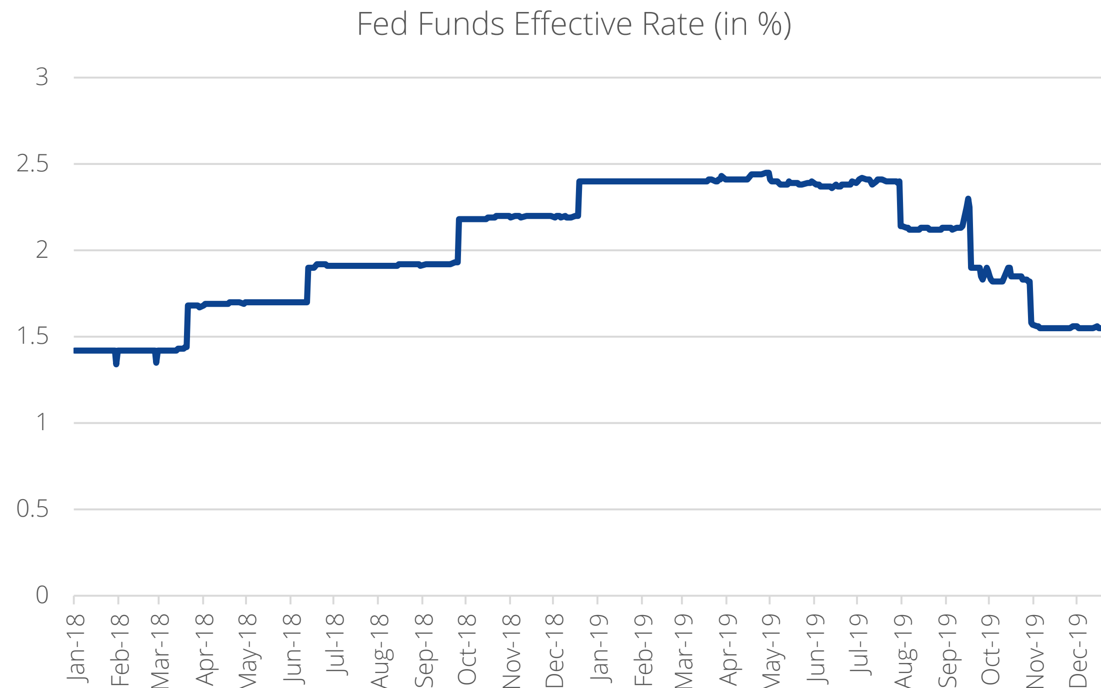
NG
NAHMANI GRUNDER
WEALTH MANAGEMENT & MULTI-FAMILY OFFICE

2019 Review

2019: What an extraordinary year, after the FED pivot on 3 January

- 2019 ended up as an extraordinary year for financial markets.

- FED increased interest rates by 4 times in 2018, with the final hike coming on 19 December. This FED monetary tightening bias and the associated communication heightened US recession fears in Q4 2018, resulting in meaningful drawdowns in financial markets during the quarter. S&P 500 dropped by 14% in Q4 2018.



- Following the crucial FED pivot on 3 January 2019, all risk assets reflated reversing the Q4 2018 losses in a V-shaped recovery. As seen above, FED overnight went from a tightening bias and 4 rate hikes to a wait-and-see stance followed by a subsequent easing cycle, with 3 rate cuts in 2019. The rationale was the softening global economy, lack of inflationary pressures and lastly growing trade rifts among the major blocks.

Best return year since 2013, on depressed realized volatility

- Receding trade tensions; diminished risks of a hard Brexit; liquidity injections by most major central banks; and improved sentiment about the state of the global economy gave a further impetus to risk assets during Q4 2019, helping push equities to all-time levels late in the year.

- As seen below, developed market equities (MSCI World) returned an impressive +25.2% for the entire 2019, with global corporate credit delivering +10.7% (both in USD). Even more impressively, the return of the Goldlilocks scenario pushed down realized volatility levels in markets, culminating in record-breaking Sharpe ratios. For example, the S&P 500 delivered a return of +28.9% in 2019 (excluding dividends) on a realized volatility of only 12% (versus its historical average of 16% since 1928). The resulting Sharpe ratio of 2.40x for S&P 500 in 2019 was the third-best in the last 30 years, after 2017 and 2013.

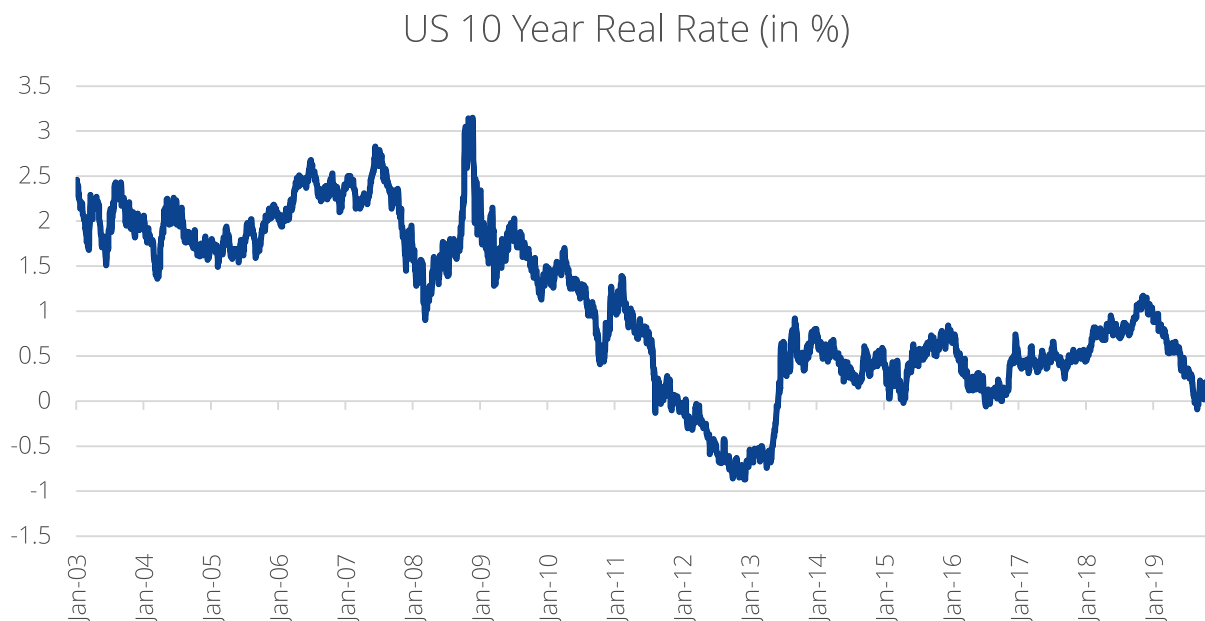
Global Equities	Dec-18	Dec-19	% Change (USD terms)
S&P 500	2506.9	3230.8	28.9%
SMI	8429.3	10616.9	27.8%
EuroStoxx 600	337.65	415.8	20.4%
MSCI DM	1883.9	2358.5	25.2%
MSCI EM	965.78	1114.7	15.4%

Global Bonds	Dec-18	Dec-19	% Change (USD terms)
Barclays Global Credit index	249.4	276.2	10.7%
US BBB spread	1.86%	1.25%	
US HY spread	5.27%	3.27%	
10-year Treasury	2.68%	1.92%	
US yield curve 3Mo10s (bps)	31.5	36.4	
10-year Inflation breakeven	1.98%	1.79%	
10-year US real yield	0.70%	0.13%	

2020 Market Insights

Base case: Soft landing with a benign growth backdrop…

- We now effectively have negative absolute and real rates in most of the developed world. Even in the US, long-term real rates finished 2019 at a minimal +0.14% (see below).



- And, the unprecedented monetary stimulus by all major central banks is here to stay for the foreseeable future, in our view, even in the US where we believe the FED won't have the courage to raise rates again in 2020, despite the core PCE being at 1.7% - 1.8% (versus the targeted 2.0%) and the unemployment rate at 3.5% being at a 50-year low.

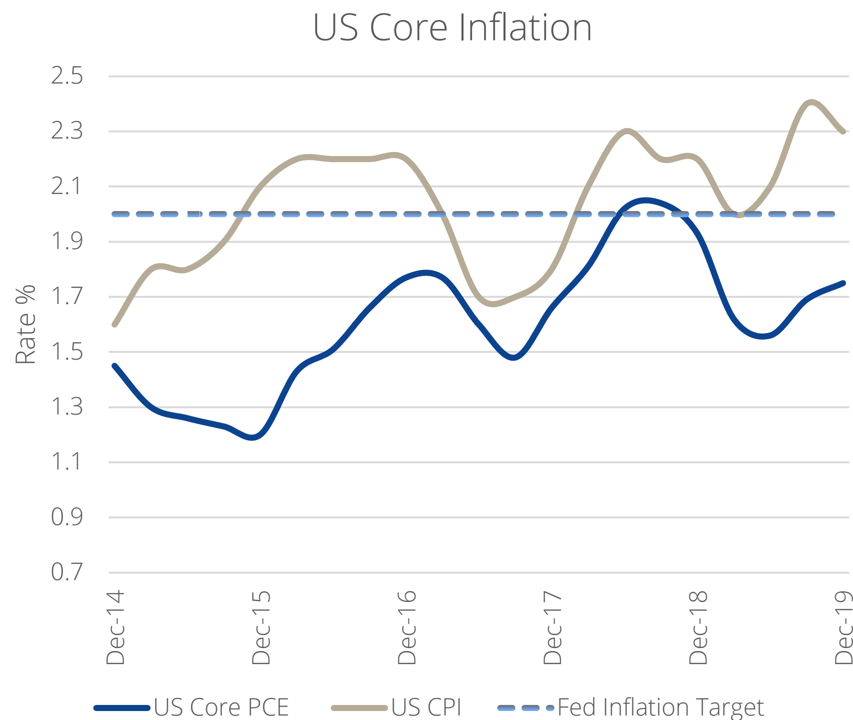
- This view forms the basis of our base case economic scenario of a soft landing with a benign economic outlook in 2020. This has been the longest expansion in history already entering its 11th year.

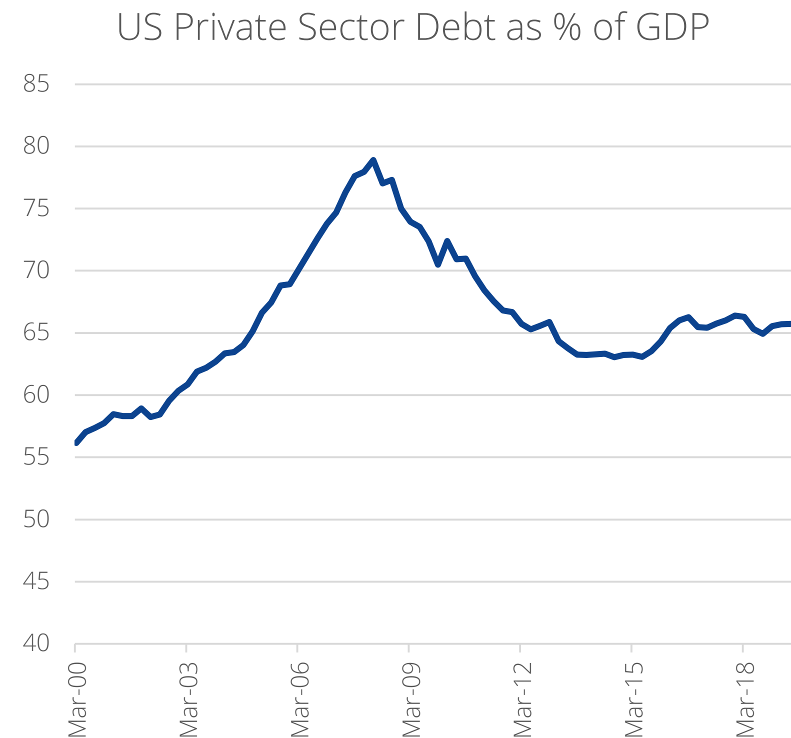
… and rather low recession risks in 2020

- Economic expansions end with either:

  1. Inflationary overheating, and too much associated tightenting as a response
  2. Credit problems / financial imbalances, similar to 2007.

- We see little meaningful signs of either yet.





… albeit with financial markets already priced to perfection

- Mid-term, our thesis remains the same: years of ultra-easy monetary policies have effectively removed appropriate hurdle rates out of the system, resulting in a period of misallocation of capital & resources, not only in China but also in the West. We are effectively now borrowing returns from the future and the end-game will be a quite adverse outcome similar to 2007, in our view.

- In the mean-time for the near-term: a benign, Goldlilocks type economic environment in 2020, albeit one in which financial markets are already priced for perfection dictates a fat and flat trading range with higher bouts of volatility.

- The risk/return is by far not as favorable as early 2019 when market were worried about an impending recession. Valuations are clearly not attractive anymore, both in Equity and Credit markets.

- The 2020 playbook for us is to focus on bottom-up securities selection in both equity and credit markets We expect negligible returns and a lot of volatility in 2020 for overall markets.

- The downside scenario of a recession will crystallize in the event of: (1) Political interference to the Goldilocks scenario, including a Sanders or Warren Presidency (including a reversal of the US tax reform) (2) Change in FED policy, which would imply inflationary overheating (3) Credit problems / Financial imbalances, similar to 2006/2007 (not really the case, but signs are emerging). That downside scenario is not our base case for 2020, and would surely create bigger drawdowns in financial markets. Every equity bear market in history has been associated with a recession, with an average drawdown of 35% in the span of 12 months.

Global Equities: Fat and flat trading range with higher volatility

- We use S&P 500 as a global barometer for Global equities, since we do not attest to a decoupling thesis for other regions, including Europe.

- S&P 500 average year-end P/E was 18.2x between 2015a – 2019a (5-year period) and 16.9x in the last decade between 2010a – 2019a. The entire return upside in 2019 came from valuation expansion from 15.4x at end-2018 to 19.5x at end-2019. Current P/E 2020e of 18.9x is already above 5 and 10-year historical averages (see below).

S&P 500 EPS per calendar year with P/E bands						
	2015a	2016a	2017a	2018a	2019a	2020e
Operating EPS	118.20	119.08	132.95	162.91	165.35	172.0
growth (YoY)		0.7%	11.6%	22.5%	1.5%	4.0%
Price low	1867.6	1829.1	2257.8	2351.0	2447.9	
Price high	2130.8	2271.7	2690.2	2930.8	3240.0	
Price close	**2043.9**	**2238.8**	**2673.6**	**2506.9**	**3230.8**	3246.28
P/E low	15.8	15.4	17.0	14.4	14.8	
P/E high	18.0	19.1	20.2	18.0	19.6	
P/E close	**17.3**	**18.8**	**20.1**	**15.4**	**19.5**	**18.9**
P/E range	**15.8 - 18.0**	**15.4 - 19.1**	**17.0 - 20.2**	**14.4 - 18.0**	**14.8 - 19.6**	

- We think valuations are very full at current levels, both in historical context as well as considering current economic and rates conditions (10-year treasury at 1.7% - 1.8%). At a forecasted 10-year Treasury rate of 2.0% at year-end 2020 with an equity risk premium of 3.5% (versus long-term average 2.7%), one would also get to a fair-value implying P/E of 18.2x.

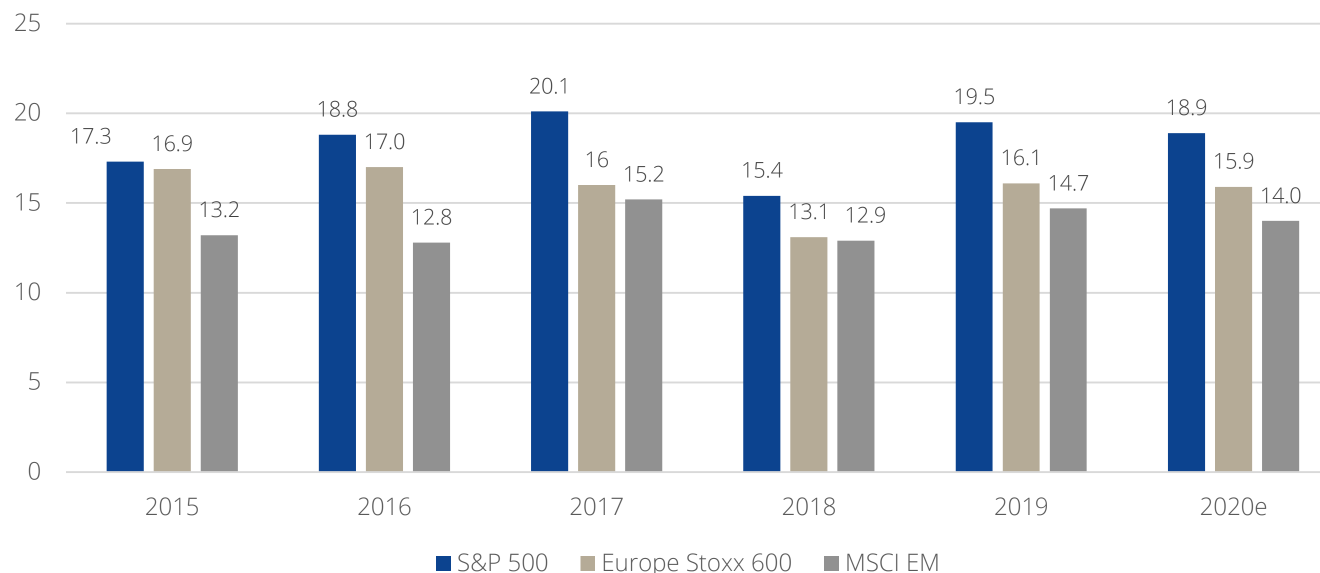
- Under our current EPS growth assumption of +4% for 2020e, we see a Fat and Flat trading range in 2020 between 2,850 – 3,200 for S&P 500. That range assumes a P/E 2020e range of 16.5x – 18.5x, versus a realized range of 14.8x – 19.6x in 2019. Only in 2017, when US economic growth was accelerating, were P/E multiples higher around 20x.

Global Equities: Our bias towards US and Technology/Health care remains

- Further upside to our equity market call can only come from an economic growth re-acceleration scenario in 2020, which we don't see at the moment. Any further escalation of geo-political issues in the Middle East (including trade issues between US and China) would only create further downside risk to this view.

- Our preference on US equity markets remains, as its current P/E premium versus Europe and Emerging Markets is highly justified in our view, from a growth as well as a ROIC perspective. For example, Europe Stoxx 600 is currently trading at a fully justified 16% discount to the S&P 500, compared to an average discount of 13% between 2015 – 2019. S&P 500 delivered an EPS CAGR of +8.8% in that period, versus only +4.2% for Stoxx 600. We expect this growth differential to remain.

- Our view continues to be that the right time to turn more constructive on EM equities will be during the next global recession.



Fixed Income – Credit Selection remains key to returns

- Over 20% of debt in the Global Aggregate Index is negative yielding. However, corporates make up only 3% of negative yielding debt in the Global Aggregate Index.

- Despite historically tight starting levels, US corporates (A rated to mid-BBB's) and selective parts of the lower credit spectrum (Bank Capital, idiosyncratic High Yield issuers) within the 5 year duration bucket stand out as being the most attractive when looking for positive yielding and fundamentally sound rated corporates in 2020.

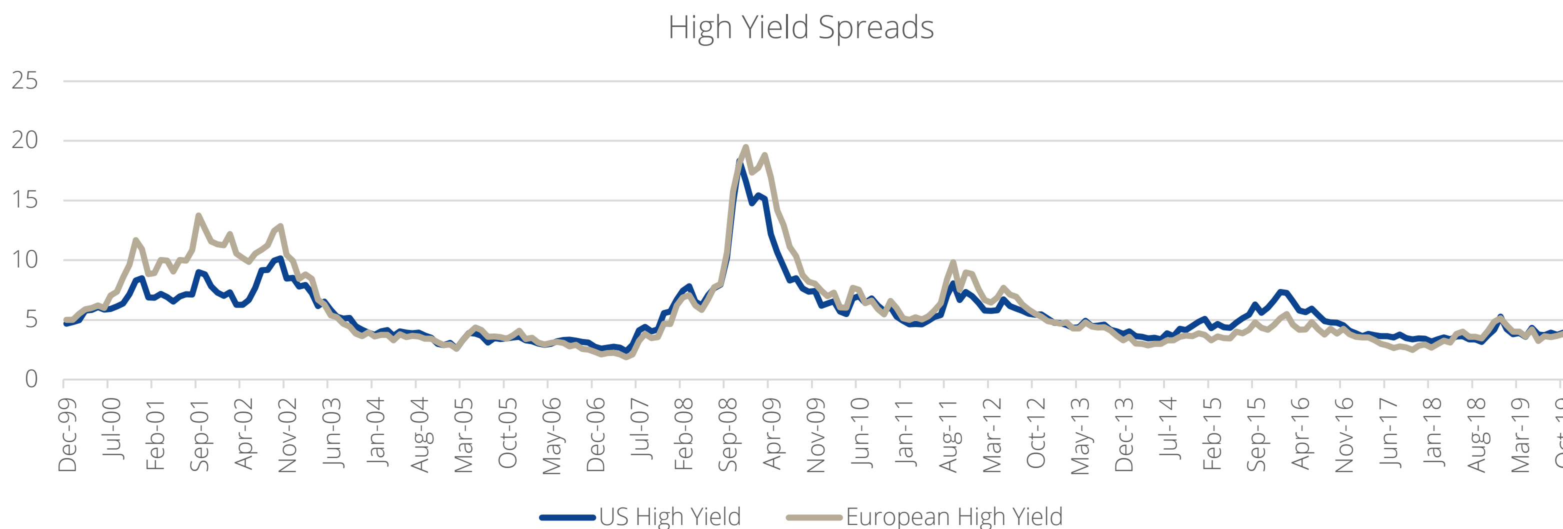
Index (Local Currency)	2019 Return %	YTW %	OAD (Yrs)	OAS (Bps)
US High Yield	14.32	5.19	3.05	336
Global High Yield	12.56	5.68	3.71	422
Pan European High Yield	12.29	3.46	4.15	341
US Aggregate	8.72	2.31	5.87	38
Global Aggregate	6.84	1.45	7.19	38
Euro Aggregate	5.98	0.23	7.1	57
Global Treasuries	5.59	0.96	8.36	11
China Aggregate	4.86	3.26	5.15	31

- In Europe, the ECB reinitiated its QE program in 2019 with intentions of net bond purchases of EUR 20bn per month for the foreseeable future. This will lead to a continued squeeze in spreads within European credit indices as negative yields and CSPP force investors to BB and Hybrids. Nevertheless, given the downside to valuations, we continue to have a penchant for the US fixed income market where both fundamentals and technical remain more supportive.

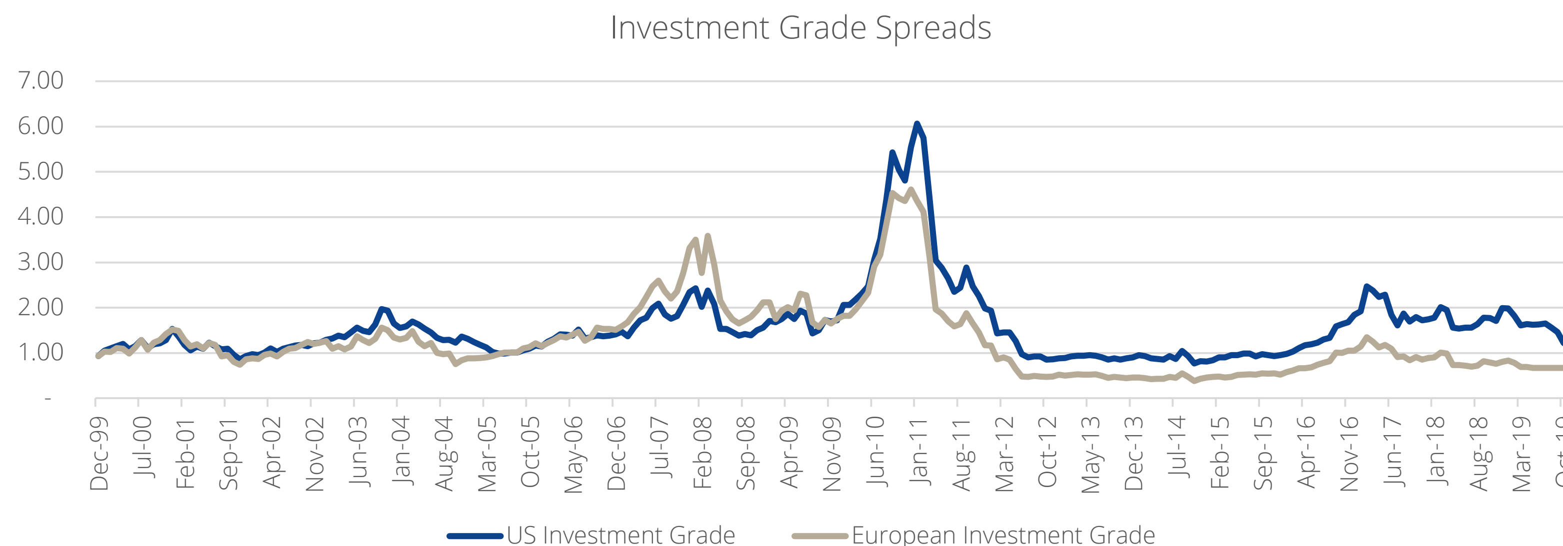
- In Emerging Markets, central banks also remain supportive. On a valuation basis, Emerging Markets investment grade screens as fair value compared to their US counterparts, whereas High Yield spreads are indeed wider but mainly due to Argentina, where uncertainty and volatility remains high and therefore unwarranted in portfolios.

Fixed Income- Spreads at all-time lows; Risk/return not favorable

- Risk 1: Recessionary scenario - would see the below high yield (HY) spreads widen meaningfully, testing the highs of 2011.



- Risk 2 : A strong rise in yields – due to surprises in macro data or a less active central bank posture (claw back in easing from the ECB or increased German stimulus). IG spreads in US and Europe are now below all-time low levels!



NG Global Economic Forecasts

- In order to turn more positive on markets at this point of the cycle, we need a clear re-acceleration in economic growth in the US, which would also be bullish for the USD risk assets, since we see Europe stuck in the current 1% real GDP growth environment at best.

- But even under that more optimistic scenario, we see upside from here as limited to mid-single digit returns.

	2017a	2018a	2019a	2020e
US	2.2%	2.9%	2.3%	2.0%
Japan	1.7%	1.1%	0.9%	0.6%
Germany	2.5%	1.9%	0.6%	0.8%
France	2.3%	1.6%	1.2%	1.2%
UK	1.7%	1.4%	1.3%	1.1%
Italy	1.5%	1.2%	0.6%	0.6%
Canada	3.0%	2.1%	1.5%	1.5%
G7-ex US	2.1%	1.5%	0.9%	0.9%
Developed Mkts. (DM)	2.3%	2.4%	1.7%	1.7%
Emerging Markets	4.7%	4.7%	4.2%	4.4%
Global GDP growth	3.7%	3.7%	3.1%	3.2%

- In 1998, FED delivered 75bps of insurance costs on the back of the Asia financial crisis and S&P 500 rallied by +27% in that year. Valuation expanded from 18x to 23x. The FED and Chairman Greenspan held course in 1999 despite signs of overheating in the US economy, and S&P 500 rose by a further +20% in that year. Some investors seem to betting on a similar market outcome in 2020, drawing parallels between 1998 and 2019. We do not think history will repeat itself this time.

Outlook 2020

Asset Classes	Positive	Neutral	Negative
Fixed Income & Cash	Money market T-Bills US IG	US Treasuries US HY	EU Sov. Bonds EU IG/HY Corp EM Corp
Equities (sectoral view)	Technology Healthcare	Consumer Staples Financials Energy Telecom Metals & Mining	Industrials Consumer Discretionary Chemicals Utility
FX	USD	EUR GBP CHF JPY	CNY EM
Commodities		Copper, Nickel Oil Precious metals	Iron ore, coal

IMPORTANT INFORMATION – MATERIAL WITH NON-PERSONALISED RECOMMENDATIONS

This document is issued by Nahmani Grunder & Cie AG. It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful to address such a document. This document is provided for information purposes only. It does not constitute an offer or a recommendation to subscribe to, purchase, sell or hold any security or financial instrument. It contains the opinions of Nahmani Grunder & Cie AG, as at the date of issue. These opinions and the information herein contained do not take into account an individual's specific circumstances, objectives, or needs. No representation is made that any investment or strategy is suitable or appropriate to individual circumstances or that any investment or strategy constitutes a personal recommendation to any investor. Each investor must make his/her own independent decisions regarding any securities or financial instruments mentioned herein. Tax treatment depends on the individual circumstances of each client and may be subject to change in the future. Nahmani Grunder & Cie AG does not provide tax advice. Therefore you must verify the above and all other information provided in the document or otherwise review it with your external tax advisors. Investment are subject to a variety of risks. Before entering into any transaction, an investor should consult his/her investment advisor and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. The information and analysis contained herein are based on sources considered to be reliable. However, Nahmani Grunder & Cie AG does not guarantee the timeliness, accuracy, or completeness of the information contained in this document, nor does it accept any liability for any loss or damage resulting from its use. All information and opinions as well as the prices, market valuations and calculations indicated herein may change without notice. Past performance is no guarantee of current or future returns, and the investor may receive back less than he invested. The investments mentioned in this document may carry risks that are difficult to quantify and integrate into an investment assessment. In general, products such as equities, bonds, securities lending, forex, or money market instruments bear risks, which are higher in the case of derivative, structured, and private equity products; these are aimed solely at investors who are able to understand their nature and characteristics and to and bear their associated risks. On request, Nahmani Grunder & Cie AG will be pleased to provide investors with more detailed information concerning risks associated with given instruments. The value of any investment in a currency other than the base currency of a portfolio is subject to the foreign exchange rates. These rates may fluctuate and adversely affect the value of the investment when it is realized and converted back into the investor's base currency. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme market conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset. If opinions from financial analysts are contained herein, such analysts attest that all of the opinions expressed accurately reflect their personal views about any given instruments. Nahmani Grunder & Cie AG may hold positions in securities as referred to in this document for and on behalf of its clients.

Switzerland: This document has been approved for issue in Switzerland by Nahmani Grunder & Cie AG, an external asset manager member of Swiss Association of Asset Managers (SAAM).

This document may not be reproduced (in whole or in part), transmitted, modified, or used for any public or commercial purpose without the prior written permission of Nahmani Grunder & Cie AG.

© 2018 Nahmani Grunder & Cie AG – all rights reserved

www.nahmanigrunder.ch