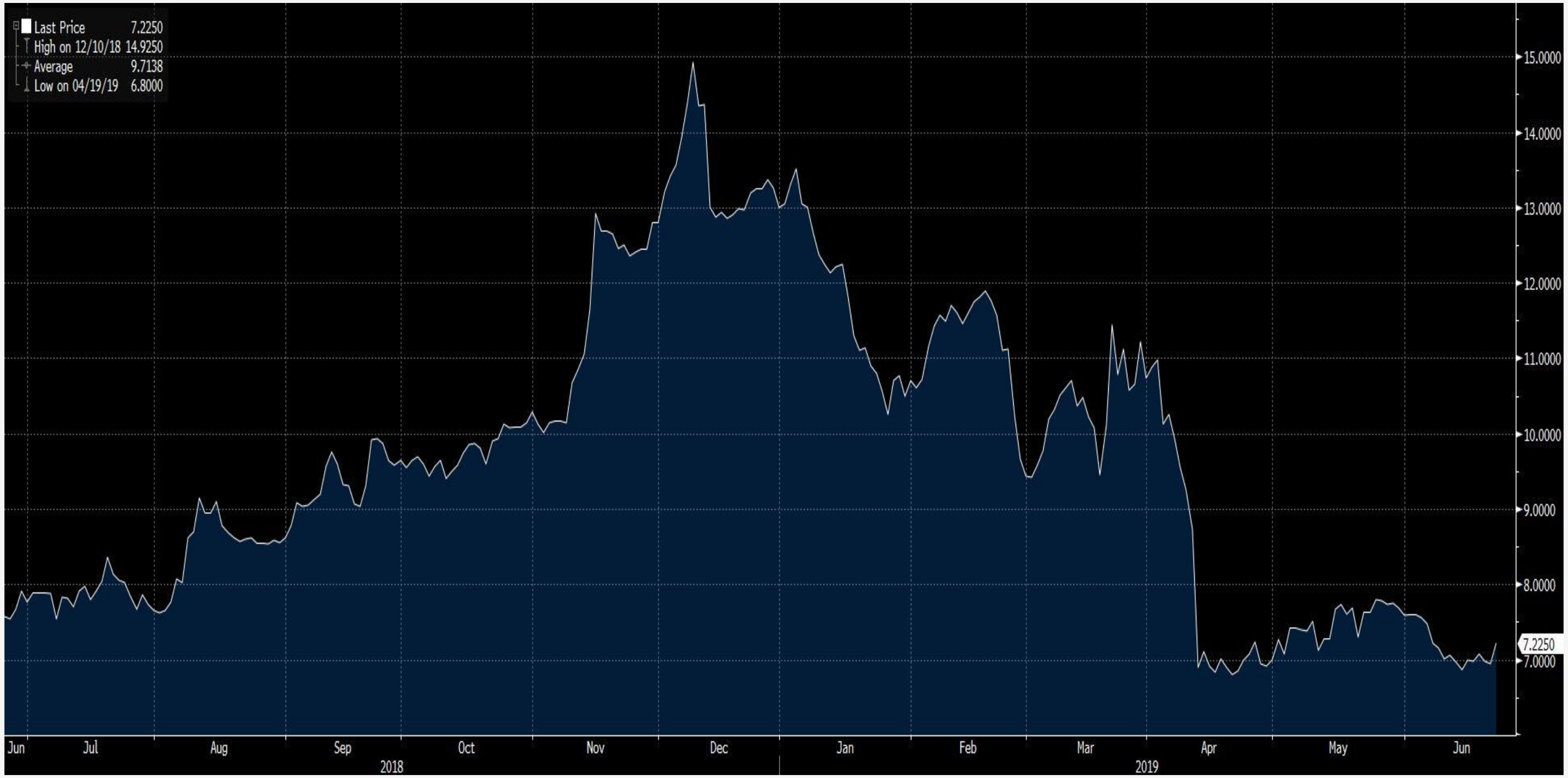


- **No asset** trades above its **high volatility range**
- Several **EM Debt** markets trade **below** to their **historical lows**
- **UKP** and **UK Equities volatilities** are low given potential **adverse development** on the Brexit side (see implied volatility chart on next page)

Sources: SYZ Asset Management, Bloomberg.
The above commentaries are the views of the Risk Balancing Analysis as at 26.06.2019.

VOLATILITY ANALYSIS

GBP USD 3 Month ATM Implied Volatility



Sources: Bloomberg Finance L.P., 24.06.2018 - 24.06.2019.

INVESTMENT STRATEGY GROUP

WELCOME TO JAPAN

GLOBAL RISK upgraded to mild disinclination

- Concerns and related **uncertainties about trade war are here to stay** acting as a drag on sentiment, delaying investment decisions, holding up production. However, **we aren't calling a recession** (resilient domestic demand so far).
- Downside risks on growth, anaemic inflationary pressures but **central banks are on the (very) accommodative side** again: **easy money is back** (the most noticeable change in our broad economic cycle analysis YTD)
- **Overall valuations have remained or even became more stretched**
- **Equities stuck in a range**: central banks' put is back, sustaining markets, limiting downside risks but not enough, given current valuation, to propel equity markets much higher WITHOUT earnings growth improvement –or at least expectations of-
- **Favouring/increasing debt carry / yield payers over pure market's beta** in a weak but positive growth scenario with plenty of liquidity, as long as we don't foresee a recession
- The main risk to this allocation remains an assumed "opportunity costs" in case equity markets soar in the next few weeks

DURATION kept in mild disinclination

- **No change overall** as long as there is no inflation's risk / central banks are dovish
- However, rebalancing part of total duration towards credit risk at the expense of **"pure" duration** (i.e. reducing core govies /increasing credit-peripheral-EM).
- Benefits of duration in a Japanese deflationary scenario (for EUR or CHF investors): better returns than cash and risk-adjusted returns comparable to equities
- Benefits of spread in a Japanese Zombieland companies environment: default risks decrease
- **Potential temporary short-squeeze on rates** as the no-inflation and very easy monetary policy is now a crowded trade
- **Energy prices may become a trouble maker** if they continue to nudge higher… potentially leading to renewed inflation fears OR much weaker economic growth (especially in case of a supply shock)

The above commentaries are the views of the SYZ Asset Management's Investment Strategy Group as at 19.06.2019.

ASSET ALLOCATION – OUR VIEWS

INVESTMENT PREFERENCES

	STRONG DISINCLINATION	DISINCLINATION	MILD DISINCLINATION	MILD PREFERENCE	PREFERENCE	STRONG PREFERENCE
EQUITIES			Eurozone United Kingdom Switzerland Scandinavia Japan Australia South Korea China	United States Canada India Brazil Mexico Russia South Africa		
FIXED INCOME			Nominal Govies ➡ HY Credit EM Local	Real Govies ➡➡ IG Credit EM (Hard Ccy.)		
CURRENCY VS. USD		CHF	EUR GBP CAD AUD	JPY *Gold*		

⬅ Change from last month ➡

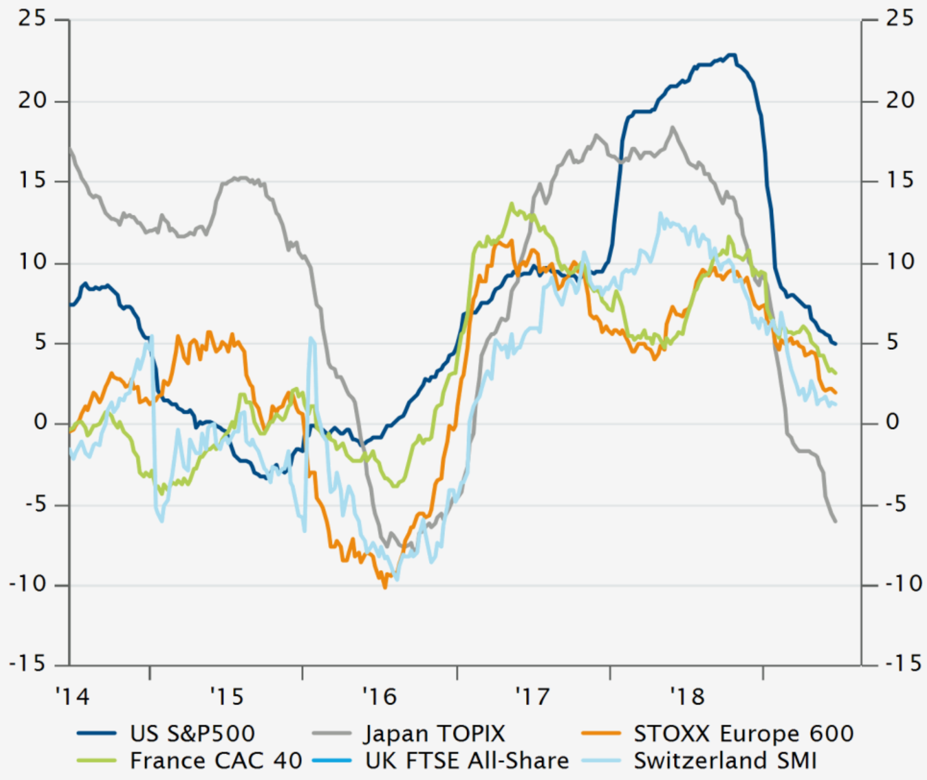
Sources: Investment Strategy Group, SYZ Asset Management. These are our investment preferences for July, based on the Investment Strategy Meeting held on 19.06.2019.

KEEPING A LOW MARKET BETA

Equities

- Euro zone, China, Korea and Japan downgraded to mild disinclination
  - Potentially the **first direct or collateral victims of growth** disappointment in the next few months and/or trade war extension-prolongation risks
  - **Less ain't more**: ultralow rates don't do much for growth
- EM: mild preference overall but UW China and South Korea
  - Favourable US goldilocks context spreading to EM
  - **Cheaper relative to DM equities.** May even become cheaper relative to their bonds (decrease in EM rates will lead to improving EM Equity Risk Premium)
- Styles/sectors allocation
  - No sectorial tilts overall but in the current environment (low growth, low rates):
    - Leaning into growth stocks
    - Scouring EM for opportunities
    - Earning income from investment that won't succumb to the low-rate trend

Selected equities markets EPS growth
This trend is not your friend



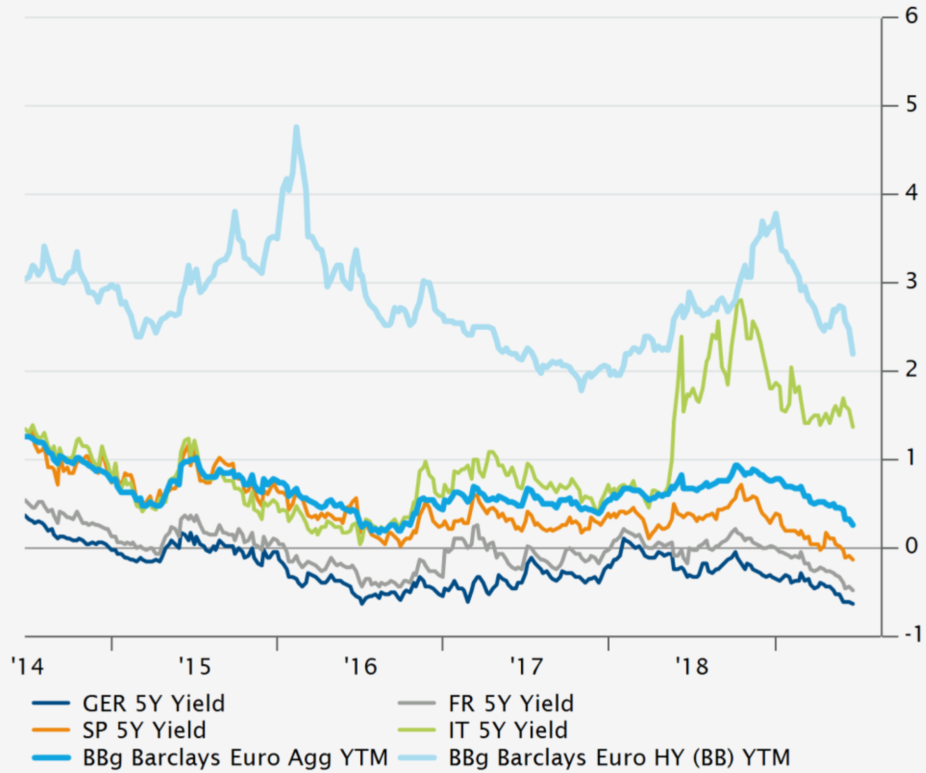
Sources: FactSet Research Systems, SYZ Asset Management, latest data available as at 24.06.2019.

TINA IN ZOMBIE LAND THE DESPERATE HUNT FOR YIELD

Fixed Income

- It's still about…
  - Relative value rather than absolutely cheap valuations
  - Looking for carry or excess return vs. cash
  - Managing potential spike in rates/credit spread and liquidity issue
- DM govies getting even more expensive
  - Sustained by lack of inflationary pressures, anemic growth and CB's dovishness (potential round of QE)
  - Top picks: US TIPS and **Italy nominal** in mild preference
- Increasing credit risk (with its duration component)
  - **IG credit upgraded 2 notches to mild preference**, favoring Europe (more supportive valuation and Japanese macro backdrop)
  - **HY upgraded to mild disinclination** favoring EUR
- The case for EM debt both hard and l.c. remains valid
  - Favorable backdrop + relative valuation appeal... as long as recession scenario is avoided

European Credit: TINA (there is no alternative)
European credit vs peripheral 5Y yield



Sources: FactSet Research Systems, SYZ Asset Management, latest data available as at 24.06.2019.

STAY UNDERWEIGHT EQUITY BETA BUT RELOAD EXTRA DEBT CARRY

EQUITIES

Stay UW in Europe, Japan, China and Korea

OW in North America and EM overall

No sectorial tilt (still prefer quality Hi-Di)

FIXED-INCOME

Increasing credit risk (with its duration component)

Still like Euro Sub. Debt and EM debt, adding now IG credit and HY

Overall preference for EUR duration and credit vs. USD

US TIPS and Italy in govies

FOREX

Gold and JPY as a diversifier

USD over **EUR** :
Despite valuation and shrinking yield/growth differentials…
What's else?

Source: SYZ Asset Management, data as at 24.06.2019.


ABOUT US

INVESTMENT STRATEGY GROUP

ECONOMIC CYCLE ANALYSIS + **ASSET VALUATION ANALYSIS** + **RISK BALANCING ANALYSIS**

Investment Strategy Group

- Global Risk Sentiment: *Is risk ‘on’ or ‘off’*
- Duration Stance: *our views on interest rates & bond prices*
- Asset Allocation Views: *what assets do we like/dislike*

THE FOUR COMMITTEES & ITS MEMBERS

ECONOMIC CYCLE ANALYSIS

Chair: **Adrien Pichoud**
Chief Economist

Fabrizio Quirighetti
Head of Multi Asset

Guido Bolliger
Co-Head of Quantitative solutions

Claude Cornioley
Co-Head of Quantitative solutions

Maurice Harari
Portfolio Manager

Wanda Mottu
Portfolio Manager

Christophe Buttigieg
Portfolio Manager

ASSET VALUATION ANALYSIS

Chair: **Maurice Harari**
Portfolio Manager

Fabrizio Quirighetti
Head of Multi Asset

Adrien Pichoud
Chief Economist

Wanda Mottu
Portfolio Manager

Christophe Buttigieg
Portfolio Manager

Roberto Magnatantini
Head of Global Equities

Antonio Ruggeri
Portfolio Manager

RISK BALANCING ANALYSIS

Chair: **Guido Bolliger**
Co-Head of Quantitative solutions

Claude Cornioley
Co-Head of Quantitative solutions

INVESTMENT STRATEGY GROUP

Chair: **Fabrizio Quirighetti**
Head of Multi Asset

Adrien Pichoud
Chief Economist

Guido Bolliger
Co-Head of Quantitative solutions

Maurice Harari
Portfolio Manager

Wanda Mottu
Portfolio Manager

Luc Filip
Head of SYZ Wealth Management Investments

SYZ ASSET MANAGEMENT

CONTACTS US

SWITZERLAND

SYZ Asset Management (Suisse) SA
Headquarter

Rue François-Diday 6
1204 Geneva

Tel: +41 (0)58 799 15 00
Fax: +41 (0)58 799 20 00

SYZ Asset Management (Schweiz) SA

Dreikönigstrasse 12
8027 Zürich

Tel: +41 (0)58 799 77 37
Fax: +41 (0)58 799 22 00

LUXEMBOURG

SYZ Asset Management (Luxembourg) S.A.

54, Rue Charles Martel
2134 Luxembourg

Tel: +352 26 27 36-1

ITALY

SYZ Asset Management (Luxembourg) S.A.
Milan Branch

Via Borgonuovo 16
20121 Milano

Tel: +39 02 65 53 56 01

UNITED KINGDOM

SYZ Asset Management (Europe) Ltd

Southwest House
11a Regent Street
London SW1Y 4LR

Tel: +44 (0) 20 30 400 500

SYZ Asset Management (Europe) Ltd

Charlotte Square 31
Edinburgh EH2 4ET

Tel: +44 (0) 20 30 400 500

GERMANY

SYZ Asset Management (Europe) Ltd
Munich Branch

Josephspitalstrasse 15, 4th Floor
80331 Munich

Tel: +49 89 20 70 40 148

FRANCE

SYZ (France) SASU

8 Place Vendôme
75001 Paris

Tel: +33 1 55 35 98 80
info@syzgroup.com

Reach our dedicated Client Services team

syzam.client_services@syzgroup.com

Want to know more?

www.syzassetmanagement.com

SYZ ASSET MANAGEMENT

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