

# Adaptability

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Geneva

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## Conclusions and 2018 challenges (January 9th Salon)

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### > An exceptional vintage:

- The 2017 market was a lot less risky than feared. As populism did not win in Europe and the global economic and earnings cycle continued to improve.
- Equity market performances generally reflected the rise in EPS growth and valuations rose modestly.
- Europe and Japan surprised positively

### > So far in 2018

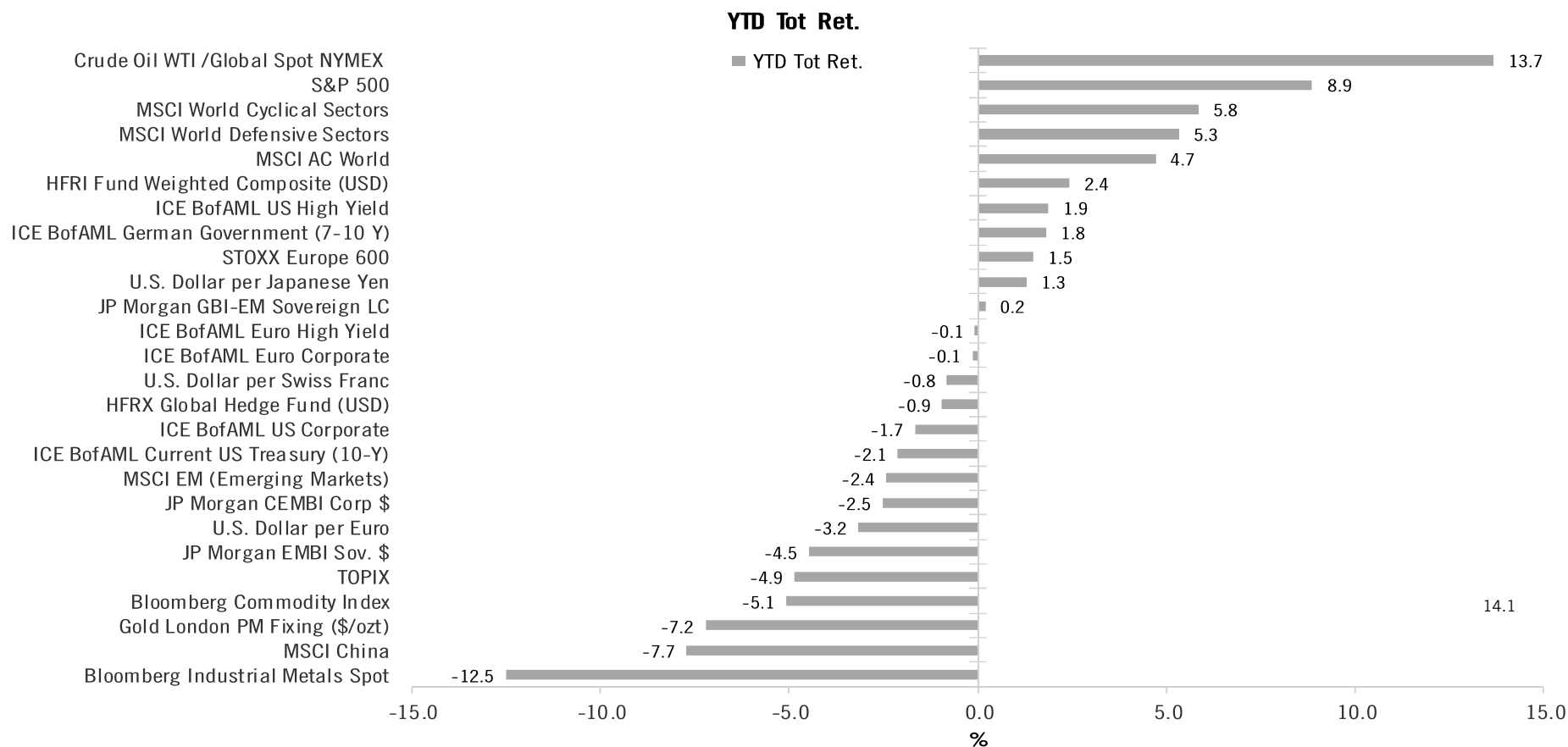
- The year started on a strong note as US economic data remained firm and earnings are revised upwards.
- The same could happen in Japan thank to Abe's cabinet new fiscal initiative
- Switzerland should benefit from stronger European orders and a marginally lower currency

### > As we enter the year 9 of the bull market, challenges increase

- Valuations are in the highest 25% of their 20 years history. The US and Japanese fiscal decisions should lead to higher growth estimates.
- Passive investing has become the norm (how will it behave in more challenging times?). Active management is better suited to a more challenging environment.
- The good economic environment is having a positive effect on interest rates when Central Banks' support diminishes. Thus the equities-bonds correlation could change.

# Performances in 2018

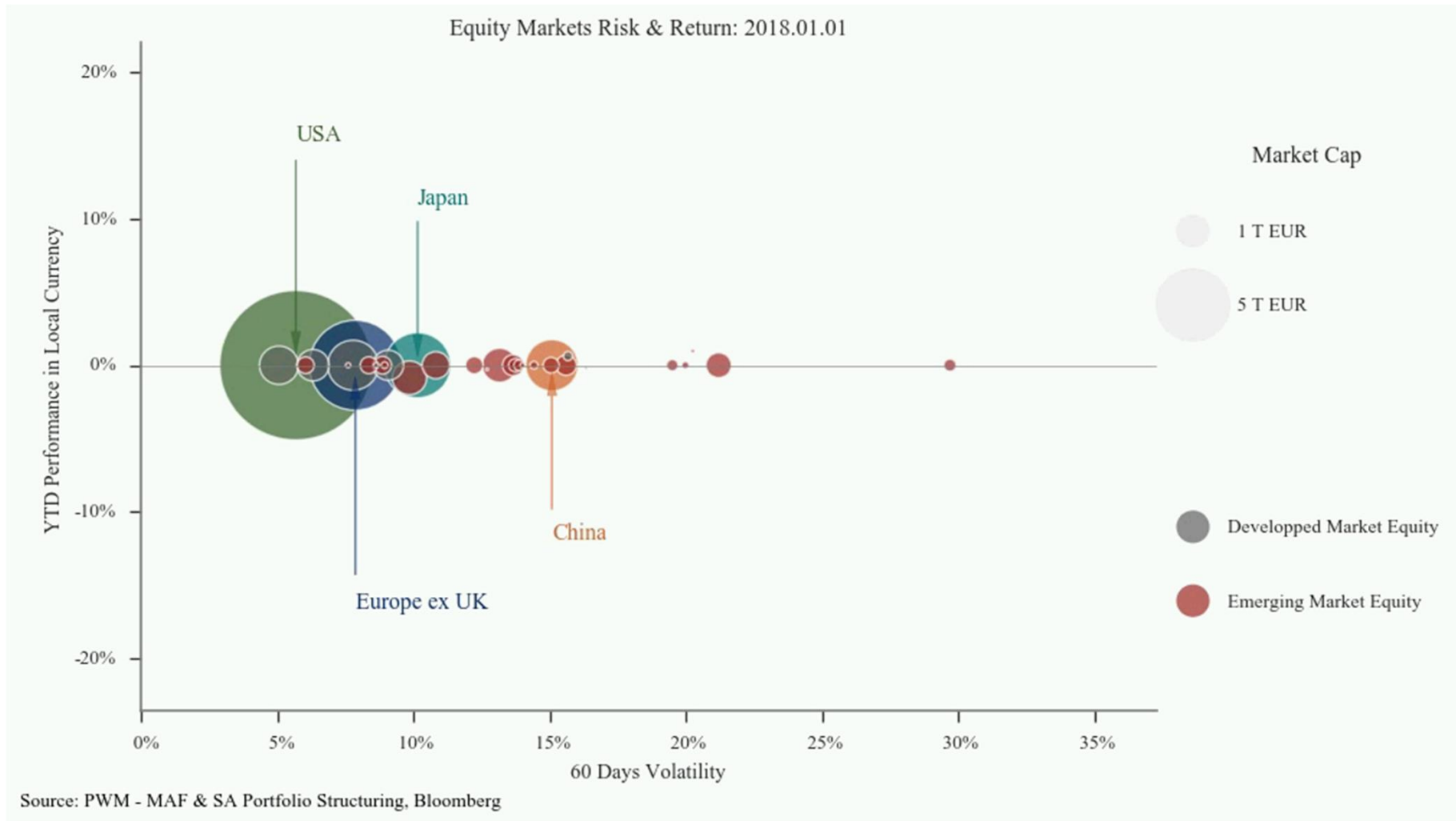
## Major Indices, local currency performances



Source: Pictet WM - CIO Office, Factset



# How did markets evolve so far ?



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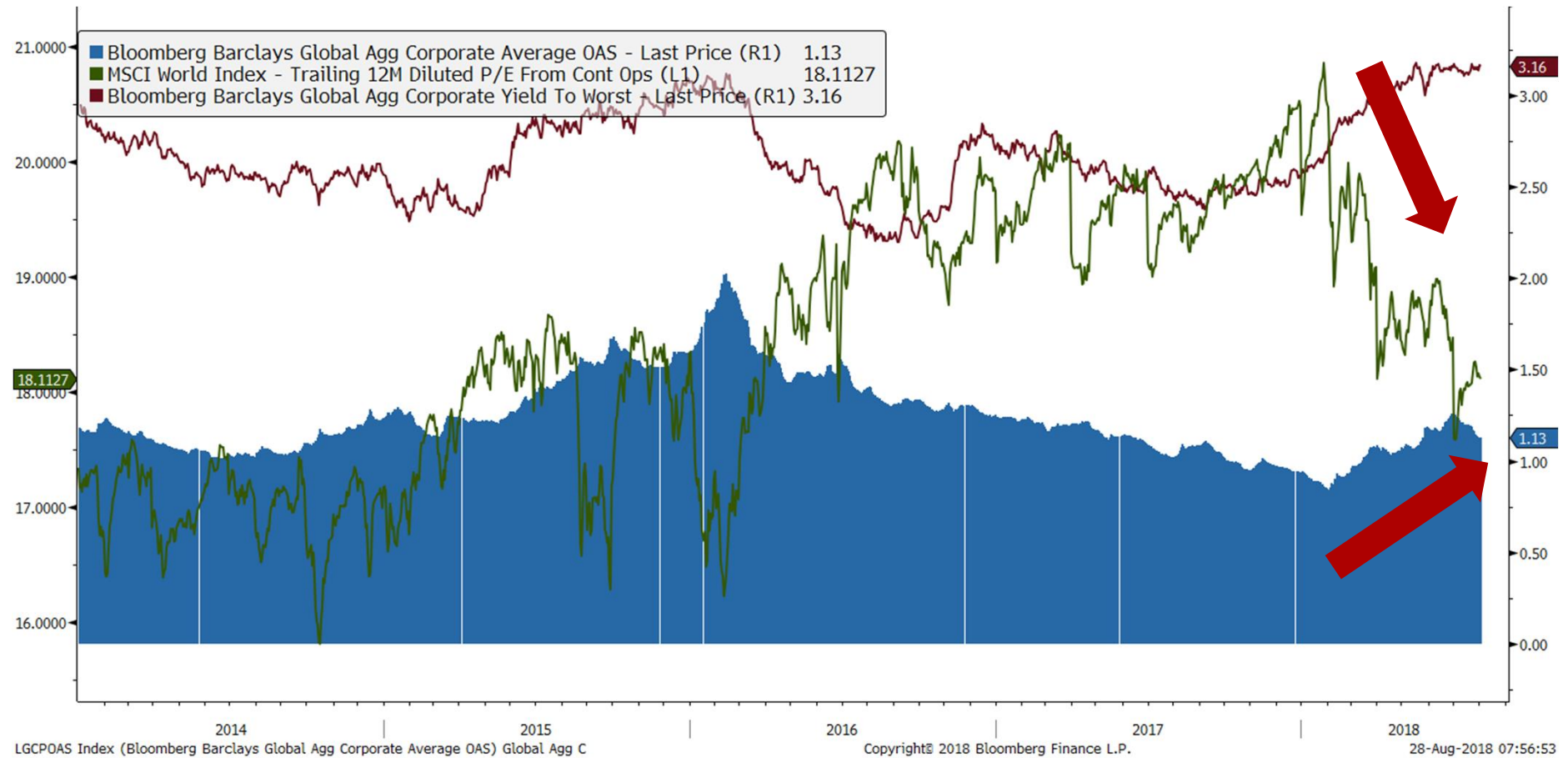
## Three words to characterize 2018 (so far)

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- 1 > **Reversal:**
  - Immediately after the start of the year, market dynamics changed
  - For the first time in many years, bonds did not compensate the decline in equities
- 2 > **Divergences:**
  - Trump policies allowed US assets to gain a clear leadership
  - Not the same for other asset classes: Europe and (EMs)
  - And disappointing economic news in Europe (initially economically and more recently politically)
- 3 > **Flash:**
  - Investors had to cope with episodes of intense tensions and lack of liquidity
  - Often leading to difficulties in linking price action and fundamentals
  - And difficulties to take a step back

# Reversal: Credit Markets & Equities Valuations

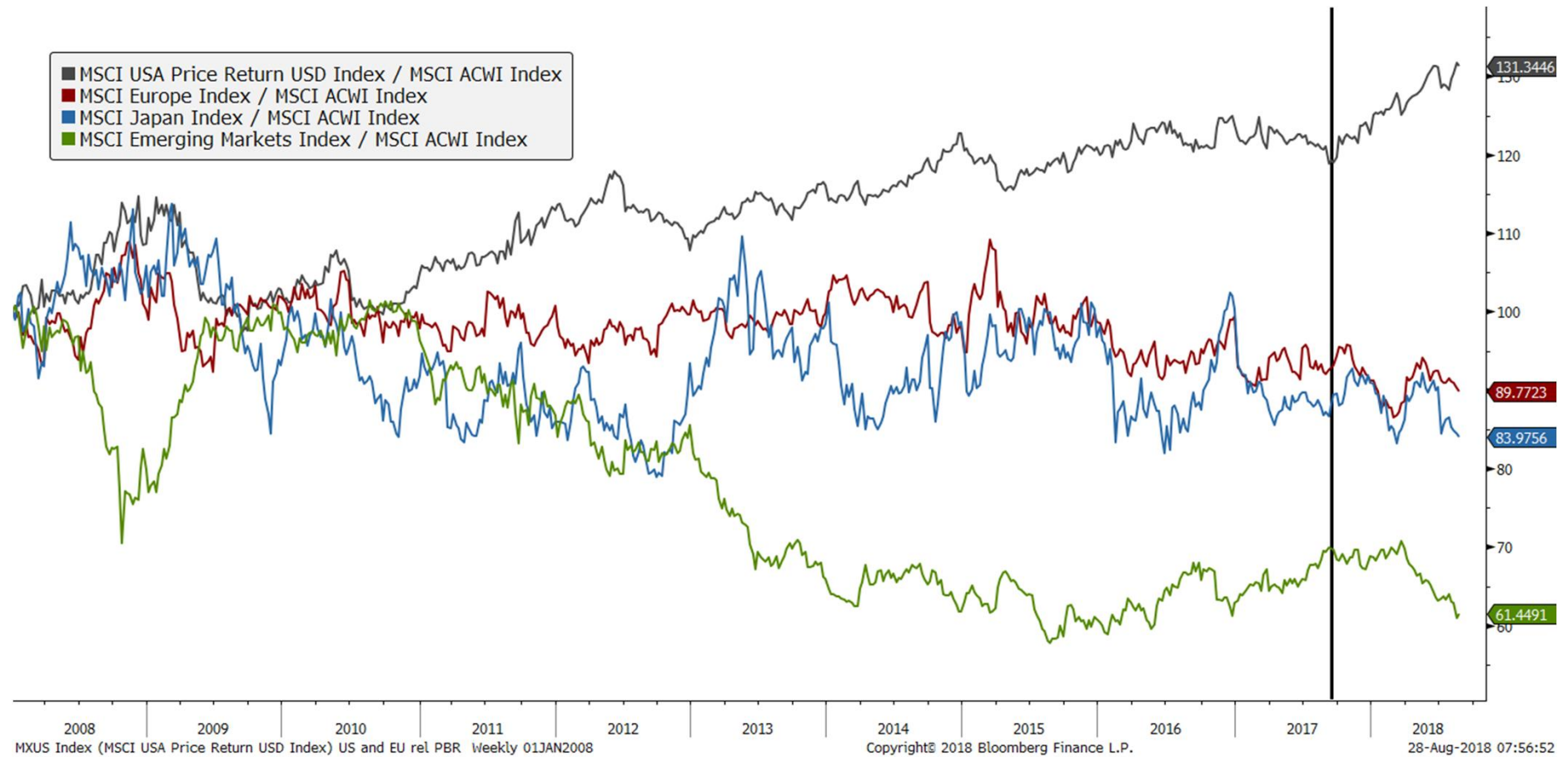
## Global Agg



Source: Pictet WM - CIO Office, Bloomberg

# Divergences: Clear US Valuation Leadership

MSCI US, EU, JP & EM PBR Relative to MSCI AC Index PBR (Jan. 2008 = 100)

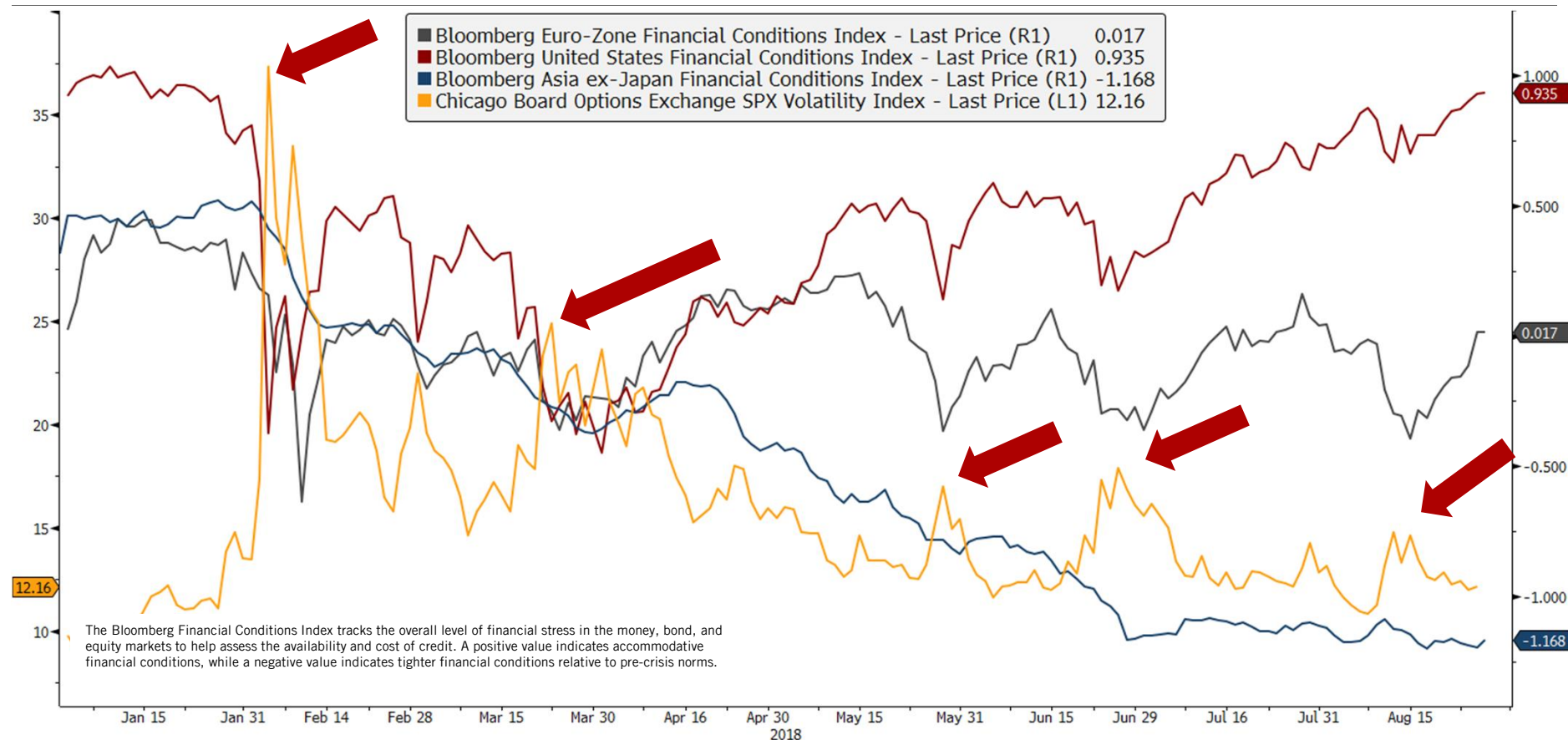


Source: Pictet WM - CIO Office, Bloomberg



# Flash: Market hurt by Flash Crash episodes but the VIX made lower highs

## Bloomberg Financial Conditions Index and Vix



BFCEIU Index (Bloomberg Euro-Zone Financial Conditions Index) Financial Cond 201

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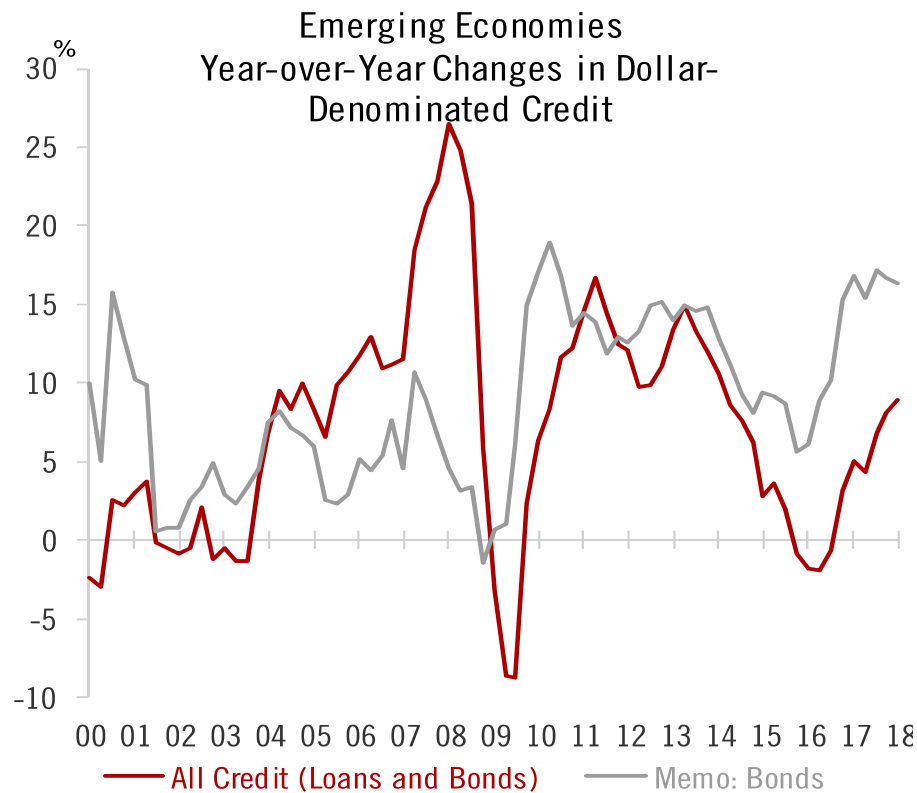
Source: Pictet WM - CIO Office, Bloomberg





# EM Bond financing mostly and no signs of extreme stress in equity markets

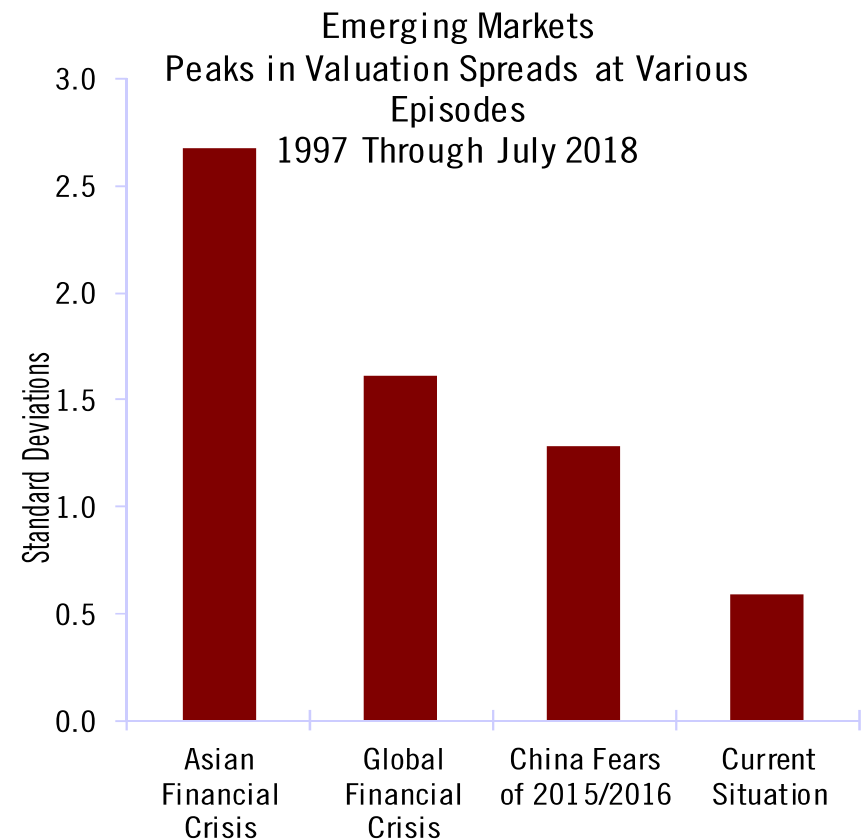
## EM Economies Yoy Growth in USD Credit



Source: Bank for International Settlements.  
<sup>1</sup> Credit issued to borrowers other than banks.

Source: Pictet WM – CIO Office, Empirical Research Partners

## EM Markets Valuation Spreads



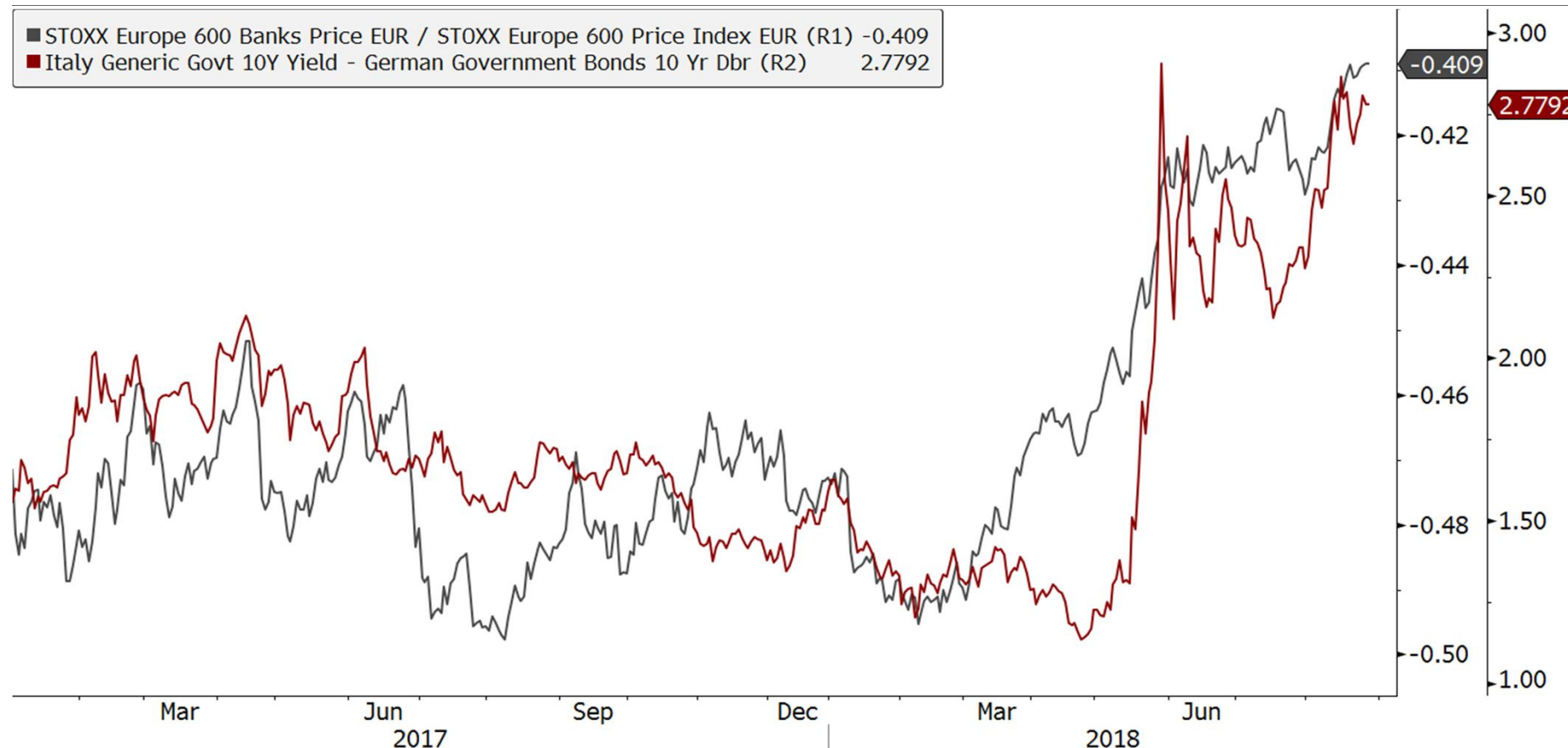
Source: Empirical Research Partners Analysis.

Source: Pictet WM – CIO Office, Empirical Research Partners



# BTP – Bund Spreads and Stoxx Europe 600 Banks Relative Performance

## BTP – Bund Spreads and Stoxx Europe 600 Banks Relative Performance (Inversed Scale)



SX7P Index (STOXX Europe 600 Banks Price EUR) Italy Yields & bnks Daily 02JAN20

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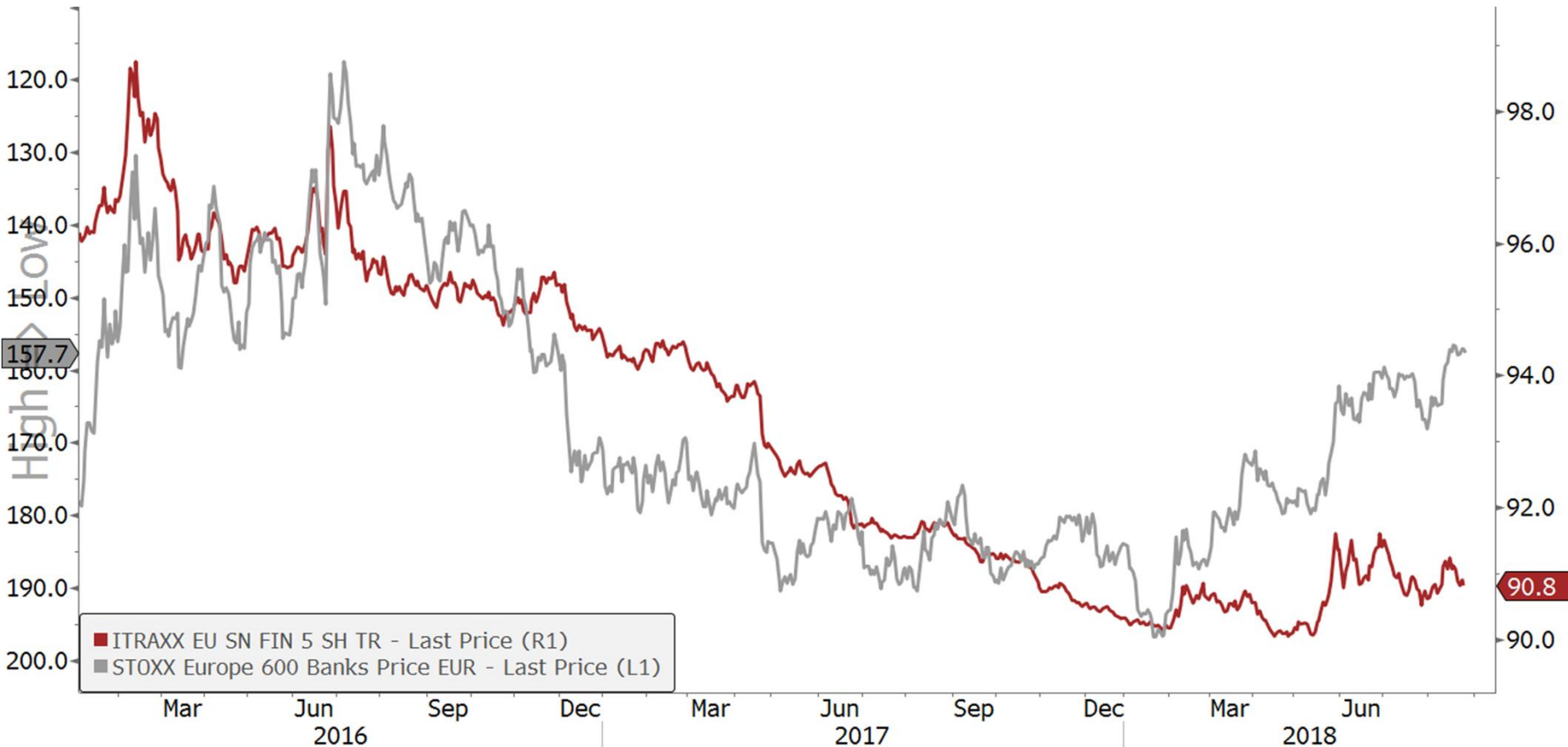
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Source: Pictet WM - CIO Office, Bloomberg



# EU Banks equity more stressed than credit

Itraxx Senior Financials and Stoxx Europe 600 Banks Performance (Inverted Scale)



ITRAXSF5 Index (ITRAXX EU SN FIN 5 SH TR) EU Itrax and Banks Relat Daily 04JAN2

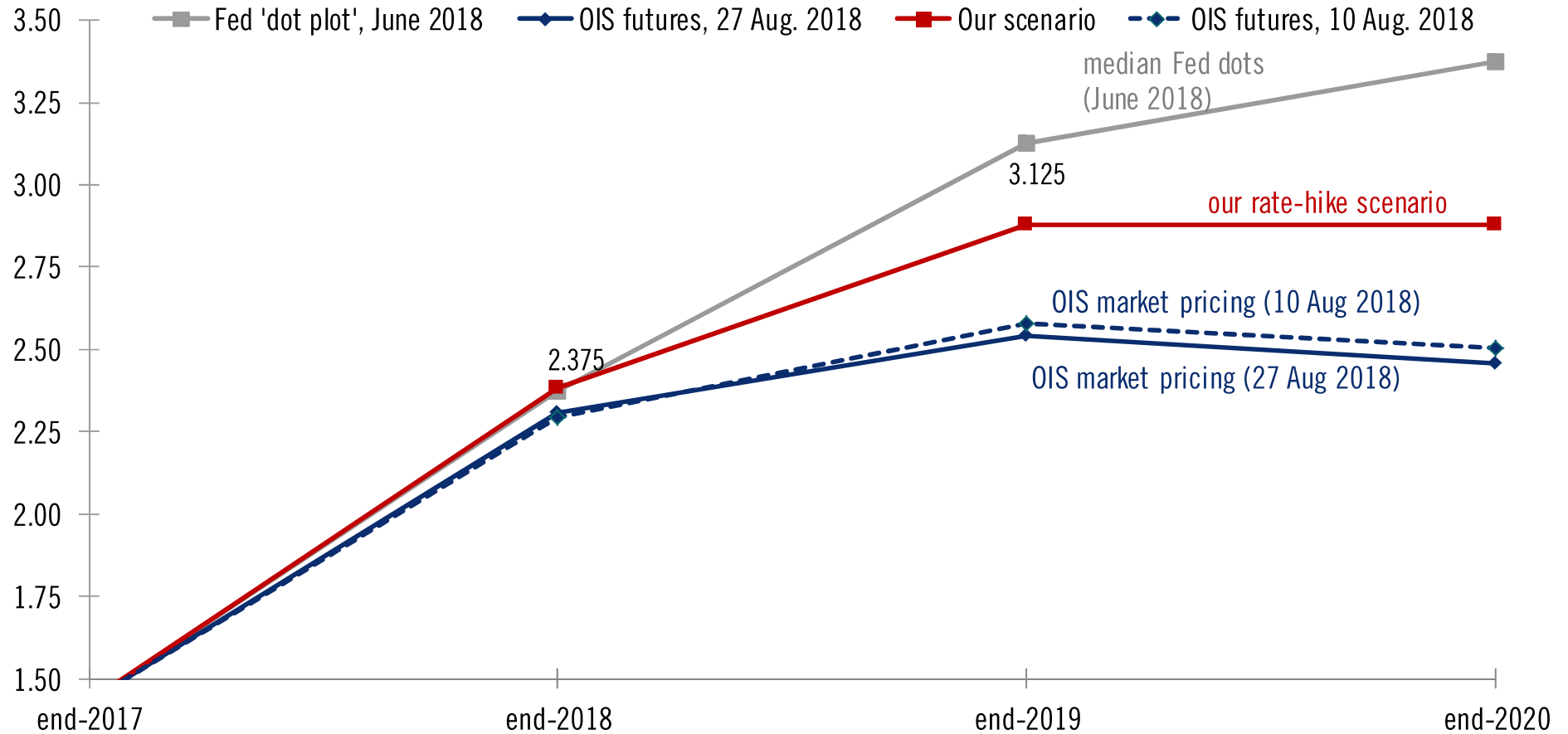
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Source: Pictet WM - CIO Office, Bloomberg

## More rates hikes priced in 2018-19...

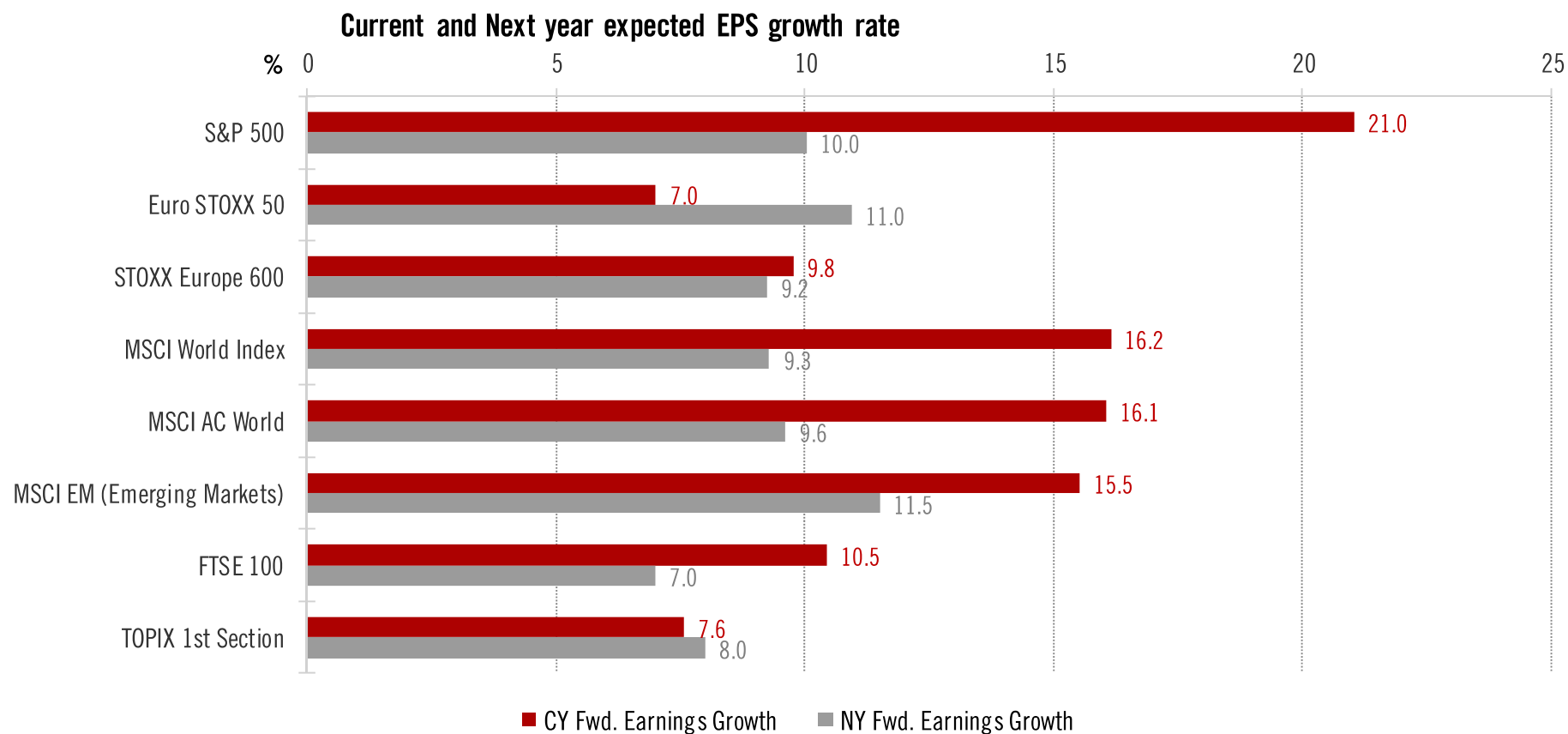
Fed dot plot (median rate) vs OIS market pricing, % -- market pricing as of 3 May 2018



Source: Pictet WM-AA&MR, Bloomberg, Federal Reserve.

# EPS Growth Estimates for 2018 and 2019

## Major Indices EPS Growth Rates

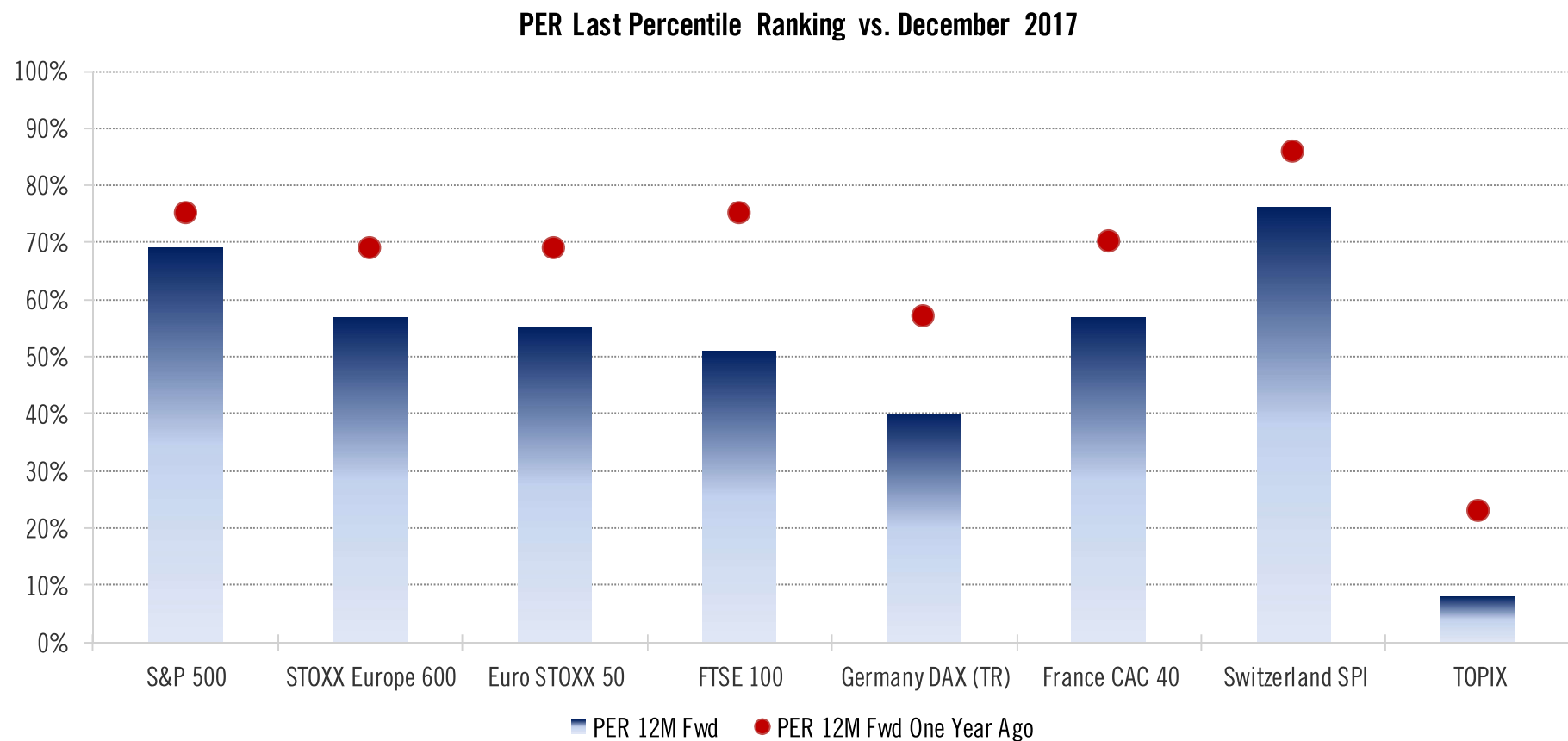


Source: Pictet WM - CIO Office, Factset



# Market Valuations have compressed and are more favourable

## 12M Forward PE Ratios, Percentile Ranking, last 20 years

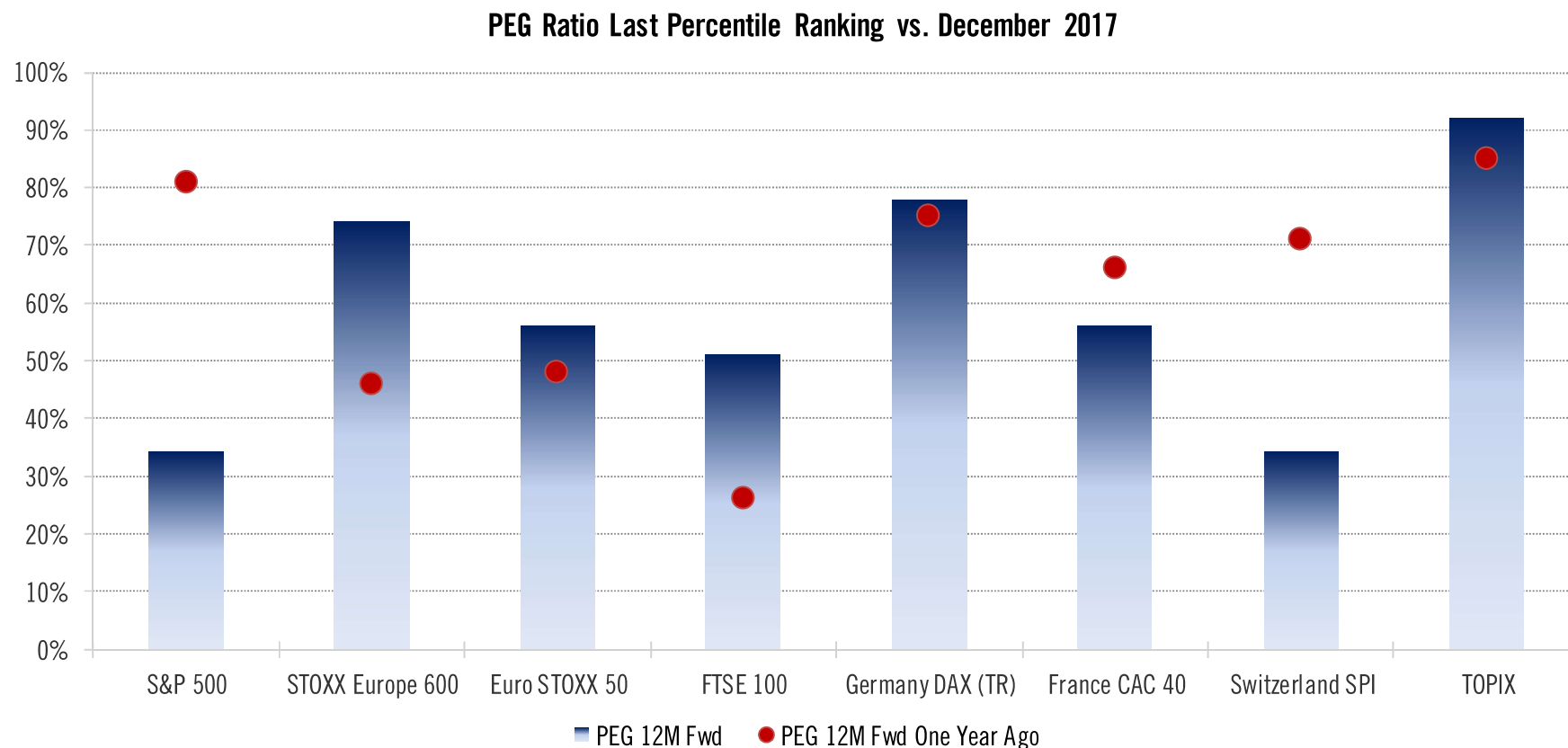


Source: Pictet WM - CIO Office, Factset



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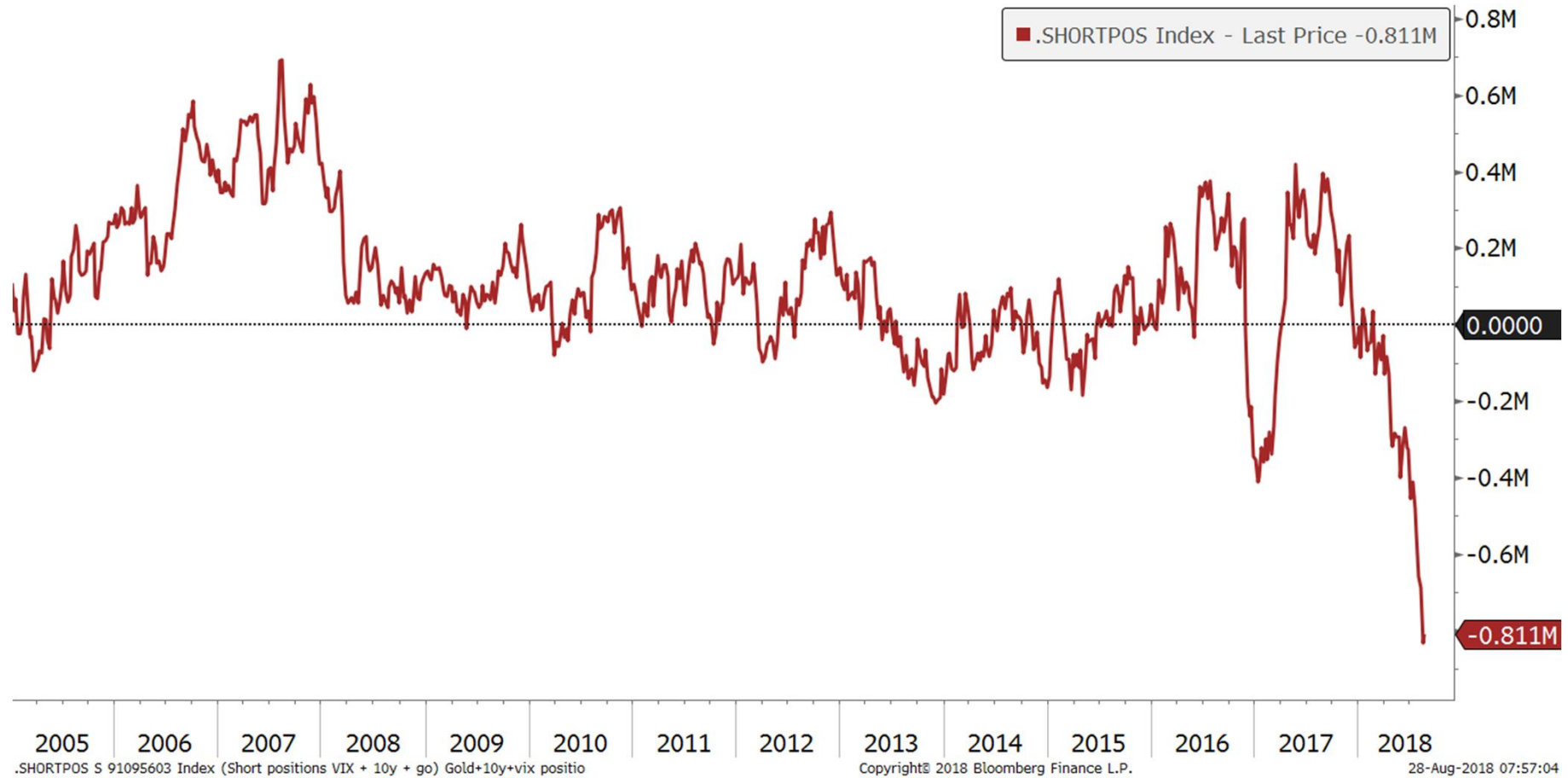


Source: Pictet WM - CIO Office, Factset



# Investors Positioning: Short Gold + 10Y Treasury + VIX

Gold + 10Y Treasury + VIX net non-commercial futures position



Source: PWM CIO Office, Bloomberg





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## Conclusions

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### 1 > A new environment

- February clearly marks a change for financial markets. Bonds did not compensate the decline in equity markets
- Credit risk is back both at the corporate (IG Spreads) and at the sovereign level (EMs and Italy), and has weighted on valuations

### 2 - The market environment has been characterized by many episodes of short-term stress but overall, volatility has remained low

### > Markets have adapted

- Short-term stress have not lasted as economic and profits growth remain strong. There is no systemic risk

### 3 - Due to the rise in financing cost, over-leverage has ben penalized. This will continue

### > As we enter the final part of the year

- Valuations are lower (but not cheap) than in January and growth is still healthy even if declining.
- If there is no systemic risk, then CB tightening will continue. US politics are still uncertain with 15% of voters still undecided.
- We are in a bilateral world: China's tariffs vs. US and Mexico's preliminary Nafta deal.
- Potential surprises: is the USD too strong for the White House ? and investors' current positioning