

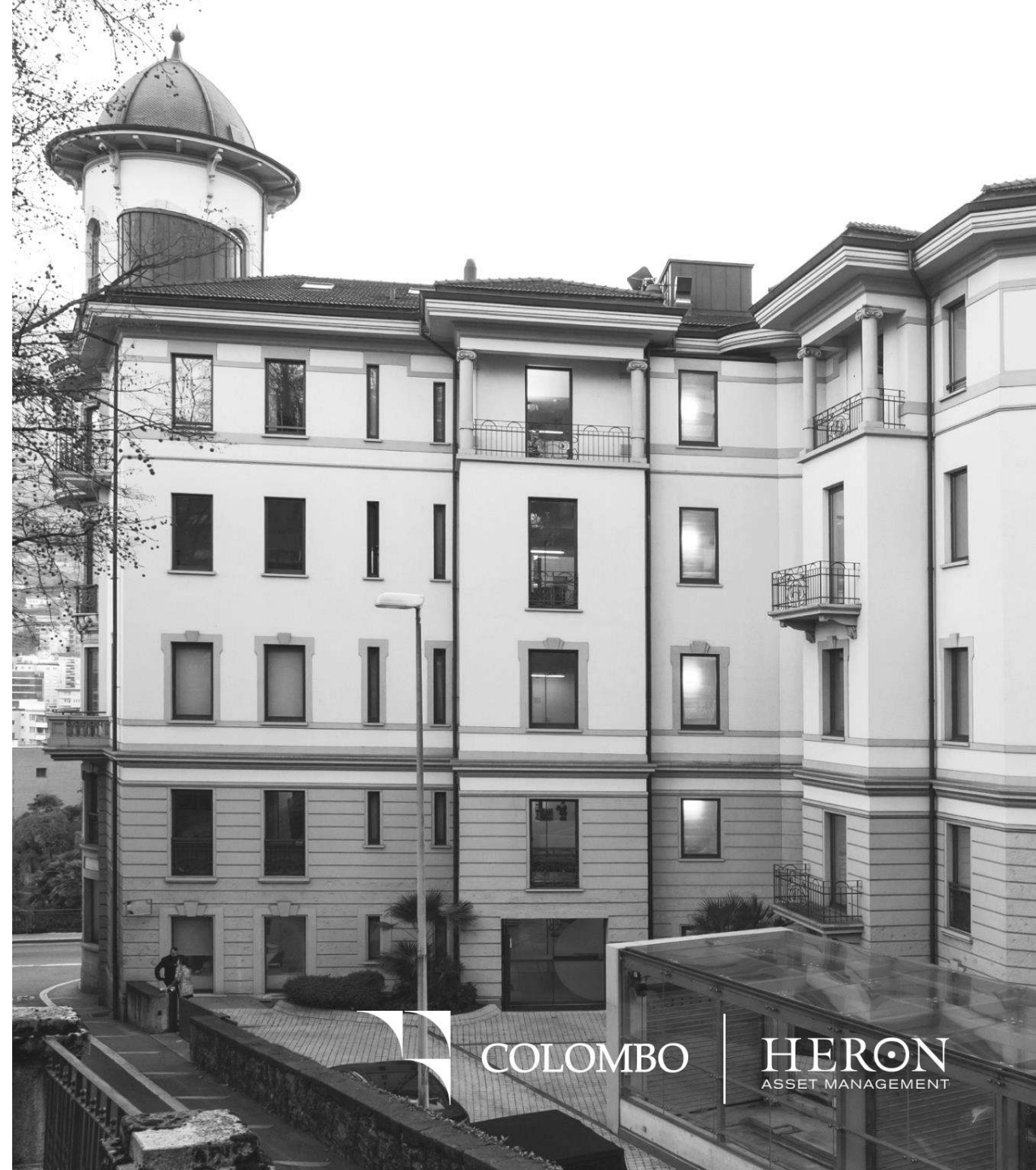
Monthly Market Update

Monthly focus on the financial markets
11th February 2019

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Market Analysis

After the worst December for stocks since the Great Depression, which saw the S&P500 tip into bear market territory if only for a few seconds on December 24, the market enjoyed a furious rebound last month, when it climbed 7.9%, the best January return since 1987, a fact that was not lost on president Trump who is back to tweeting about the market after taking a 3-month hiatus during the Q4 swoon.

MSCI World jumped 7.7% in January, the best start to the year since 1987 and among the four highest ever dating back to 1969.

The S&P is now up more than 16% since the Christmas lows and sector breadth has exploded higher over the last days as most stocks moved back above their 50-DMA's. Now ~80% of S&P 500 stocks sit above their 50-DMA's, the highest reading in a year.

As you remember, 2018 has been the worst year since 1901 if we consider how many asset classes have generated a negative performance in \$ terms. 89% of the world different asset classes have closed negatively vs. 84% in 1920. This was in stark contrast to 2017, as it has been the best year ever in terms of number of asset classes closing positively with only 1% in negative territory (Philippines Bonds).

2019 has started well with every major asset class beating inflation.

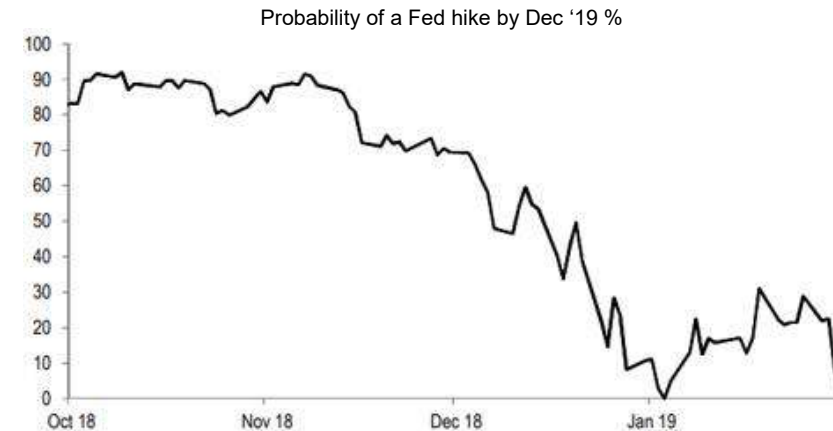
asset classes beating the inflation (green)

Ranking	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
1	US 10yr	MSCI EM	REITS	US 10yr	MSCI China	Russell 2000	REITS	MSCI Japan	Commodities	MSCI China	US 2yr	REITS
2	US 2yr	MSCI China	Russell 2000	Inflation Bonds	MSCI Europe	S&P 500	S&P 500	REITS	Russell 2000	MSCI EM	US 10yr	Russell 2000
3	US Agg. Bond	Global HY	Commodities	EM\$Sov Credit	Global HY	MSCI Japan	US 10yr	US 10yr	US HY	MSCI Europe	US Agg. Bond	MSCI China
4	EM Local Debt	US HY	MSCI EM	US IG	REITS	MSCI Europe	MSCI China	EM\$Sov Credit	Global HY	MSCI Japan	US HY	MSCI EM
5	US IG	Commodities	MSCI Japan	US Agg. Bond	MSCI EM	US HY	US IG	S&P 500	S&P 500	S&P 500	US IG	S&P 500
6	Inflation Bonds	MSCI Europe	US HY	REITS	EM\$Sov Credit	Global HY	EM\$Sov Credit	US 2yr	MSCI EM	Russell 2000	EM Local Debt	MSCI Europe
7	EM\$Sov Credit	EM\$Sov Credit	S&P 500	US HY	Russell 2000	MSCI China	US Agg. Bond	US Agg. Bond	EM\$Sov Credit	EM Local Debt	Global HY	MSCI Japan
8	US HY	REITS	Global HY	S&P 500	REITS	Russell 2000	US IG	REITS	Global HY	REITS	Commodities	Commodities
9	Global HY	Russell 2000	EM Local Debt	S&P 500	US HY	US 2yr	Inflation Bonds	MSCI Europe	US IG	EM\$Sov Credit	Inflation Bonds	US HY
10	Commodities	S&P 500	EM\$Sov Credit	US 2yr	EM Local Debt	US IG	US HY	Global HY	EM Local Debt	REITS	EM\$Sov Credit	Global HY
11	MSCI Japan	US IG	US 10yr	EM Local Debt	US IG	US Agg. Bond	US 2yr	Russell 2000	Inflation Bonds	Inflation Bonds	S&P 500	EM\$Sov Credit
12	Russell 2000	EM Local Debt	US IG	Russell 2000	Inflation Bonds	MSCI EM	Global HY	US HY	MSCI Japan	Commodities	Commodities	EM Local Debt
13	S&P 500	Inflation Bonds	US Agg. Bond	Commodities	MSCI Japan	Inflation Bonds	MSCI EM	Inflation Bonds	US Agg. Bond	US HY	Russell 2000	US IG
14	REITS	MSCI Japan	MSCI China	MSCI Europe	US Agg. Bond	EM Local Debt	MSCI China	MSCI China	US IG	MSCI Japan	Inflation Bonds	Inflation Bonds
15	MSCI Europe	US Agg. Bond	MSCI Europe	MSCI Japan	US 10yr	US 10yr	MSCI Japan	EM Local Debt	US 2yr	US Agg. Bond	MSCI EM	US Agg. Bond
16	MSCI China	US 2yr	Inflation Bonds	MSCI EM	Commodities	EM\$Sov Credit	MSCI Europe	MSCI EM	US 10yr	US 10yr	MSCI Europe	US 10yr
17	MSCI EM	US 10yr	US 2yr	MSCI China	US 2yr	Commodities	Commodities	Commodities	MSCI Europe	US 2yr	MSCI China	US 2yr

The Fed has certainly helped this “miraculous” rebound as it delivered a dovish message, which means lower rates (slower/less rate hikes) and slower normalization of the Fed’s balance sheet.

The rally this year began on January 4th, the day that Fed Chair Powell suggested the Fed would be patient which is code for a pause in rate hikes. The Fed signaled that would be prepared to use its full range of tools, including altering the size and composition of its balance sheet, if future economic conditions were to warrant a more accommodative monetary policy than can be achieved solely by reducing rates... in other words QE4 will be coming with the next downturn assuming Fed funds rate cuts don’t work.

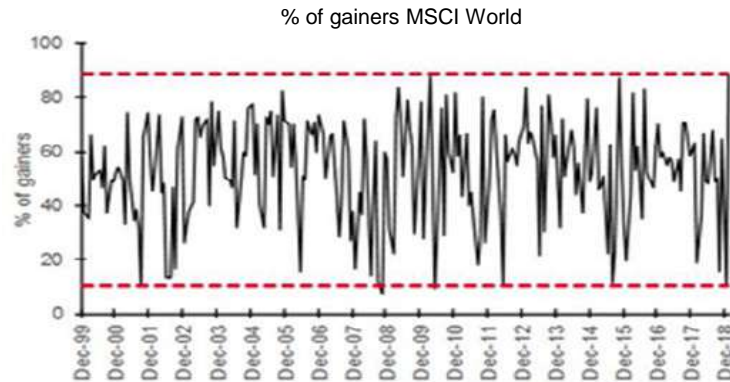
The chart shows the probability of Fed rate hikes in 2019.



Market Analysis

January is often a time for reversals and risk taking as it happened in 2018, however, the extent of the bounce back has taken many by surprise. As we show in the chart below, December 2018 saw 90% of MSCI World stocks falling, while January 2019 has seen 88% of stocks going up, a 20-year record!

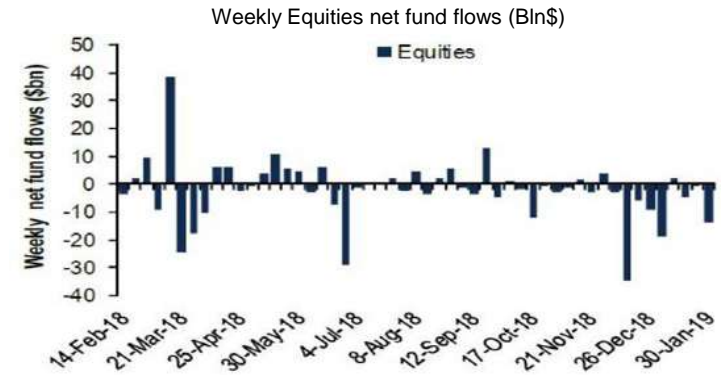
From indiscriminate selling to indiscriminate buying, % of stocks up in MSCI World during the month.



Historically, after a significant pull-back on S&P, recovery has typically taken 60-70 days to recover, this time it took just 20-working days to recover back 50% of the loss we had in 2019!

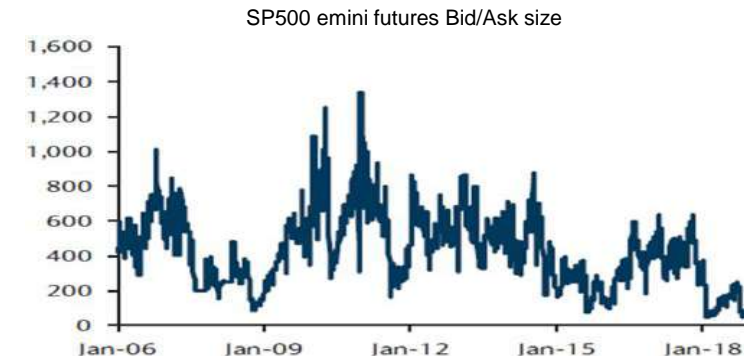
If we look more in details, something strange has happened: investors were not buying the latest market recovery and last week we saw wildly risk-off flows with 15bn\$ pulled out of Equities and 9bn\$ allocated to Bonds.

US Equity funds had outflows for 10 of the past 11 weeks culminating with a record outflows over the past 3-months, amounting to 82bn\$, equivalent to a whopping 2% of all AUM.



Volumes were instead high on futures as roughly 28bn\$ of recent shorts have been covered since the 27th of December (7% of total open interest) with basically all shorts established during the month of December covered.

S&P futures market dept declined significantly even with the beginning of the year/market bounce. We are at a point where both the Central Banks and Volatility in general are negatively impacting liquidity.



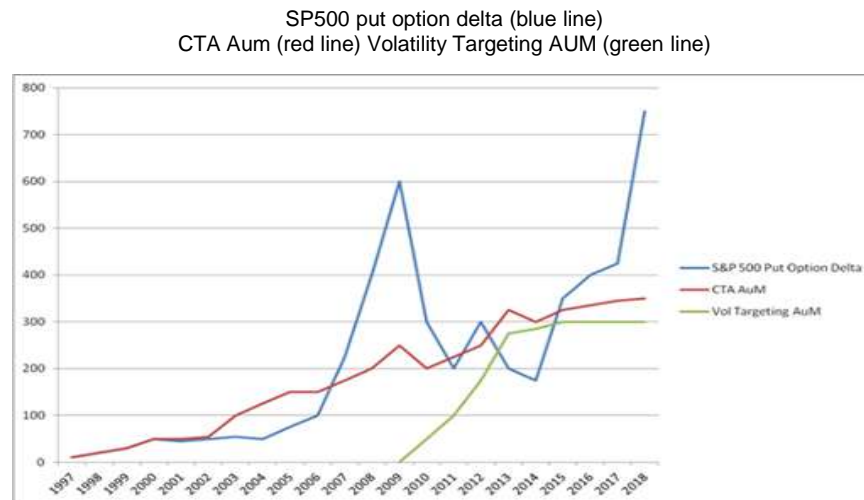
Market Analysis

With alpha being more difficult to generate for most of investors and money being less 'sticky' than ever... especially after last year's performance for many funds... investors are 'following' more than ever, amplifying the moves generated by the systematic strategies.

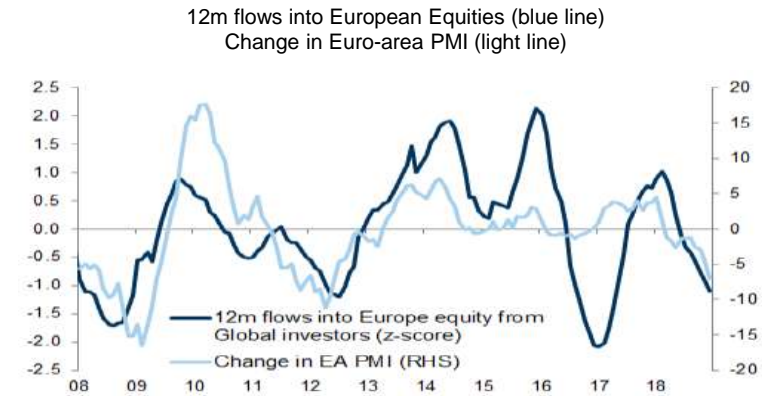
Systematic strategies are becoming more and more relevant and there can be (and is now) a massive divergence between current traditional market sentiment, narrative, and market directionality.... Meaning, sentiment can be bearish, the data can be bad, the geopolitical backdrop negative, etc, but the systematic strategies can be buying, and vice-versa.

CTA trigger level has been breached upwards on the S&P and is likely to accelerate further into strength. Volatility Target funds need to buy as volatility goes lower.

The overall S&P 500 Put Option Delta (daily option hedging delta) is ~\$750Bn. Vol Targeting AuM is about ~\$300Bn, and CTAs are about ~\$350Bn.



The decline in flows is also a reflection of the weaker economic picture as the chart is clearly showing.

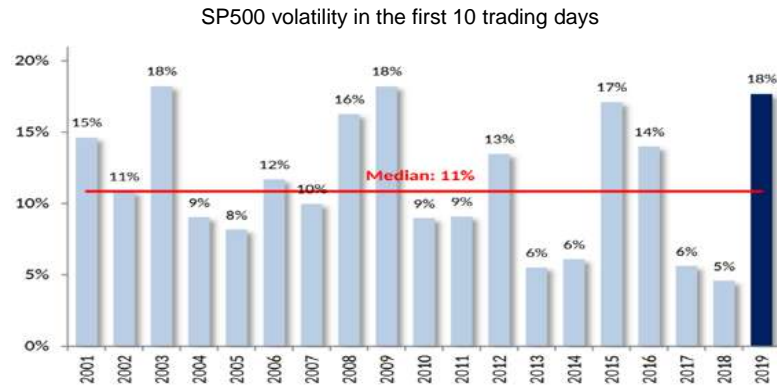


Looking back to how things started a year ago, it seems we're following a very similar trajectory. Many market indices are up mid-high single-digits MTD and HF performance has also bounced back. In contrast, the positioning story remains very different YoY as most funds have much lower gross than a year ago, while net leverage is still about 1-standard deviation below average.

It's not clear how much managers will increase leverage unless volatility continues to fall more substantially and we actually expect volatility to be up from current levels.

Market Analysis

There is a high correlation between volatility in the first 10 trading days of the year vs. full year volatility (chart).



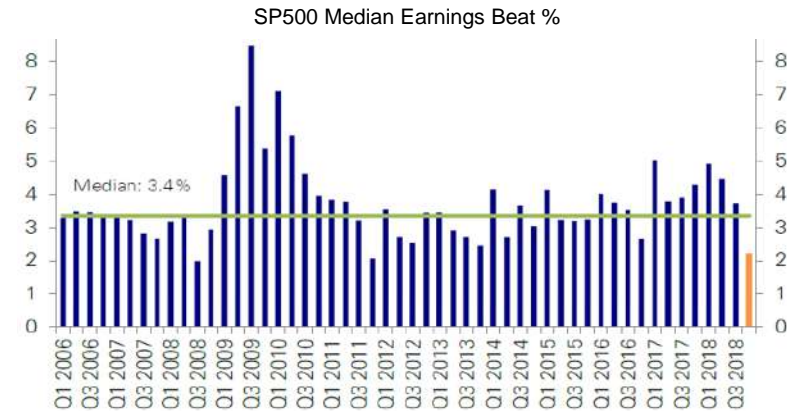
Economic growth is decelerating sharply and corporate earnings are being revised lower at a rate we haven't seen since the global recession in 2015-16.

This lack of enthusiasm, which also manifests itself in subdued trading volumes, likely explains the resilience of markets in the face of deteriorating economic and earnings news flow and suggests that the latter may have to take a more material turn for the worse if equity markets are to move lower.

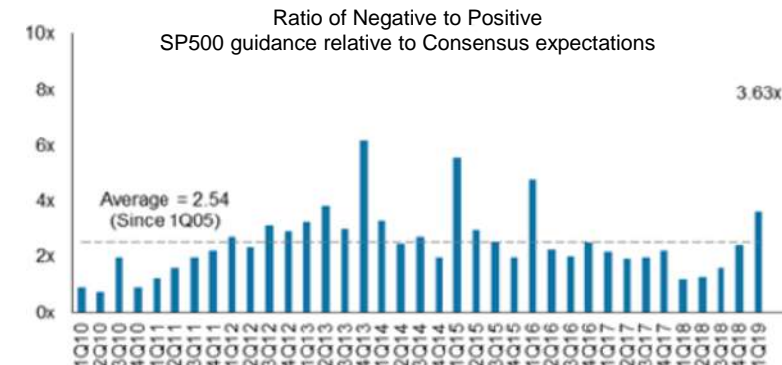
With most stocks up at least 10-15% from the lows, led by the high beta names, we think the risk reward is much less attractive at this point given the numerous hurdles still confronting equity investors.

Earnings

In US, Q4 earnings have disappointed significantly so far with the lowest beats in 7 years; underlying growth has fallen sharply to 3.4% in Q4 from a relatively steady 11% earlier, raising the risk of zero to slightly negative earnings growth in Q1.



In strong contrast, solid equity market and off-the-charts individual stock performance suggest the slowing was more than priced in. The ratio of negative to positive guidance for Q1 is the highest it has been since 2016, the last time we had an earnings recession (chart).



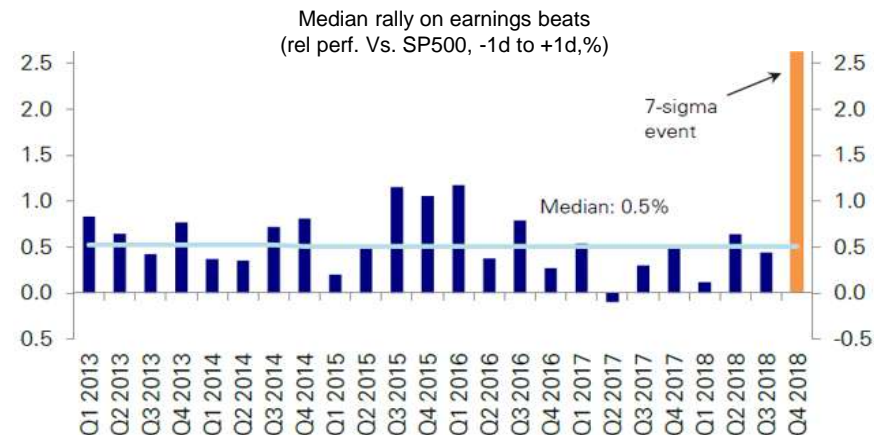
Earnings

Negative guidance for Q1 is being given 3.6 times more than positive guidance; the median level post-crisis is 2.5 times. Finally, earnings revision breadth has reached the lowest levels since the last earnings recession in 2015-16.

The growing divergence between the performance of S&P and Forward EPS data is striking.

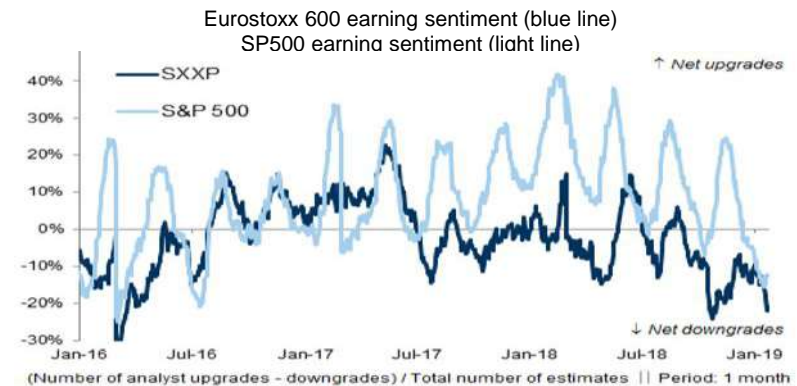


This is also explained with positioning, outperformance after reporting has been extreme. With the worst guidance since 2015, downward revisions are likely to continue.



In Europe, in both Q218 and Q318 results, we saw the trends of decent sales beats lagged by disappointing earnings numbers, as margins weighed on results. So far in Q4, we have seen a similar pattern, with 22% more companies beating sales than missing, while EPS has registered a net miss. Some of this may be explained by FX given EUR weakness in the quarter, but it does suggest a continuation of the trend of a weakening margin backdrop.

Chart below shows Eurostoxx 600 earning sentiment vs S&P earning sentiment.



However, on the positive side, we believe investors already anticipate challenging earnings, and as such **weak earnings and guidance may not come as a surprise**. It is still early days, but encouragingly stock price reaction is showing strong rewards for companies beating estimates, while companies missing estimates are being penalized to a lesser extent, compared to history.

So, while the earnings story has been weaker than expected, the Fed pivot (as well as optimism on US/China trade) is currently winning out but also getting priced in quickly.

Executive Summary

Over the 1st newsletter of 2019 we started saying that although the macro backdrop for 2019 was very challenging, a reasonable degree of bad news were the price and valuations were looking more attractive and investor sentiment decidedly bearish. We expected a big bounce in equity prices once the new calendar year began.

We also mentioned that 2019 was going to be a potential better year vs 2018 as the risk-reward on Equities was easier but we would still need to face high volatility where market timing is going to be the only winning tool.

A strong start to the year in global equity markets has repaired much of the damage done in December. Despite this, we're yet to see any real signs of an upturn in investor sentiment. Prime brokerage data shows that hedge fund net exposure ratios remain stuck close to record lows, while Investors had in Europe the most negative skew in risk positioning since 2012.

If there is one thing the events over the past two months have proven beyond a reasonable doubt, it is that when it comes to risk prices, one thing matters, not fundamentals, not political risks, not earnings forecasts, not squiggly lines on charts, not opinions about the economy or even inflation and interest rate forecasts. The only thing that truly matters is **how much liquidity is being generated or drained by the Fed and other Central Banks at any given moment.**

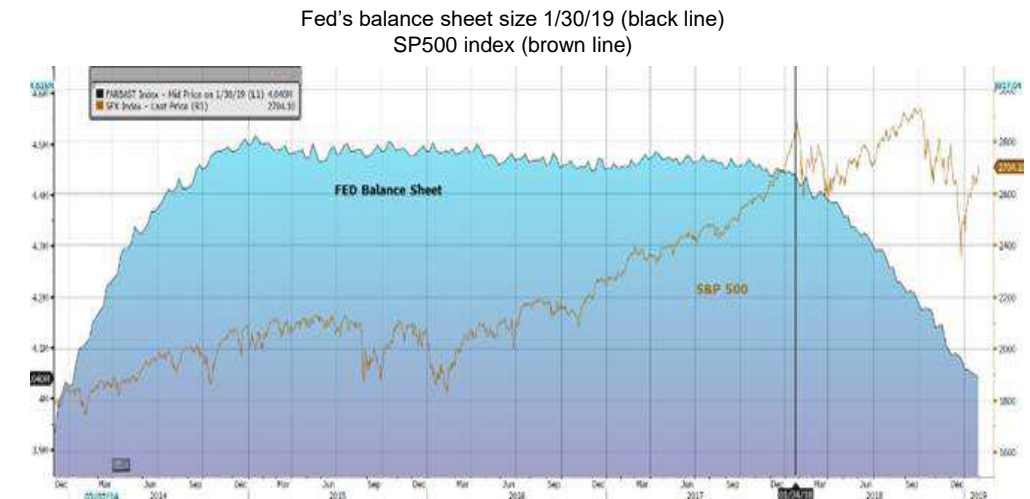
In fact, the rally began on January 4th, the day that Fed Chair Powell suggested the Fed would be patient which is code for a pause in rate hikes. There was also acknowledgement that they need to be more flexible on the balance sheet.

The Fed signaled that would be prepared to use its full range of tools, including altering the size and composition of its balance sheet, if future economic conditions were to warrant a more accommodative monetary policy than can be achieved solely by reducing rates...in other words QE4 will be coming with the next downturn assuming Fed funds rate cuts don't work.

Have things changed so much since the end of last year that Mr. Powell had no choice but to make such a staggering U-turn or have we simply experienced the most embarrassing capitulation ever consented by a FED chairman? Are Central Banks hostages of the market behavior?

Valuations generally don't matter much when liquidity is injected and expanding price- earnings ratios don't end bull markets but when markets perceive a drying up in liquidity or central bankers pivot, as in late 2018, markets suffer.

All this damage happened after the greatest US expansion on record and after the Fed been able to reduce its balance sheet by just 10% (total balance sheet over 4trn\$) and get interest rates above 2%, they are already talking about ending the normalization.



Executive Summary

The ECB is in a similar situation as it currently has negative interest rates and no plans to reduce its balance sheet. Draghi has also mentioned the possibility of further supporting a slow European economy including the restart of its QE bond buying program which ended only few weeks ago.

The BOJ now owns about 45% of all Japanese Government Bonds and its balance sheet now totals to more than the entire Japanese economy.

Quantitative Tightening has barely begun and markets have already shown how vulnerable they are. In Europe the interest rate cycle may have peaked at -0.4%, it tells us that there may be something fundamentally wrong with the economy. Central Banks are not the only problem but it is clear how the global bubble was inflated by QE.

The Fed will face the dilemma if the best option is to have a permanent QE and eventually lower rates as the economy is indeed weaker than expected or to start surprising again the market with some normalization as markets have quickly recovered and economy is not in such a bad shape.

In both situations the equity rally is probably drawing to an end and it's hard to understand the prevailing optimism.

Looking at Europe, things are looking even worse. The release of the Q4 GDP data for the Euro area confirmed the slowdown in economic growth; If France and Spain showed relatively solid growth, Germany seemed to hint at a slower expansion pace and Italy simply entered a technical recession after two consecutive quarters of decline.

The message we gave last month is still reiterated but we would now opportunistically reduce some weight on Equities with the aim to buy them back at lower prices.

We still prefer strong versus weak balance sheets and focus on quality and keep Gold as a considerable part of the portfolio.

Let's now analyze the current positive and negative factors for the market:

Positive factors (4): *unlike at the beginning of last year, equities are still pricing in slower economic growth and Earning Per Share concerns. In January we had 6 positive points, in addition to the below we had light positioning, Short open-interest and Seasonality. We have now a new point, Insider activity.*

- **Equity valuations** are still compelling, the Eurostoxx 600 Forward P/E has bounced from extremely cheap levels at the beginning of the year but it is still below the last 5-year level.



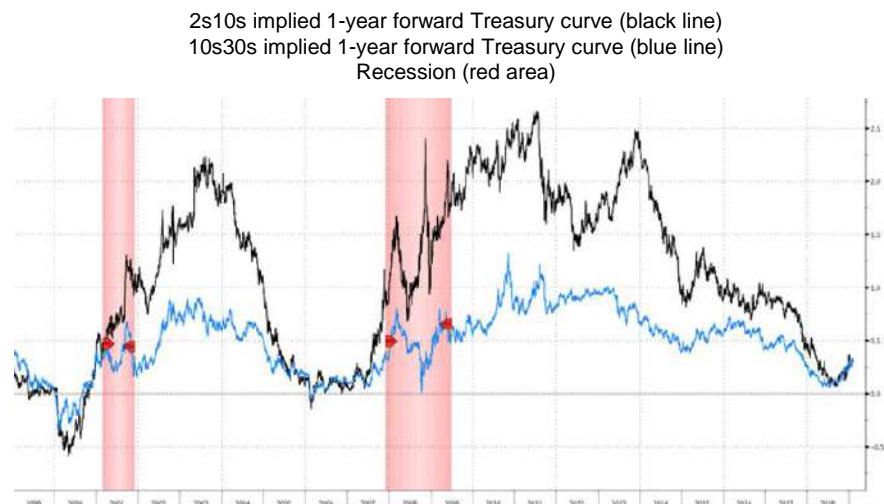
Executive Summary

- **Central Banks (positive view):** Central banks are still accommodative, with US real policy rates near zero.

Core inflation shows little signs of accelerating in recent months. Just three months ago the market was pointing to a quarter-point hike in 2019 and is now factoring a 0% possibility of hike for this year and 23% possibility of a cut in 2020.

Encouragingly the US Yield curve might have stopped flattening and as Fed seems to have paused, the chance of “policy mistake” reduces. The recent tentative steepening of 10-2y US curve, from the low of 10bp in mid-December, is encouraging. Crucially, the recession tended to start only 18 months post the curve inversion.

The chart shows the 2vs10 implied 10year forward Treasury curve (blue line) and 10vs30 forward Treasury curve.



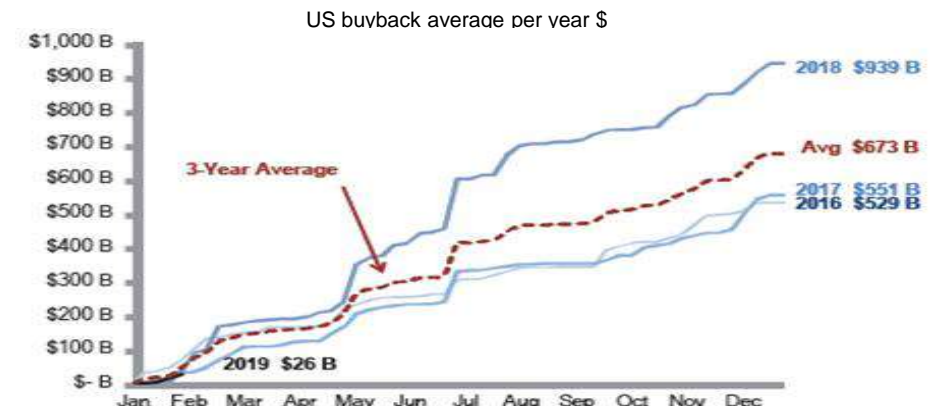
- **Buyback** should continue to support markets in 2019: Buybacks have been a key theme through this cycle with S&P 500 companies returning ~\$5 trillion to shareholders since 2009 and contributing ~2% to annual EPS growth.

Despite the recent market volatility, buyback activity has been very strong during Q418 (including December) and we expect it to remain robust in 2019 given profit growth, lower valuation (~1x lower than average and ~4x lower than cycle peak), and a record high ~\$700bn\$ available to execute under existing authorizations.

In 2019 we expect S&P companies to execute ~700bn\$ in buybacks and return an additional ~500bn\$ via dividends which is in-line with 2018 shareholder return but the cash repatriation and Tax Reform effects could have a negative effect on the above numbers.

Companies with buyback programs have historically outperformed during sell-offs. Since 2000, stocks with higher buybacks outperformed sector peers by 150bps during corrections and 200bps during recessions.

The chart shows US buyback average per year. Since the US Tax Reform it has been higher.



Executive Summary

- **Insider activity:** implies that corporates are still optimistic about the current cycle. In fact, the current near record level of insider bullishness is similar to the prior two intra-cycle resets (i.e. 2011 and 2015-16) in which insiders sold fewer shares and stepped up purchases on lower valuation.

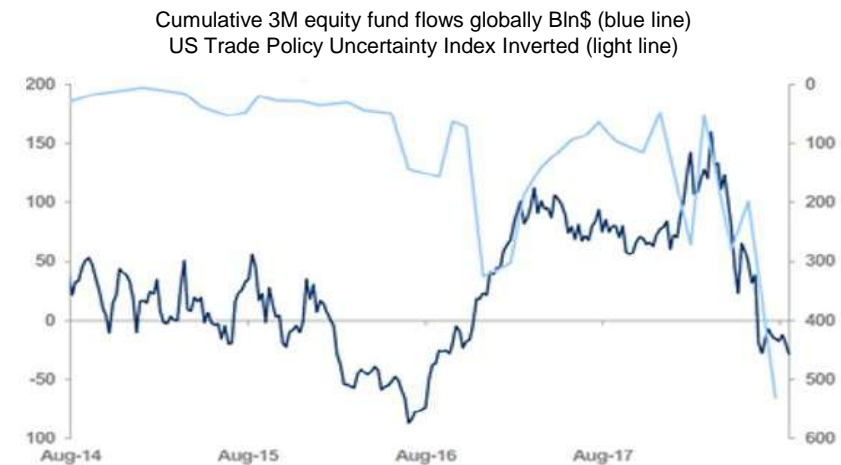
Chart showing 6-month rolling (number of insiders buying less selling).



Negative factors (15): unfortunately, still largely outpacing the positive factors. In January we had 13 negative factors, the new additions are Fund's redemptions and US consumer sentiment downbeat.

- We see limited risk that global economic momentum will re-accelerate here, as the year-on-year comparisons get tougher in the coming months and **the uncertainty around trade and tariffs will continue to weigh on activity going forward.**

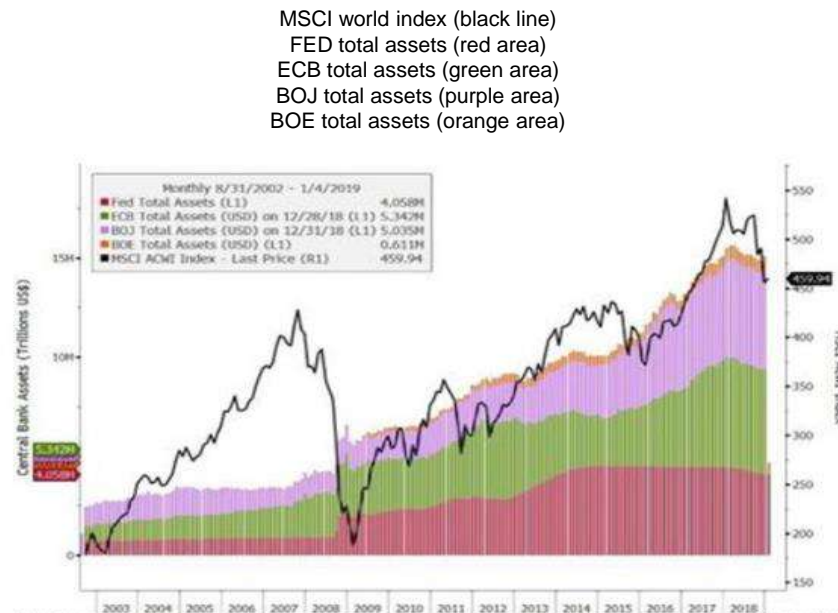
Rising US trade policy uncertainty has already weighed on global equity fund flows this year as shown on chart.



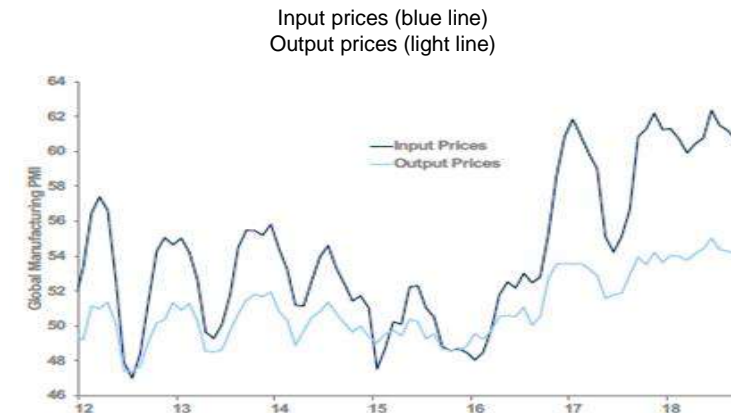
Executive Summary

- **Central Banks (negative view):** Global monetary policy is set to (gradually) tighten further, this will increase the pressure on the 'weaker links in the chain' and the chance that we see higher volatility. Credit spreads should slowly widen, unhelpful for equity valuations.

Chart shows Central Bank balance sheets vs. MSCI World.



- **Margin pressures** are continuing to build, which is perhaps not surprising given that input cost inflation (PPI) has been above CPI for much of the last two years. With labor costs gradually rising and tariffs offering up the potential for higher input costs and supply chain disruption ahead, profitability concerns look set to become more of a focus for investors in the coming months. Input prices are rising more rapidly than output prices (chart), negotiated wages are now rising sharply even in Europe. Margin environment is less favorable now.



- **US estimated Quarterly S&P Earning Growth** set to decelerate to its long-term average of 6% in 2019. Guidance of Q1 numbers has been very conservative.
- **IPOs / Secondary/ Placing:** the percentage of US listed IPOs that lost money in the last 12 months is marking a new record high (83%) exceeding the top reached in the dot bubble, the highest proportion since 1980 when record started. Over the last Quarter, a great number of IPOs has been called off and the performance of IPOs and Placings has been dreadful. Not a great sign as it seems that the market cannot absorb any further paper.

Executive Summary

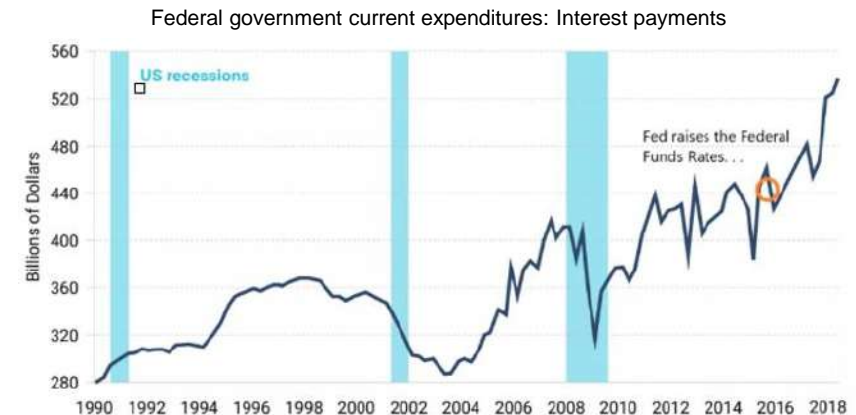
- **Cash Repatriation:** the flow slowed considerably in the last 3 Quarters. Given that 330bn\$ of repatriation took place already in H1 this assessment implies a significant slowing of the flow in the second part of the year. The Q4 reporting season is revealing further slowing in the pace of cash holdings reduction by US companies. The boost that US repatriation provided to US equity and bond market via share buybacks and corporate bond redemptions is likely to slow during 2019.
- **Fund's redemptions:** This year we are likely to see more redemptions following the bad performance and high volatility of most of the funds. Depending on the type of fund, if you assume the notice period being from 1 to 3 months, investors will start some redemptions soon also helped by the better performance Ytd.
- In US the relative appeal of stocks is waning compared to fixed income. Yields on 10-year Treasuries are around 2.7% while US equities are estimated to yield just above 2% in 12 months despite the sharp correction. Black line S&P 12-month dividend yield vs US 10Y Yield.

SP500 estimated 12-month dividend yield (light line)
US generic govt. 10-year yield (black line)
US generic govt. 10-year yield minus SP500 index (purple line)



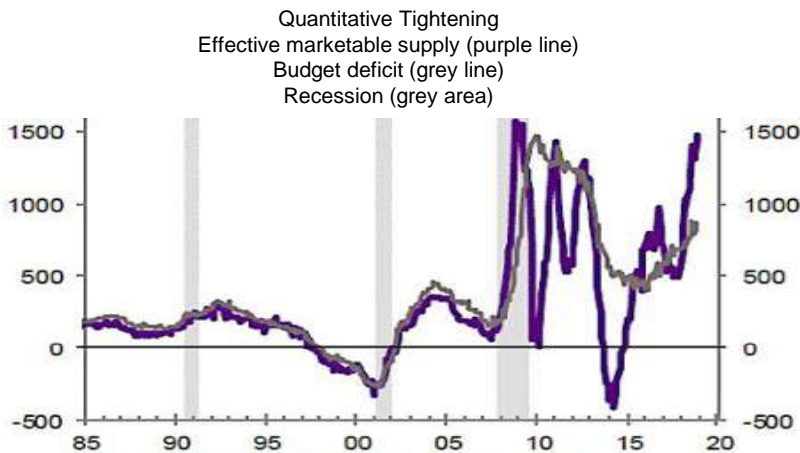
- **US government's borrowing** has increased to amounts that it hasn't since the 2008 recession. The US budget deficit is just shy of \$900 billion which means a 40% increase since last year.

Ignoring private consumer debt (which is greatly affected by rising rates), the US National Debt recently hit \$21.3 trillion and the interest payments due on all this debt is at a record high. You can see on the chart that since the Federal Reserve began raising rates in December 2015, the cost of interest payments on the national debt has soared hitting an all-time high of 538bn\$ per year!



Executive Summary

The ratio between the US budget deficit (grey on chart) and the Treasury issuance (purple) poses substantial risks as they are going to issue 1.3trn\$ this year and the unbalance has never been that great!



Remember that US is taking in *less* tax revenue because of Trump's tax cuts and the Treasury will have to borrow *new* debt just to pay off maturing *old* debt and interest.

- **Junk Bonds:** They crashed really hard just before the financial crisis of 2008, and they started to fall again at the end of last year. **We are in the terminal phase of the biggest debt bubble in human history. In fact, total indebtedness in the United States has increased by more than 2 trillion dollars over the past 12 months...**

All of this debt has fueled a short-term bubble of relative "prosperity" but meanwhile all of our long-term problems just continue to get worse.

Moody's has recently affirmed that "Leveraged loan are in uncharted territory and that's a big risk"

Deutsche Bank has calculated that since US QE began, 14trn\$ in monetary and fiscal spending has created about 13mln jobs, that's a cost of 1mln\$ per job created!

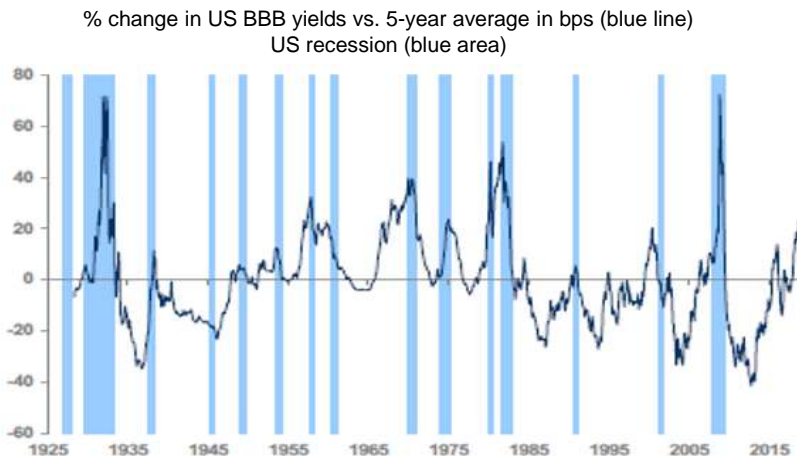
- **Abnormal Libor-Euribor spread:** London Interbank Offered Rate known as Libor is spiking to new highs.

Libor reflects what banks charge to borrow dollars from each other and is used as a benchmark for trillions of dollars' worth of loans. The increase is seen as a further indicator of tightening financial conditions showing that corporate costs are experiencing a much further increase in interest rates than Fed funds.



Executive Summary

- **Corporate Debt:** even before we see any further widening in credit spreads, corporates are already facing a very hefty increase in their cost of capital. The chart shows that the increase in US corporate bond yields relative to their trailing 5-year average is at its highest level since the early 1980s (if we exclude late 2008, when default rates were spiking).



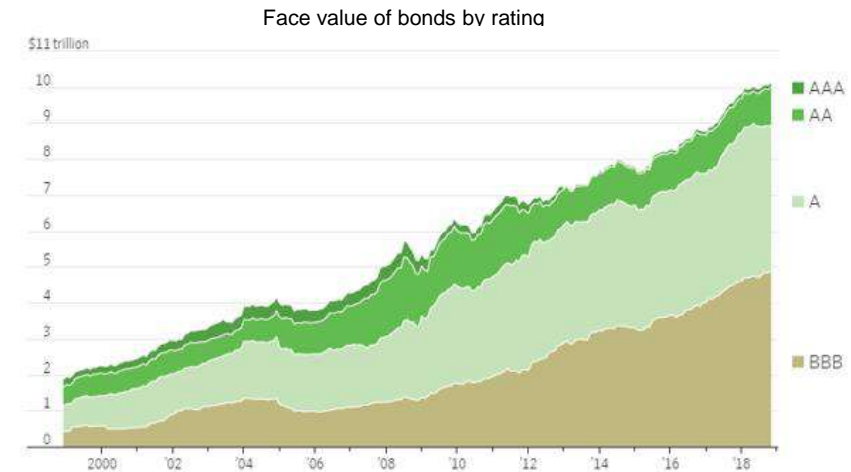
As we have seen above, the cost of debt (Libor) relative to corporate earnings is on the rise and is at the highest level since 2008.

US nonfinancial corporate debt is at its all-time high and average credit ratings of IG debt have fallen sharply. Corporates have shown little inclination to reduce debt despite strong earnings (+25% yoy in Q3), whilst an estimated USD5.6trn debt matures by 2023.

Over the last few years, yields on bonds with triple-B credit ratings (the lowest score, still considered investment-grade), have risen faster than those on safer debt.

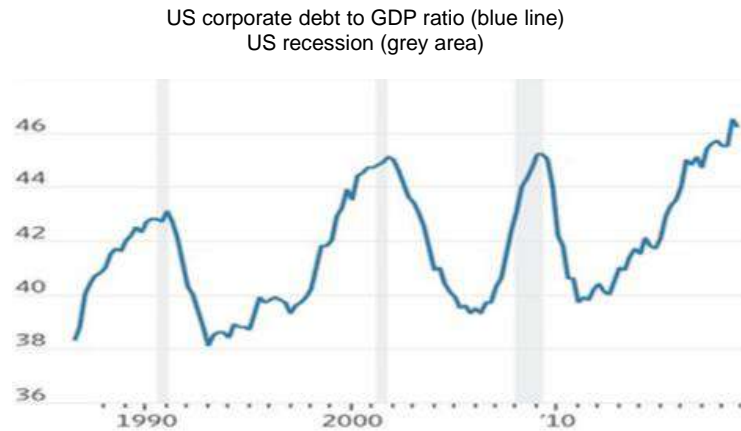
The Q4 pace of downgrades from A into BBB territory is the largest since the late 2015 wave of commodity related fallen angels. Last month Fitch has warned of a possible cut to US AAA rating. The effect of a potential downgrade would generate a tremendous selling pressure. S&P has recently put \$140 billion in investment grade bonds on downward watch, about \$11 billion of which is due in the year ahead.

Among companies at risk of a downgrade include Walt Disney, wrapping up a \$71 billion takeover of 21st Century Fox, and Bristol-Myers Squib, acquiring Celgene Corp. in a record \$74 billion deal.



Executive Summary

The ratio of US corporate debt to Gdp is on new all-time highs as shown on the chart. The grey areas are the previous recession levels.

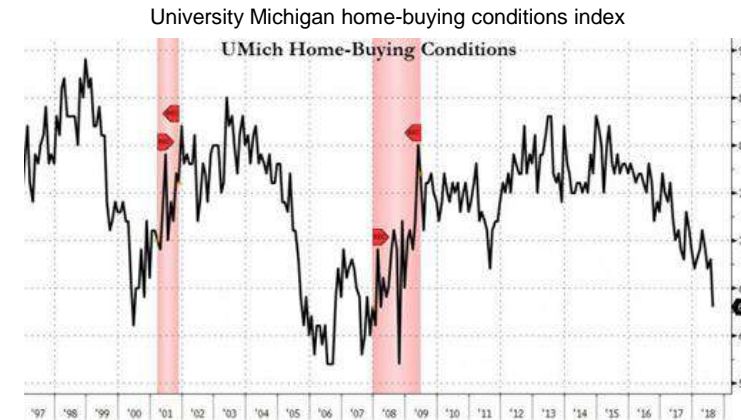


Even European credit markets are likely to see further spread widening in 2019 as growth moderates and ECB QE ends. BBB ratings represents more than 50% of IG volumes in Europe and the largest 25 BBB names account for 26% of IG Index.

Markets could therefore soon face a “tsunami of junk rated debt” as about half of 5trhn\$ market for investment-grade bonds now resides in the lowest tier of ratings prone to a downgrade to junk.

- **Declining US House Prices:** US Housing data are continuing to surprise on the negative side.

The University of Michigan Home-buying conditions are currently the worst since Lehman... and supply is soaring.



Executive Summary

Existing home sales surprised to the downside in December, falling to a 3-year low. The annual pace of sales has reached a rate of 4.99 million, the slowest since 2015 and down 10.3% from a year ago.

US Pending home sales crashed the most in 5-years in December.



- **Market liquidity continues to drop** and we have already seen in December how can this affect markets when there is the need to sell.

Looking at some statistics helps to understand the entity of this factor. Current average of US S&P futures is 66% below the 2018 average and 85% below the average since December 2015. US 10Y futures are trading 31% below 2018 average. WTI crude futures are trading 25% below the 2018 average and 48% below the average since March 2016.

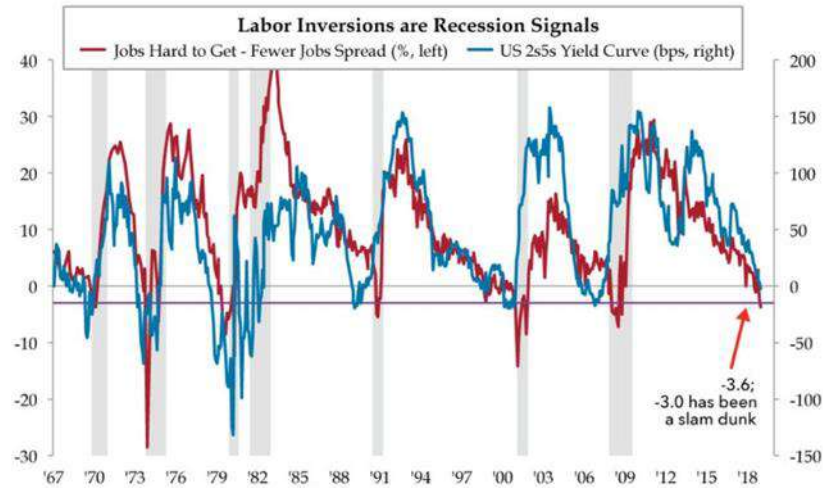
- **US consumer sentiment very downbeat.** US consumers have given up on outlook for improved business environment for the next 12-months as it tumbled to the lowest level since August 2017 (before Trump elected President).

If you look the chart showing the ratio of “present situation” to “expectations” is a great leading indicator at turning points because it either coincides with the recession or occurs a few months prior.



US consumer outlook on labour market has inverted, generating another recession signal. Jobs hard to get-fewer jobs 6 months spread dropped to -3.6%, lowest since October 2008. Since the 60s, we always had recessions following this indicator at -3%.

Executive Summary



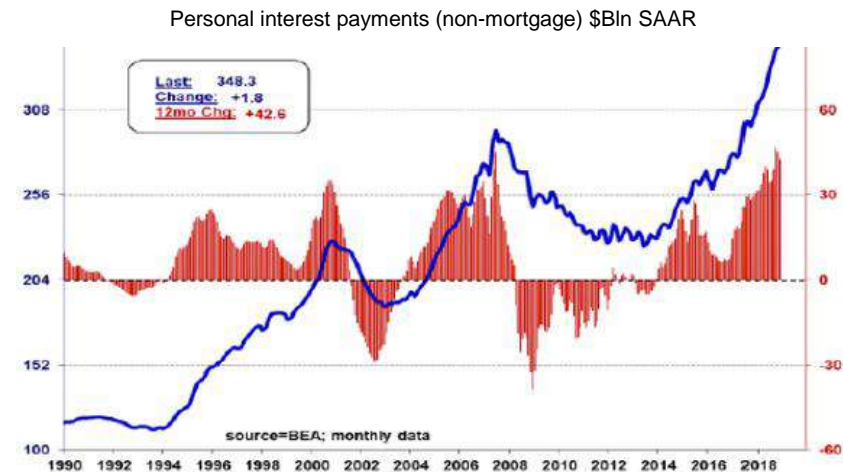
US personal interest payments have soared to a new all-time high exposing even more the consumers to a recession.

According to the recent data in the US, stocks now make up an increasing portion of household wealth and has overtaken real estate for the first time. Furthermore, not surprising, growth in household wealth has been highly uneven for the last 10 years. Bottom income earnings have recovered a lot less relative to the top 10% of earners.

The growing concentration of the world's wealth has been highlighted by a report showing that the 26 richest billionaires own as many assets as the 3.8 billion people who make up the poorest 50% of the planet's population.

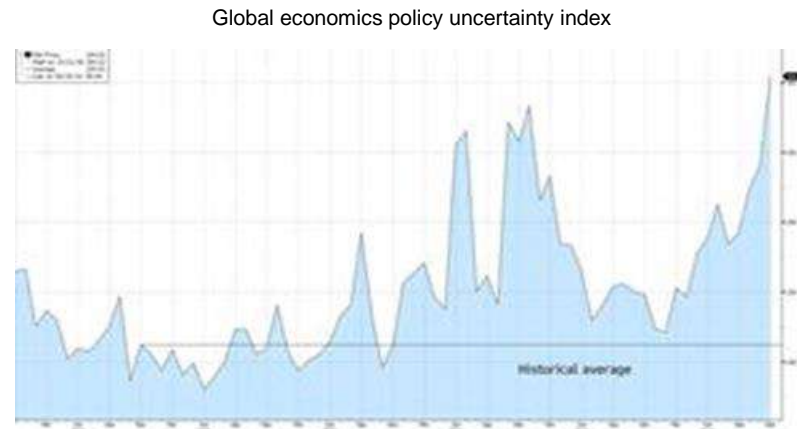
The 12% increase in the wealth of the very richest in 2018 contrasted with a fall of 11% in the wealth of the poorest half of the world's population.

In the 10 years since the financial crisis, the number of billionaires has nearly doubled.



Macro

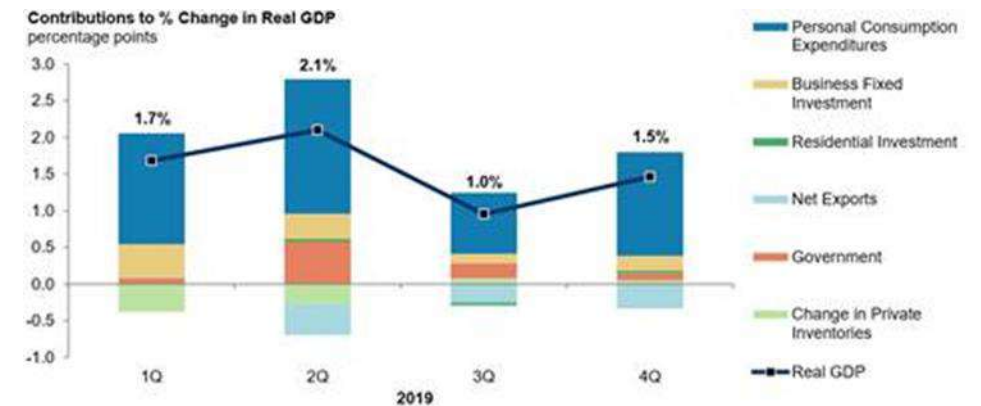
Global Economics Policy Uncertainty surges to a new record high.



US

The government shutdown is temporarily over as the Congress and the President have come to a deal that will reopen the government until February 15, allowing for more time to continue negotiations over a final spending bill. Having lasted 35 days, the longest government shutdown on record, is likely to leave its mark on incoming data on 1Q19 economic activity, not to mention that the flow of economic data is likely to remain disrupted for the next couple of months as well because of information-gathering backlogs (some of the data such as trade, inventories, durable goods orders, home sales etc. are missing for the quarter due to the shutdown). The good news is that after an expected weak first quarter, 2Q19 GDP growth is likely to come in a bit stronger than forecast. The partial government shutdown will cost the economy about \$3Bln in reduced output in 2019 (Congressional Budget Office). US GDP forecast for 2019 in chart.

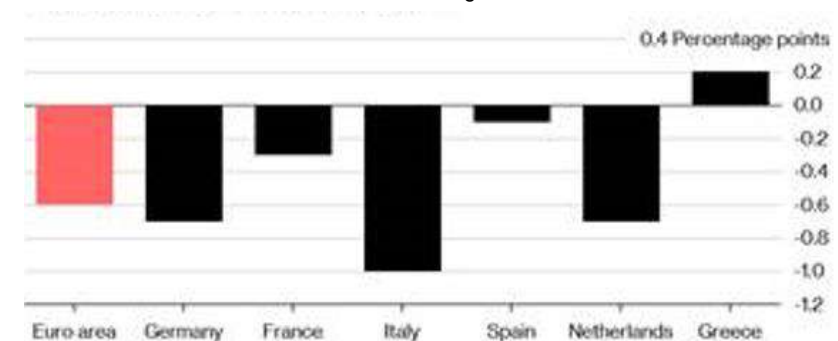
US real GDP growth contribution forecast



Europe

Euro-area data are quickly deteriorating. The European Commission slashed its growth forecasts for all the euro region's major economies from Germany to Italy and warned that Brexit and the slowdown in China threaten to make the outlook even worse. EU growth forecast has been revised down to 1.3% from 1.9%.

2019 GDP forecast changes vs. November



Macro

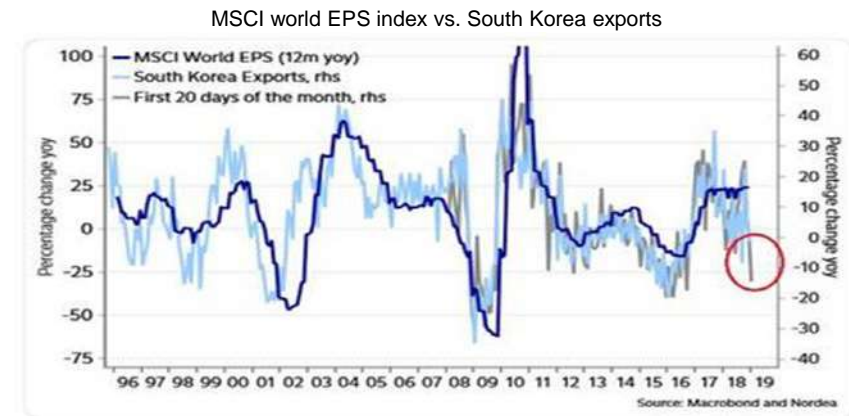
Germany is slowing and the recent data are increasing investor worries. The German manufacturing PMI fell below 50 for the first time since November 2014. The new orders component of the manufacturing PMI was particularly weak falling to 45.3, the lowest level since 2012. Last week the IFO business expectations index showed a similar trend registering the lowest reading since 2012 too. German industrial output fell 0.4% MoM in December against expected growth 0.8% MoM, 4th contraction in a row, leaving industrial production index down 5% YoY. German factory orders fell 1.6% MoM against expected growth 0.3% consensus.



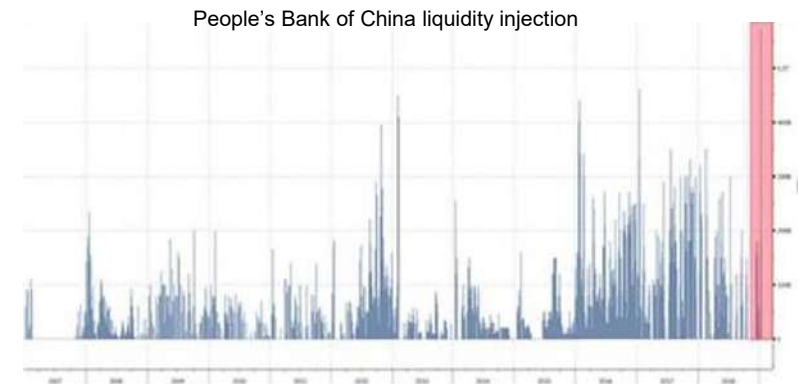
China

China Macro data are quickly deteriorating too. The latest Caixa China PMI showed a contraction, 48.3 against 49.6 consensus in January. China's economy cooled in the fourth quarter under pressure from faltering domestic demand and bruising United States tariffs, dragging 2018 growth to the lowest in nearly three decades and pressuring Beijing to roll out more stimulus to avert a sharper slowdown. Fourth-quarter gross domestic product (GDP) grew at the slowest pace since the global financial crisis, easing to 6.4% on-year as expected, from 6.5% in the third quarter.

Korean exports appear to have collapsed in January, bad news for global EPS growth! President Xi Jinping stressed the need to maintain political stability in an unusual meeting of China's top leaders, a fresh sign the ruling party is growing concerned about the social implications of the slowing economy.



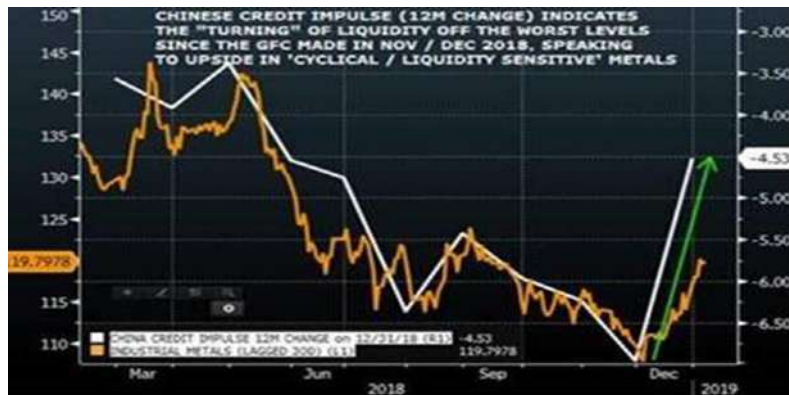
China is adopting extraordinary expansionary measure in order to cope with the slowing global growth. The People's Bank of China pumped in a net 560Bln yuan (\$83Bln) in January, the biggest one-day addition on record.



Macro

If look at the market performance in January, it is quite striking to see how much liquidity is being generated by China and how industrial metals and basic resources reacted, SXPP (Eurostoxx Basic Res) + 12.3% in January.

Chinese credit impulse 12-month change (white line)
Industrial metals index (orange line)



Forex

The new Fed's dovishness, slightly positive news on Trade-War and some concerns about the US debt have had the result for the **USD** to have lost the attitude of "safe" currency (CNY has appreciated a further 2% since the beginning of the year) and the EUR has attempted to break 1.15 twice for the first time in 4 months.

The **DXY Dollar Index** is up 1% since last update, net speculative positioning has started to decrease while the DXY has gone back to the trading range we had since June last year.

US dollar net long-short positions on 1/1/19 (blue histogram)
Dollar spot index (black line)



Forex

The optimism on USD is therefore slowly changing but as you can spot from the chart it is still a consensus long.

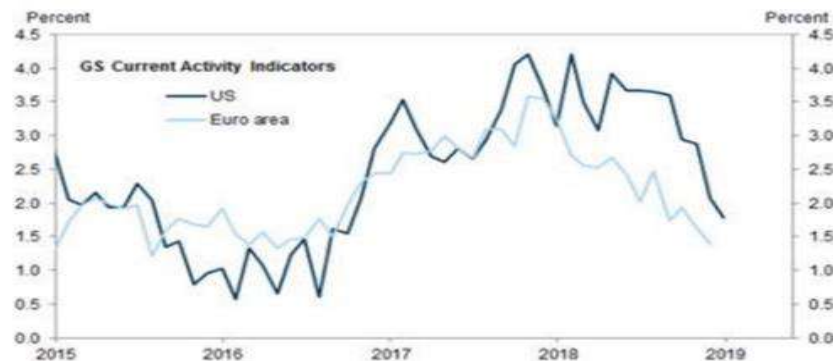
As we said over the last three newsletters, we remain confident for a very limited USD upside from here if not a proper downside.

These should be the main factors for a potential weak USD:

- US growth peaked in Q2 an annualized rate of 4.2% and is likely slowing down from here (sectors sensitive to funding costs, such as housing and autos, have all slowed). Warning signals of a potential significant decline in the USD are flashing, with foreign investors no longer steering funds into long-term USD-denominated assets. It seems the trust of investing in US assets for the long-term has declined.

Currently, both US and Europe are slowing in something of a “race to the bottom.” But while the Euro area has been slowing for the past year, US activity levels are now slowing faster, from a higher level,(chart) and in a more reactive setting for policymakers.

Current Activity Indicators: US (blue line) vs. EU (light line)



- Short-term fiscal stimulus running out of steam.
- US corporate leverage.
- Relative inflation may soon start to support a higher Eur/Usd exchange rate.
- The Eurozone current account surplus has increased materially over the last few years, driven by Germany.

This, coupled with the upcoming unwinding of QE by the ECB, will likely support a rising euro over time.



- Global tensions caused by economic sanctions and trade conflicts triggered by Washington have forced targeted countries to take a fresh look at alternative payment systems currently dominated by the US dollar.

This is especially true for China (trying to internationalize its own currency, the yuan, which was included in the IMF basket), India (6th largest economy, switching to ruble for payment to Russia and other currencies for main trading partners), Iran (finding alternative USD payments for oil exports) and Russia.

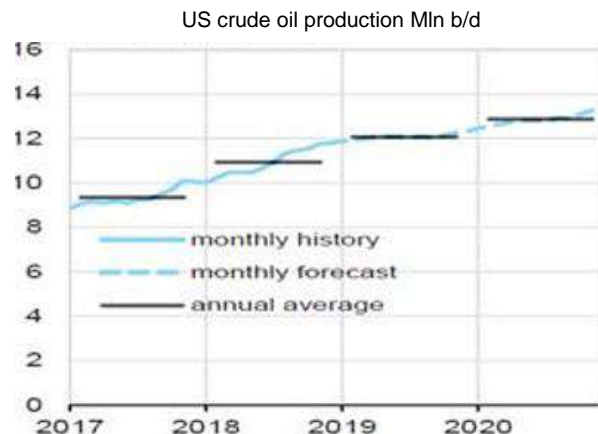
Commodities

The Bloomberg commodity Index is up 5% year-to-date. It's striking to see how China is making a difference here, with a strong direct correlation between the CNY appreciation and the commodities.

Oil

After the precipitous and volatile late-2018 oil decline, exacerbated by low liquidity, prices are starting 2019 with their first meaningful rally in three months, with the WTI up 18.5% in January, one of the best months in 20 years.

According to the US Energy Information Administration, global petroleum inventories increased by 1Mln b/d in Q418, contributing to downward pressure on oil prices. Inventory balances will continue to build in the first half of 2019 at a pace of 0.3Mln b/d, with production to average 101.8Mln b/d and consumption to average 101.5Mln b/d. Production growth in 2019 is mainly led by non-OPEC countries, particularly Brazil and the US which will become a net exporter by 2020 (US crude oil production averaged 10.9Mln b/d in 2018, forecast 12.1Mln in 2020, the world's leading producer).



Brent spot prices are forecast to average \$61 in 2019 and \$65 in 2020 while WTI spot prices are forecast to average \$8/b lower than Brent prices in Q1 2019 before the discount gradually falls to \$4/b in Q4 2019.

We have called the profit taking at the beginning of October and at the end of 2018 we suggested to start getting back into the sector. After the recent strong performance we are currently neutral on oil as we expect some volatility coming forward (implied volatility averaged 44% in January): a) OPEC+ has not been willing to cut output enough to put a floor under prices as members do not want to lose market share to US companies b) US production of shale oil and alternative fuels has been increasing putting pressure on prices c) As the biggest oil importer, China macro trends affect the oil markets along with global demand which has been slowing d) uncertainty remains regarding how much oil the US sanction on Iran will take off the market following the expiration of waivers in 2019 e) future developments in the Venezuela crisis after US imposed sanctions on the state-run company PDVSA f) technical shocks.

Gold

In our previous newsletters, we suggested to keep gradually increasing gold in the portfolio. Well, we were right! December and January were positive months with a performance of, respectively, +5% and +3%.

Over the past month gold prices continued to appreciate, extending the positive momentum built in Q4 2018 due to lower rates, Equities sell-off and increasing fears of global recession risk. Gold central bank purchases remained strong in Q4, rising 130% YoY and bringing 2018 total purchases to 650 tonnes (source: World Gold Council), which is the highest demand in the last 50 years!. China added gold to its foreign reserves in Q4 for the first time in more than two years and its holdings totaled 1,852 tons at the end of 2018, worth roughly \$76Bln, according to central bank data, an increase of about 10 tons from the previous month and the first rise since October 2016.

Commodities

Central Banks have purchased in 2018 more gold than any year since 1967, up 74% YoY.

So far, we have been reducing our positioning on gold strength because we think investors might take profit in the short-run, although we are increasingly becoming more bullish in the long run.

Going forward we continue to see upside to gold in the mid-long run primarily driven by a) the demand for portfolio diversification purposes b) a dovish Fed will lead to lower rates (inverse relation) and dollar weakening (gold becomes cheaper to buy) c) slowing global economy, US and China mainly, increases market fears d) Central banks buying gold might become more systematic i.e. China.

Gold is the only real money that has survived throughout history. Current economic, financial and geopolitical risk is unprecedented. **Physical gold is the ultimate insurance against these risks and should form the solid foundation of investors' wealth pyramid.**

Geopolitics

Trade war: following our previous update on China/US trade truce, we remain optimistic about a positive resolution, considering that the global economy is slowing down and neither US nor China can afford to keep losing percentage points in GDP. In late January, the US and China held in-person talks in Washington D.C., with Liu He leading China's trade delegation. Trump recently announced that he will meet with Xi in-person in February.

US politics: The government shutdown is temporarily over until February 15. The bill contains no funding for a border wall, which was at the root of the shutdown in the first place. Trump demanded that Congress agree to allocate \$5.7Bln for some 200 miles of a wall at the US-Mexico border and for weeks refused to sign any legislation without it, resulting in the longest government shutdown in US history. The nonpartisan Congressional Budget Office estimated the shutdown cost the economy \$11Bln and that some \$3Bln in economic activity has been permanently lost.

Brexit: As things stand now the UK is due to leave the European Union on March 29. A lot of events happened in January with the Brexit vote defeat 432-202 (worse than expectation), followed by the government surviving a motion of no confidence and Theresa May presenting the plan B which was not very different from the original one. It seems Theresa May is preparing to delay the second parliament vote on her Brexit deal until the end of February because she will not have renegotiated her deal in time with the EU. According to recent rumors, the EU is unlikely to renegotiate the Brexit deal.

Italy: Internal frictions between 5-Star Movement & League party on Italy's high-speed rail link (TAV) and potential Salvini's kidnapping trial which might have the potential to be a source of break-up for the coalition, with the respective widening of the Btp Bund spread and Euro-wide political turmoil. The European Union recently cut Italy's GDP growth forecast to 0.2% from 1.2%.

Current Investment Ideas

Long Put spread on Indexes

We would advise trying to get advantage of the low volatility and protect portfolios through a cheap Put spread on Indexes.

As an example, the Put Spread on S&P 2600 (out 4.6%) / 2350 (out 13.8%) costs 0.5bps of performance for every 1% notional covered and has a current delta of 17%.

Long CDS and Btp/Bund spread

We would start buying some protection through ETFs that synthetically replicates the performance of the short iTraxx Crossover 5-year CDS like the XTC5 GY ISIN LU0321462870. This trade would benefit from spread widening.

A similar idea would be achieved through the spread of long Bund vs. short BTP future in Italy. The spread has tightened considerably over the past two months but unfortunately the economical and political news are not having a great momentum on Italy. We believe there could be a new widening of the Italian spread.

Closed Investment Ideas

Long Dax in relative terms

Germany's stock market was one of the worst performer in 2018 being down 18.3% Ytd, underperforming the Eurostoxx 600 by more than 5%.

Dax has bounced more than 3% from last update and more than 6% Ytd. We would temporarily close the idea and take some profit as we feel uncomfortable being long equities at current levels.

Long Miners (SXPP Index)

The European SXPP miner sector has bounced 9% since the last update and nearly 14% Ytd.

Improvements on US/China Trade War, expansionary Chinese measures and Iron Ore pushing higher have helped the sector to outperform all other sub-sectors Ytd, it was a great call indeed,

Considering everything written above we would now close the trade and try to get back in at lower prices.



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