Optimal Income Strategies

Wind of Change

- Equities continue their upwards rally as monetary policy continues to accommodate
- A Brexit deal was reached, promising to unleash the UK's and Eurozone's full potential
- We increase our equity exposure while taking on tactical trades for increased returns

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What's happening?

In the US, GDP growth looked to stabilize at 1,9% (qoq annualised) driven by strong household consumption. The Trump administration postponed its 5% tariff increase on Chinese imports in exchange for some concessions by China. The political standing of President Trump remains shaky however, with the House of representatives launching an official investigation. The Fed once again lowered its base rate by 25 bps, while S&P 500 rose over the month by 2%, while US bonds remained stable at 1,7%.

In Europe, some economies, such as Spain and France, proved more resilient in light of the global slowdown, growing by 0,3% and 0,4% respectively in Q3. PMI surveys across Europe showed a stabilization of activity. This reflected positively on equity markets, as the Eurostoxx grew by 1%, while the DAX recorded an increase of 3,4% over the month. In the UK, the government was able to reach a Brexit deal with the EU and extend the deadline to January 31st. This allowed the ruling coalition to call for snap elections, where polls show a strong lead for the Tories. As a result, the GBP bounced back up 5,3% against the USD, while UK stock markets were down 2% due to the pound's appreciation.

The Japanese government increased VAT in October 1st, with little to no effects on the course of the Japanese economy. In China, growth fell to 6%, its lowest level in three decades, due to the slowdown of the manufacturing sector, heavily affected by the trade war. The Nikkei jumped 5,4% higher, while the Hang Seng still moved up 3,1%.

Positioning & Performance:

	GLOBAL OPTIMAL STRATEGY				OPTIMAL STRATEGY				DEFENSIVE OPTIMAL STRATEGY			
	Dec-18	Sep-19	Oct-19	Δ	*Dec-18*	Sep-19	Oct-19	Δ	*Dec-18*	Sep-19	Oct-19	Δ
Equity	*40,1%*	48,80%	50,10%	↑	*47,9%*	49,00%	50,00%	↑	*13,9%*	22,50%	25,10%	↑
Equities	*37,3%*	48,40%	48,70%		*51,2%*	56,30%	56,50%		*11,1%*	21,50%	23,90%	
Equities derivatives	*2,8%*	0,30%	1,40%		*-3,3%*	-7,30%	-6,50%		*2,8%*	1,00%	1,20%	
Fixed Income	*49,4%*	41,90%	36,10%	↓	*40,3%*	35,90%	34,60%		*75,3%*	76,70%	70,10%	↓
Govies	*27,1%*	13,90%	11,60%	↓	*24,7%*	8,10%	8,20%		*38,4%*	19,80%	17,90%	↓
Bond Derivatives	*-16,5%*	*-2,40%*	-2,10%		*-21,6%*	*0,00%*	0,00%		*-13,9%*	*-4,20%*	-4,20%	
High Yield Credit	*5,3%*	5,40%	4,40%	↓	*5,2%*	7,20%	5,90%	↓	*6,0%*	7,20%	5,00%	↓
Investment Grade	*17,0%*	19,30%	19,50%		*10,4%*	18,40%	19,40%		*30,9%*	45,80%	46,30%	
Emerging Debt	*0,0%*	3,30%	0,70%	↓	*0,0%*	2,30%	1,10%	↓	*0,0%*	3,90%	0,80%	↓
Risk Mitigation Strategies	*0,1%*	-0,50%	0,40%		*0,0%*	-0,70%	0,30%		*0,0%*	0,70%	1,00%	
Diversification	*2,6%*	2,20%	2,10%		*4,4%*	4,40%	4,40%		*0,6%*	0,80%	0,80%	
Cash & Money Market	*7,7%*	7,70%	11,30%	↑	*7,4%*	11,40%	10,70%	↓	*10,2%*	-0,80%	3,10%	↑

MONTHLY PERFORMANCE CONTRIBUTORS

Global Optimal Strategy	Optimal Strategy	Defensive Optimal Strategy
Contributers Equities	**Contributers** Equities	**Contributers** Equities
Detractors None	**Detractors** None	**Detractors** None

In terms of Positioning, some movements were made in the three funds, as we slightly increased our exposure to equities in all funds, with a focus on sectorial equities in the US and Europe as the relative valuation of cyclicals remain depressed and market pessimism on economic growth is still extreme. We have selected sectors/industry groups which have suffered on a relative basis compared to the rest of the market. Industrial and consumer discretionary sectors in the US, energy and telecoms in Europe.

On the Fixed Income side, we continued along the lines of the trend we started beforehand by continuously reducing our exposure to Emerging market debts, High-yield credit, all while increasing our IG exposure in all three funds in a way to extend the duration of our portfolios. We also added two FX carry trade positions in the portfolios through a long CAD vs CHF which we complement with a long CAD vs USD. The CAD will likely benefit from a strong job market and BoC's will to not keep things unchanged. With two more cuts expected from the Fed this year, we believe the carry of the CADUSD may turn positive. The CHF has well benefited from the heightened risk sentiment, reaching levels Swiss National Bank is now willing to defend as Switzerland fundamentals deteriorate. Moreover, we introduced a GBP vs USD position as we believed that the probability of a no-deal Brexit are marginal.

With regards to our performance, all three strategies posted positive returns over the past month. Once again, equities proved to be the main contributor to this success, highlighting the quality of our stock picking.

Outlook:

We believe that pressure will be eased on markets on the short term, as news of positive developments continue to flow, most notably the Phase 1 trade deal reached between the US and China, the new Brexit deal negotiated between the Tories government and the EU and the Fed's 60 bn dollars "liquidity injection".

We have reinforced our cyclical tilt in our US equity exposure, as valuations remain depressed, while consumer confidence, the main driver of US demand, remains very high. Our macro indicators in the Eurozone are showing signs of stability, while market sentiment in both the UK and the Eurozone is likely to be boosted by the ever-slim chances of a no-deal Brexit. We think this could support the cyclical and value type companies which are lagging relative to the visible growth sectors. In China, the simmering trade tension is very destructive for trade and growth. Chinese growth remains problematic. Valuations are not yet cheap enough to offset the uncertainty, so we prefer a neutral stance.

On the Fixed Income side, we maintain our positive call on EUR HY as the higher spread offers a better protection in the event of another market yield correction, all while reducing our risk allocation to this asset class. Our stance with regards to govies is neutral, with the exception being Italian government bonds, where we will seek to reduce our exposure to 1% due to the continuous apathy towards future political risks. Inflation expectations are still very low, and as such, we remain long Eurozone and US breakeven inflation for the moment being.