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Monthly Market Update

Monthly focus on Financial Markets

Contents

ASV/ASWM Alliance of Swiss Wealth Managers

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"We think that the year 2020 will be a "transition year" to the new world where Investors will need to start to think outside of the traditional schemes.

Market Analysis

After the correction we had in August, we rightly predicted the bounce during the month of September and got increasingly cautious towards the end of the month.

What has however surprised us was the persistent strength during October and the "melt up" phase we are witnessing at the beginning of this month, mainly generated by binary events that were difficult to predict correctly without taking significative risk.

While we understood the potential stabilization of some Macro data, a potential better-than-expected earnings season and light market positioning, we got admittedly surprised by the sudden potential US-China trade war resolution and the market perception of much lower political tail risk.

The unusually strong rise of Equity markets this year, (MSCI World +20%), is largely a function of H1, (helped by global renewed monetary easing), following the drawdown in Q4 2018. But 8.5% increase from the more recent August low, also seems to reflect a huge shift in investor sentiment.

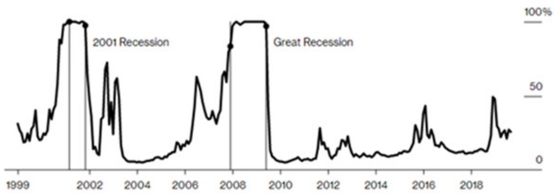
Decreasing fears of recession have also triggered a rise in bond yields from the record lows reached in August, despite the beginning of a new QE in Europe, Fed cutting rates and intervening on Repo market in a "similar QE" and dovish BOJ.

The market is now already discounting a positive outcome of Phase 1 deal, with a likely roll back of existing tariffs.

The latest political events are also influencing the optimism of the market. We got a significative re-pricing of the Hard Brexit risk in Europe. Germany, ready to intervene into the economy with some form of stimulus, seems in favour to turn on its fiscal taps and open to a European Banking Union.

The most recent US recession odds are estimating a chance of 26% which is considerably lower to where it was at the beginning of the year. This is the result of the growing optimism.

PROBABILITY OF US RECESSION WITHIN 12 MONTHS



Source: Bloomberg Economics

The Equity bounce we had in the past two months is, however, masking a much more complex situation underneath. The "pain trade" from Active Managers has been once again higher than what is perceived looking at Index performances.

The pro-cyclical trade has been the main market mover, with painful rotation and short covering. Value sectors such as Auto +18% (since the middle of October), Basic Resources +16% and Oils +8% have been outperforming along with rising interest rate yields.

The Dax Index has been the best European Index in October, despite Germany set to enter a technical recession with the upcoming Q3 GDP number. A stream of solid earnings and the pro-cyclical rotation have helped the Index and gains have quickly changed the

12-month forward P/E above 14x vs a 5-year average of 12.8x, with a very quick rerating in just few weeks!

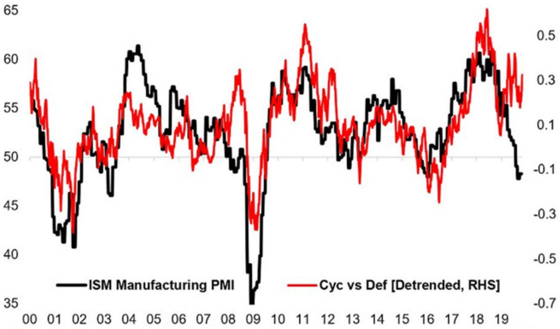
Everything seems to be different from what we observed for the whole year.

Looking at the rotation out of Growth into Value, it is still minimal going from -59% discount at the end of August to -56% today. The rotation could continue if we will see a stabilization of global Macro data over the next weeks but it may be premature to interpret value's recent outperformance as a sign that the economic and earnings slowdown is coming to an end.
Interesting also to spot that every one of the 14 rotation periods over the past decade has been accompanied by a rise in US bond yields and also coincided with a rebound in survey data like the PMIs.
We should therefore continue to monitor the PMI components in order to better understand if this recent move could go ahead further. We suspect that most of the recent factor turmoil has to be related with the excessive positioning as we have mentioned over the last newsletter.

MSCI EU VALUE/ EU GROWTH (BLACK) VS 10Y BUND YIELD (BLUE)

The chart below gives us to think, as bears might argue that Cyclicals should be lower

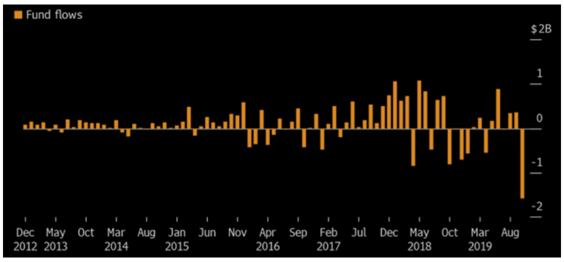
CYCLICALS VS DEFENSIVES DIVERGENCE (RED) VS ISM MANUF. PMI (BLACK)



than current levels and close the gap with the ISM index, while bulls would say the market is getting right and the ISM index will rebound to close the gap.

Almost $1.6 billion was withdrawn from momentum-focused ETFs in October, the most for any month on record! The outflows were the biggest of any smart-beta segment last month, and marked a change of pace after two quarters of net inflows.

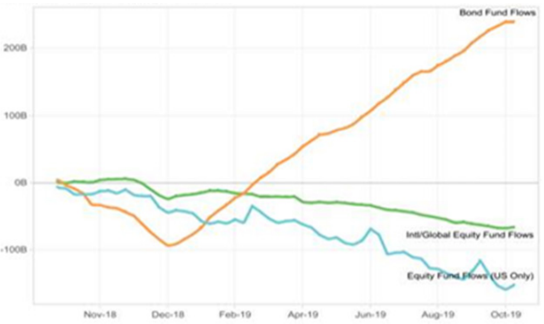
MOMENTUM ETFS FUND FLOWS



In terms of market positioning, while we continued witnessing inflows into Bonds, quite a lot has changed on Equities in a brief time.

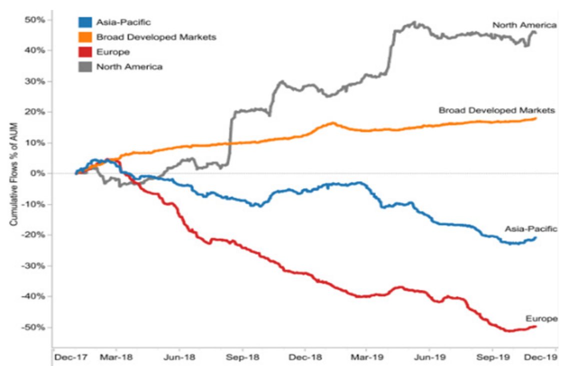
Recent net fund flows, (U.S. mutual funds and Exchange Traded Products combined), show equity redemptions have lessened while bond funds continue to see consistent inflows. Year to date, there have been a combined $120 billion in domestic equity fund outflows, $50 billion in international equity fund redemptions, and $320 billion in bond fund inflows.

EQUITY VS BOND FLOWS
BOND FLOWS (ORANGE) VS GLOBAL EQUITY FLOWS (GREEN) VS US EQUITY FLOWS (BLUE)



However, within Developed equities (ex US), we can spot a small turn-around in Europe and Asia-Pacific.

EQUITY FLOWS
US (GREY) VS BROAD DM (ORANGE) VS ASIA (BLUE) VS EUROPE (RED)

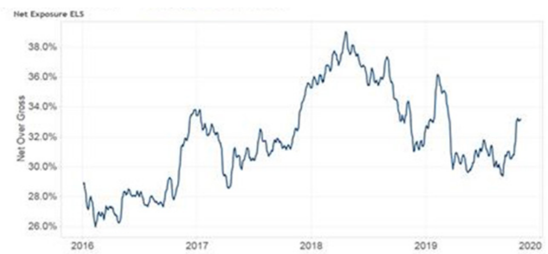


On Hedge Funds, the most recent stats are showing that the net exposure has been rising considerably with a quick short-covering on the Value sector.

The situation is, however, still far from ideal with rising markets as the 1-month beta of daily returns of Equity Hedge funds to the S&P500 was stuck at 0.16 at the end of October (very low) and about half of its average level since 2002.

No wonder why the aggregate Hedge Funds are up roughly 6% YTD.

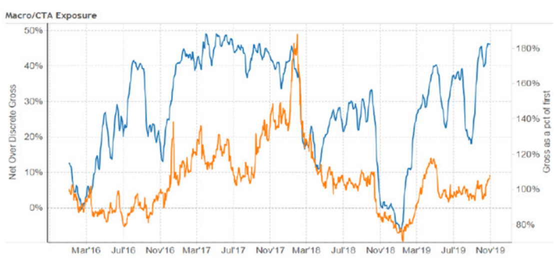
HFS NET EXPOSURE EQUITY LONG/SHORT



At the same time, the amount of puts on Eurostoxx has decreased substantially over the last 3 weeks from $13 billion (2-year highs) to just $2 billion now. This unwind of positioning has also contributed to sustain the markets and dilute the protection of investors.

Macro/CTA funds have also increased Net and Gross exposure, a significative change compared to the situation we had at the beginning of the year.

MACRO/CTA NET EXPOSURE (ORANGE) VS GROSS EXPOSURE (BLUE)



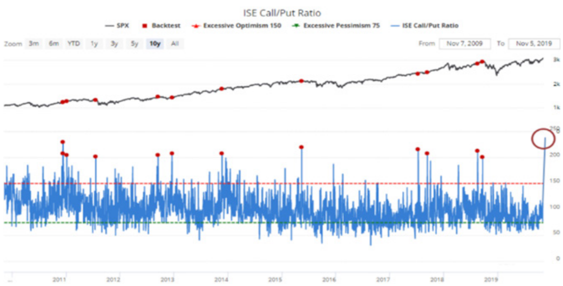
The great difference in performance YTD of Active vs Passive is not going to help the industry as we have already seen the biggest YTD Active Funds outflows of any calendar year.

Markets are currently very over-heated. Positioning is much higher than what it was a couple of months ago and there is now very little protection on portfolios. There is little room for a negative surprise from these levels.

The AAII Bull sentiment indicator has rebounded above 40, at its highest level since May this year, while the Bear indicator is below 24, a very low level indeed.

A similar message is given by option traders on the ISE exchange which bought 238 calls for every 100 puts, the most since December 2005! The last time they have bought >2 calls for every 1 put was in September 2018. It hasn't happened too many times over the past decade.

ISE CALL/PUT RATIO



The Fear/Greed indicator published by CNN has been another good short-term trading indicator of over-extension. While at the end of August was too low, now it's at 89, an overheat area which is higher even than January 2018, October 2018 and May 2019. The result is shown on the chart underneath.

FEAR/GREED INDICATOR PUBLISHED BY CNN

While we understood and closely followed the market since the beginning of a difficult year, now we are a bit more uncertain about the future.

A complicated and volatile geopolitical landscape has added further complexity to investors' decision-making and a potential near-term reduction of geopolitical uncertainty wouldn't negate concerns around the increasingly late cycle nature of the global economy and more immediate risks of a spate of further earnings downgrades. Investors are also benefitting from a very supportive monetary environment, especially in Europe.

While we appreciate a better than expected Q3 earning season, (because of bearish expectations), and some early indicators of an improving Macro picture, we are concerned that the market is enacting a mirror image of where we were a year ago. Then, it grossly overestimated the risk of Fed tightening, triggering a huge rally. Now it might be doing precisely the opposite.

Earnings

Overall the Q3 2019 earnings season is delivering better results, although as we will see, consensus estimates are already quite low and earnings downgrade continues. As seen in recent quarters, US numbers look better than European.

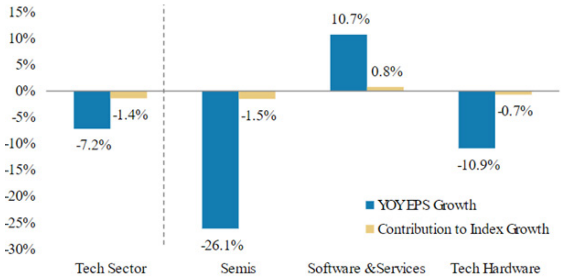
As far as **US** is concerned, Q3 results are continuing the trend of broad-based weak earnings growth and negative operating leverage. For most sectors, revenues growth will outpace earnings growth in the next quarters, which translates into higher fixed costs lowering net operating income. So far, for Q3 2019, the blended earnings decline for the S&P500 is -2.5%. If -2.5% is the actual decline for the quarter, it will mark the first time the index has reported three straight quarters of YoY earnings declines since Q4 2015 through Q2 2016.

Before the season, the S&P500 consensus was -4% YoY EPS growth projection, down from +5% at the start of the year, a massive change and possibly too pessimistic.

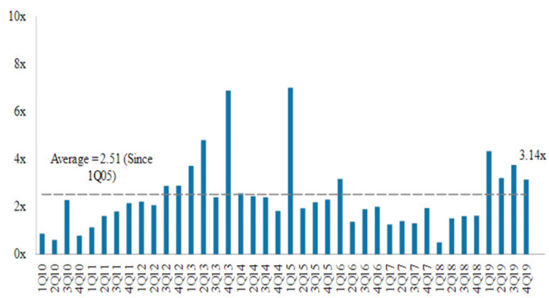
Defensives are delivering better numbers as expected, but Cyclicals earnings haven't collapsed either, leading to a generally positive and more pronounced market reaction than usual. Healthcare, Real Estate and Utilities reported EPS growth rate above 4%, while Energy and Technology were the biggest detractors, respectively -40% and -7% EPS growth.

The broad message for firms' guidance is a bit more mixed than previous quarters as expected, with final year estimates remaining on a downtrend. While companies are more reluctant to provide color on the next years, Q4 2019 guidance is more skewed to the negative side (as shown below, companies are offering more negative vs positive guidance, 3.14X).

US TECH SECTOR Q3 EARNINGS EPS GROWTH YOY (BLUE HISTOGRAM) VS CONTRIBUTION TO INDEX GROWTH (YELLOW HISTOGRAM)



RATIO NEGATIVE TO POSITIVE US GUIDANCE TO CONSENSUS

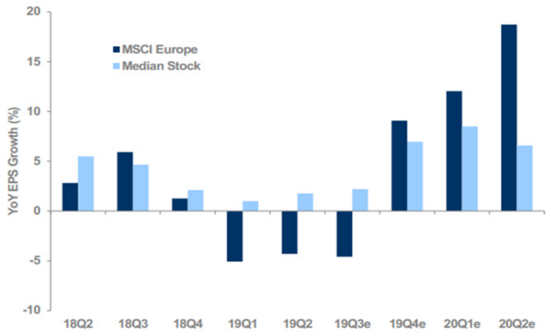


As far as **Europe** is concerned, net EPS estimates beat of 5% are being delivered which is modest relative to history but reassuring compared to the expectations. However, if we go in deep into numbers, it remains a low-quality beat as expectations were very low and results so far suggest that weighted earnings are currently on track to fall by 5.1% YoY in Q3 2019, for the third consecutive quarter.

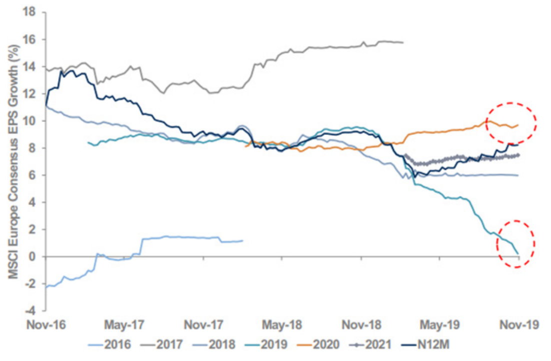
In terms of sectors, Energy, Industrials and Materials are beating EPS consensus estimates the most, with Financials and Communication Services still the weakest.

Earnings revisions in Europe remain deep in negative territory, not just on Q3 2019 earnings but also on estimates further out. Commodities sees the most negative revisions.

MSCI EUROPE EPS GROWTH (BLUE HISTOGRAM)



MSCI EUROPE CONSENSUS EPS GROWTH 2019 CONSENSUS (LIGHT) VS 2020 CONSENSUS (ORANGE)



The median stock price reaction of companies beating estimates is the highest on record while those missing estimates are not being penalized. The market is not reacting badly to profit warnings.

Central Banks

The Fed delivered the so-much-awaited 25bps rate cut (already priced-in), lowering the range of the Federal Fund rates target to 1.50-1.75%.

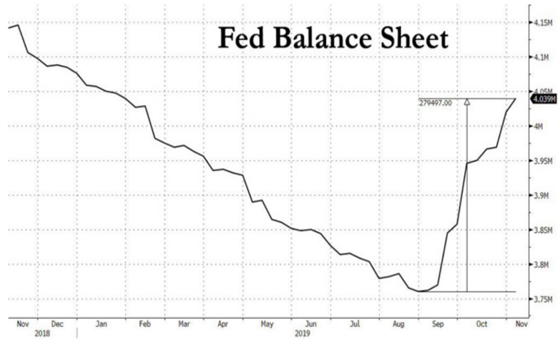
During his press conference Powell stated that the Fed is in a wait-and-see mode, after recognizing that accommodative monetary policy is already having a positive impact on consumer spending (mainly interest rate sensitive sectors) and the economy as a whole, implying that a very high hurdle for rates is now needed to move either up and down from here. More properly, the Fed now requires a material change in current conditions for growth, inflation, labor market and consumer spending to lower rates again. On the other side, realized inflation and inflation expectations should rise significantly in order to trigger a rate hike, which is unlikely at the moment, as Powell sounded less certain that inflation would reach target in a short run. Still the role of consumers will be the main driver of growth for the near future.

Broadly, the Street doesn't see any rate cut at the current conditions, with rates on hold at least through 2020. Current probability for a 25bps interest rate cut at the next December meeting is 10%.

Fed, which following a mini repo market crisis sparked by JPMorgan launched "NOT QE", and injected $280 billion in fresh liquidity in just the past two months, pushing the Fed's balance sheet above $4 trillion for the first time since February.

Fed added $60 billion a month in "not QE", Repo market at $75 billion a day, $1 trillion deficit, what could go wrong? Balance sheet expansion continues as the Fed continues to buying more US debt. Total assets rose by another $20 billion to more than $4 trillion equal to near 20% of US GDP.

US FED BALANCE SHEET IN $ TRILLION

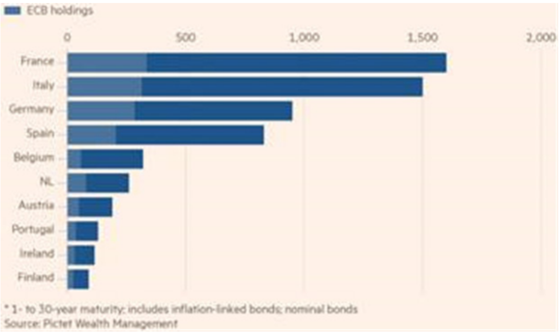


The **ECB** meeting, the last for Draghi, was in line with expectations. Rates & QE guidance unchanged. Draghi highlighted that the inflation outlook is so weak that QE and a rate cut are needed but also a significant monetary accommodation is still needed to ensure inflation convergence.

Market consensus is therefore expecting Lagarde to continue the expansionary stance (no rate lift until 2022 at least). Current 0.1% depo rate cut probability at the next ECB meeting very low, 2%.

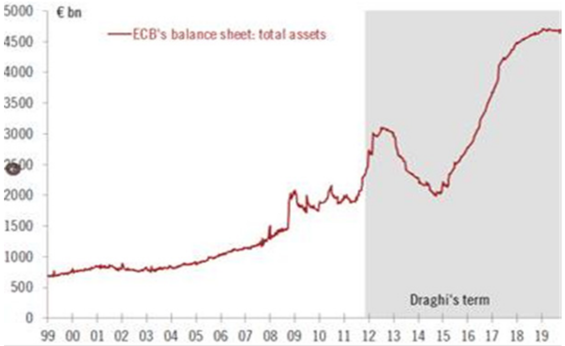
On the 1st of November the **new QE plan** of €20 billion per month has re-started. There are two rules (Issuer limit at 33% and Capital keys) which will limit the purchases in some countries (mainly Holland and Germany). This should therefore limit the number of bonds and countries where the QE could be effective. As you can see from the chart below, France and Italy off the most room for the ECB.

TOTAL BONDS ELIGIBLE FOR QE PURCHASES (€ BILLION)



Draghi has ended his ECB successful presidency (2011-2019), over his term he had 8 rate cuts (0 rate hikes), 10 QE announcements (including changes in side, duration and rules), 6 (T)LTRO announcements and €2.6 trillion asset purchases. The ECB balance sheet has doubled over his term. Lagarde's job won't be an easy one.

ECB BALANCE SHEET TOTAL ASSETS (€ BILLION)



Not everybody in EU is satisfied of the recent policy dovishness tilt. Already at the September 12 meeting, the heads of Germany, France, Holland, Slovenia and Estonia (together more than half EU GDP and population is represented) expressed their discontent on additional monetary stimulus, respectively QE and Depo cut (the committee's advice is usually followed by the president, not this time though). Another sign that Lagarde might invert the ECB current policy guidelines was given, at the last week's IMF meeting, by recent hawkish commentaries of Austria Governor Robert Holzmann, Netherlands Governor Klaas Knot and also Ignazio Visco, who is not considered as hawkish as the others (it means more than those well-flagged are worried about further stimulus).

COUNTRIES OPPOSED TO NEW QE

Indeed, it seems that the German finance minister is pushing for a **Eurozone Banking Union**. Olaf Scholz said he is supporting a common European deposit insurance scheme to shield depositors during banking collapse (Germany previously rejected that proposal). Has something changed after Brexit among EU leaders? Is the much-awaited EU banking union closer? A potential positive news for EU Banks!

As far as Japan Macro is concerned, Prime Minister Abe is currently preparing a stimulus package, looking for an extensive supplementary budget. In addition, Finance Minister Aso is considering issuing 50-year.

Trade War/Geopolitics

Trade War
As far as Trade War is concerned, in the past few weeks, US and Chinese top negotiators had serious, constructive discussions and agreed to remove the additional tariffs in phases as progress is made on the agreement. For example, in early November, the FT reported that US was considering rolling back 15% tariffs on $112 billion of Chinese goods imposed in September. On the other side, Chinese pledged to buy approximately $50 billion of US agriculture products and study restriction removal on US poultry imports.

Despite we noted some real risk-on improvements in the evolution of the US-Chinese saga, such that the market has already started pricing in a positive outcome, we saw some recent headlines from US Trump where he would not fully roll back Chinese tariffs. And tariffs removal from US is the most important sticking point for Chinese. The first phase of the trade deal which had to be signed in October was then further delayed onto November APAC meeting and delayed onto early December (APAC meeting cancelled, US-China meeting to be held in neutral territory early December, London).

After 16 months of tit-for-tat trade tariffs, it is clear the impact of trade war has consequences on China's role in global value chains, its unfettered access to global markets and the prospects for China's massive export apparatus. Also, high value-added, hi-tech sectors highlighted in the controversial "Made in China 2025" are core assets in the Country's future. In the first nine months of 2019, China's exports to US fell 10.8% YoY, leading to 0.1% in overall exports, while imports from US declined by 26.5% YoY, contributing to 5% drop in overall imports.

So far trade tensions costed 90-100bps of global growth momentum. If the current pause turns out to be durable, global consumer spending, corporate confidence, capital expenditures would jump back into Q120. On contrary, further weakness should be expected in H120.

Geopolitics
Brexit: we had an eventful month. As of October 17, Johnson and Juncker, European Commission president, found an agreement for an orderly Brexit. As of October 19, the Government had to abandon the meaningful vote, losing the Letwin amendment, requiring PM Johnson to request an extension up to end of January.

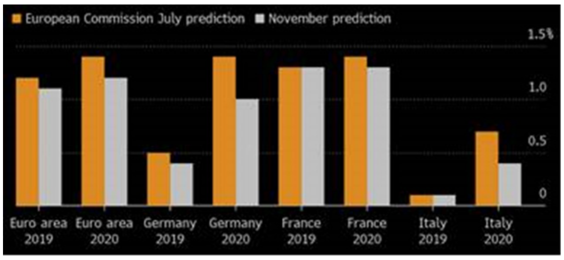
Johnson lost a key vote in Parliament to get his motion approved for three times, before UK MPs voted 438-20 in support of PM Johnson's bill to hold a general election on the 12th of December, paving the way for Parliament to be dissolved on 6th November. Johnson's Brexit deal will be put on hold until after election.

FT noted Johnson's push for an election in part motivated by his party's healthy lead in polls, it remains however uncertain whether he can command a majority in the Commons. It is still fresh the memory when in 2017 they lost the elections when party lost its majority despite a big polling lead. Tories were polling 44% on day 2017 election was called, but now have 36% share of the vote. We therefore believe that there will some uncertainty ahead of the elections. The GBP had the best month since January 2018 in

October, we would expect to retrace a bit before possibly going higher after the elections.

European Commission: cut its Euro-area growth and inflation forecast for the next years, signalling that the worst may be ahead. According to official data, the Euro zone should grow to 1.1% this year from 1.2% expected in July, and to 1.2% in 2020 and 2021 from 1.4% while inflation will be far below the 2% ECB target level, 1.2% this year and next, rising to 1.3% in 2021. To underline, the worst revisions are mainly hitting Germany and Italy.

EURO-AREA DOWNGRADES
EU COMM JULY FORECAST (ORANGE) VS NOVEMBER (WHITE)



US: Michael Bloomberg is running to become the next president of United States. He submitted paperwork to enter the presidential primary in Alabama, an unconventional risky strategy of skipping all four traditional early-state contests in Iowa, New Hampshire, Nevada and South Carolina, and focus instead on big states that hold primaries.

Germany: recent state election in Thuringia saw Angela Merkel's CDU plunging 12%, to 22% and SPD Social Democrats (Merkel's allies), slowing to 8% from 12%. On the other side Afd (extreme right), gained 10% reaching a striking 23.5%. Again, this election confirms a spread malaise in Germany with revamping populism. Merkel's CDU is preparing for some fiscal stimulus measures if GDP would be hit (rumours about €50 billion). This would be a massive development for Germany and all Europe as the conditionality to a bad GDP data is very likely to happen. Among the potential initiatives: A) Increased subsides for electric car sales B) Broader corporate tax write-offs C) Lower unemployment contributions for employees and employers (0.3/4% reduction would free up €4/5 billion) D) End the solidarity surcharge (would free up €10 billion). Also, remember that Germany announced a €54 billion of spending measures to cut emissions (green new deal).

Spain: another hung Parliament. This round of elections hasn't helped much the situation as current PM Sanchez is blamed for the mess. This unnecessary election, six months after the last one, was meant to bolster his support.

The only winner is Vox which have more than doubled the number of their seats, a Spanish nationalist group that will raise the political costs of any kind of deal. PM Sanchez could still remain the PM as the Socialist remain the most popular party but he will need to set up a new coalition possibly with Podemos. The problem is that both the Socialist and Podemos are in a weaker position as they have lost 11 seats between them on Sunday, leaving them 21 shorts of a majority.

Italy: along with Spain, populism is rising in Italy as well. Salvini won the regional election in Umbria with 57% of votes, in a key region where the right party didn't rule for at least 50 years. That is a strong message. Is Conte bis government set to last until the end of the legislature? The current executive might lose further consensus following the decision of ArcelorMittal to leave from Ilva production plant in Taranto (20k people at risk of redundancy in a region with the highest unemployment rate). Emilia Romagna is the next key region to vote (left-wing fortress) in January 2020. Is Salvini going to breach into the left-wing temple as well?

Argentina: opposition candidate Fernandez has won the general elections ousting pro-market Macri and tilting the nation back toward left-wing populism. This will create another point of uncertainty in a very fragile moment in Latin America. The Central Bank of Argentina has already declared that it would tighten further limits on the purchases of dollars to just $200 per month.

Bolivia: three weeks of political violence, leading President Morales to resign after alleged election irregularities. Another example of the fragile stability of Latin America.

Executive Summary

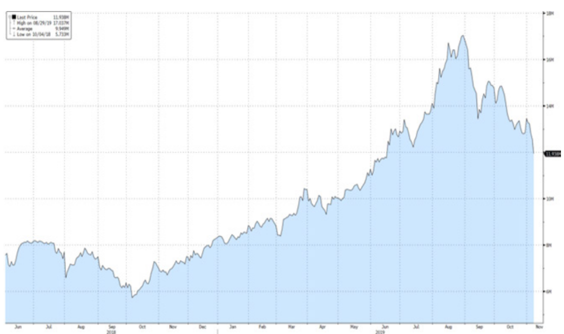
Since the last newsletter there has been a major positive shift from the recession scare to a recovery phase mainly due to an increasingly positive news flow on Trade-War/Brexit and some first early green shots on Macro data.

Central Banks have been possibly over-delivering and helping further the markets. The Fed started to cut interest at the end of July, the ECB started a new QE on the 1st of November adding €20 billion per month for as long as necessary. And if that wasn't enough, the Fed also decided to deal with the front-end funding market distress by announcing a $60 billion-per-month balance sheet expansion.

The shift on narrative has been dramatic in such a short time-frame, both equity and bond markets performance have moved in a sudden and partially unexpected way.

In US, 10Y Yields are hovering around 2% with the biggest jump in a week since the day after Trump was elected in 2016. At the same time, Global negative yielding debt continues to come off at a very fast pace and we are now below $12 trillion from $17 trillion just two months ago!

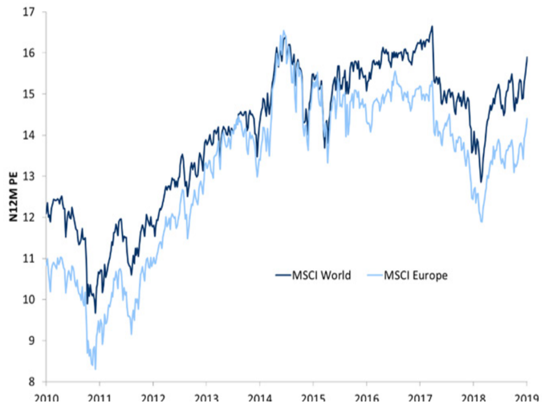
GLOBAL NEGATIVE YIELDING DEBT IN $ TRILLION



Over the last newsletter we mentioned that a move higher on Yields and a shift towards Value factor vs Quality & Growth were due, because of the excess positioning. This is exactly what has happened.

The difficult question we ask ourselves now is to understand if this is sustainable.

MSCI WORLD (DARK) VS MSCI EUROPE (LIGHT)



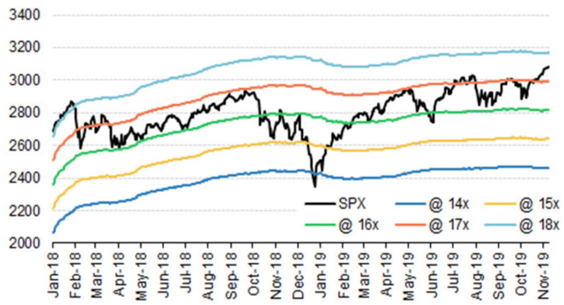
Over the short-term, we believe that markets could start to cool-off and valuations have reached the top of the typical range. The MSCI World's 12-month P/E has reached 15.9x (rarely goes above 16x) while in Europe we are at 14.5x, in the middle of the range of the last few years.

Even looking at the Macro picture, aside from a small tick up in PMI's, data remains lackluster and most forward-looking indicators are still weak and backward-looking indicators such as employment and consumption are still strong.

The market might have run too ahead of itself and equity markets appear to be pricing in a considerable Macro improvement now.

In terms of valuations, the current Forward Price/Earnings on the S&P500 is approaching the highest band of 18X, while less than a year ago we were breaking the lower band of 14X.

S&P500 FORWARD P/E MULTIPLE



We are concerned the market is mirroring where we were a year ago. Then, it grossly overestimated the risk of Fed tightening, triggering a huge rally. Now it might be doing precisely the opposite.

MSCI WORLD (LIGHT BLUE LINE) VS YOY CHANGE IN GLOBAL COMPOSITE PMI (DARK BLUE)

Over the mid/long-term the situation is not easy. A complicated and volatile geopolitical landscape added further complexity to investor decision-making and a potential near-term reduction of geopolitical uncertainty wouldn't negate concerns around the increasingly late cycle nature of the global economy and more immediate risks of further earnings downgrades.

There will be few challenges ahead for asset allocators as low growth, low inflation expectations and low yields, are driving expected returns for a traditional 60/40 equity/bond portfolio close to a century low. Beyond the base-line difficulties of a lower return world, asset allocators will likely be further challenged by lower yields and rising relative volatility dampening the diversifying nature of bonds. Some firms are predicting the S&P500 to return 5% per year for the next decade while returns for Bonds close to 3% p.a. Investors will likely face a lower and flatter frontier compared to prior decades with a considerable higher volatility.

On Equities we should be more prepared to stomach volatility and lower yearly returns, while on Bonds we should be keener to strategically invest on names linked to inflation and low duration. We have started to reduce bond exposure in a multi asset portfolio as the risk-reward trade-off is no longer as favorable as it was especially on corporate credit exposure.

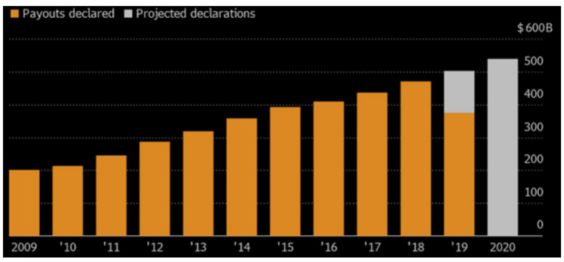
We think that the year 2020 will be a "transition year" to the new world where Investors will need to start to think outside of the traditional schemes. We are possibly not alone thinking about this potential shift as Ray Dalio recently affirmed that "*the set of circumstances is unsustainable and certainly can no longer be pushed as it has been pushed since 2008. That is why I believe that the world is approaching a big paradigm shift.*"

Let's now analyze the current positive vs negative factors for the market (please note that these factors are not all comparable in terms of timing, some factors are short-term while others mid to long-term oriented):

Positive factors (7):
- **Attractiveness of Equities**: Negative-yielding debt makes up 25% of global debt, with the Euro area driving the most recent rise in negative-yielding assets. In contrast, the earnings yield on SXXP is above 7% and dividend yield alone is 3.6%, showing that there is no lack of yield in equity.

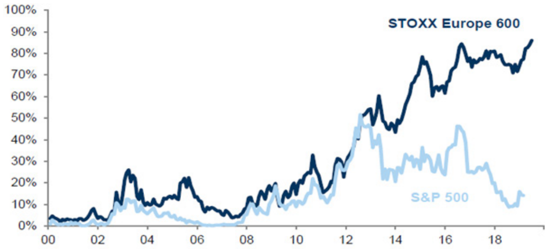
For the first time on record, cash-distribution declarations for S&P500 Index companies are projected to exceed a half-trillion dollars, according to Bloomberg estimates. While the pace of annual dividend growth is expected to slow to 7% next year, from 7.3% this year, payouts are seen hitting $537.8 billion in 2020.

PAYOUTS DECLARED (ORANGE) VS PROJECTED DECLARATION (GREY)



In Europe, almost 80% of European companies have a dividend yield higher than corporate bond yields.

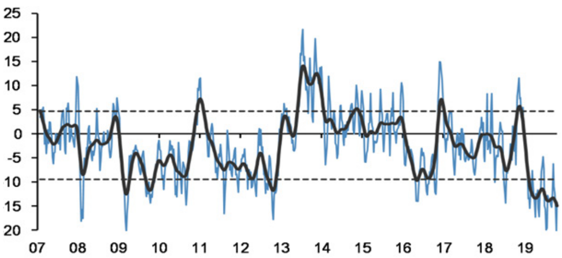
STOXX 600 DIVIDEND YIELD HIGHER THAN CORPORATE YIELD (BLUE) VS S&P500 DIVIDEND YIELD HIGHER THAN CORPORATE YIELD (LIGHT)



- **Positioning/Flows**: Aggregate investor positioning is not as cautious as it used to be this year. In Europe we started to get a couple of weeks of inflows after the longest stretch of outflows ever! (83 weeks).

According to EPFR data, there has been $149 billion of outflows from European equities over the last 3 years, equivalent to 12% of AUM.

FUND FLOWS INDICATOR, DIFFERENCE BETWEEN FLOWS INTO EQUITY AND BONDS



Important to note that despite the very strong equity markets, money continues to pour into money-market funds, with assets standing at $3.5 trillion now, up from $3.05 trillion at the start of the year.

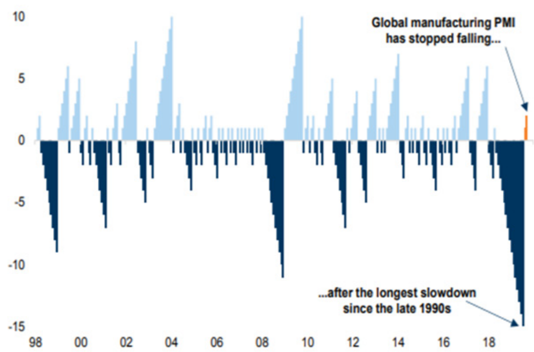
The last time so much money went into cash was in 2008 as the financial crisis was heating up, and it's a marked difference from 2013, the last time stocks were having a year as good as this one. Back then, money funds only attracted $28 billion.

- **Q3 reporting season not as negative as expected** as explained above.

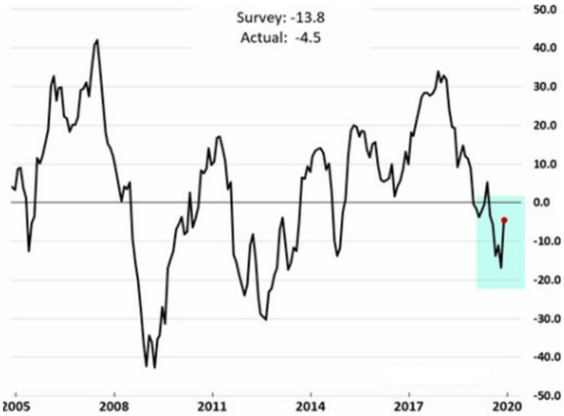
- **Macro numbers getting better from very deep levels**: we started paying attention to this point already 2 months ago. We explained over the last newsletters how this year would have been different from 2018 given favorable base effects, reduction in inventory overhang and the bottoming out in M1 in all key regions. At the same time, Fed has been cutting rates and ECB re-starting QE.

If the activity momentum stabilizes, the recent slowing in the EPS growth rate will stabilize too. Profits and margins remain operationally leveraged to economic growth.

GLOBAL MANUF. PMI INCREASED AFTER 15 MONTHS OF CONSECUTIVE DECLINE



SENTIX EUROZONE INVESTOR CONFIDENCE



- **Buyback should continue to support markets in 2019**: Buybacks have been a key theme through this cycle with S&P500 companies returning $5 trillion to shareholders since 2009 and contributing 2% to annual EPS growth.

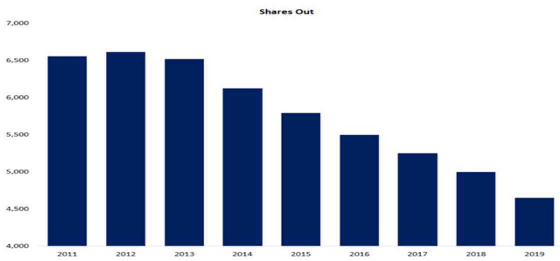
We are now out of the blackout period when companies can resume their buyback program.

The pace of repurchasing has reached the slowest pace in 18 months and the daily average is now down 35% week on week vs the YTD average.

However, it is still a very powerful tool and the main example is given by Apple. The pace of repurchases was robust, including acceleration in the pace closer to August's low share price levels. Repurchases tracked at 24 million shares in July, accelerating to 35 million shares in August and 27 million shares in September. Apple's lowest share price level in the quarter was $193 in early August, demonstrating the willingness to use repurchases opportunistically and limit downside for investors. Share repurchase authorization of $78.9 billion remained outstanding at the end of the year.

Have a look at the chart showing the number of shares outstanding on Apple, that's 30% fewer shares in just 7 years!

SHARE OUTSTANDING APPLE



- **Seasonality**: Looking back over the past 10 years, November has averaged a gain of 1.86% on the S&P500, only second to October. Since 1983 and the end of the Financial Crisis, November has historically started off strong with solid gains of more than 0.5% on an average basis in just the first few trading days. Then there is a more sideway pattern during the 2nd and 3rd week with a resume of the rally over the last week of the month.

- **Global M&A**: the activity has been very strong in the first 6 months of the year but Global takeover volumes decreased sharply since the beginning of September, -33% YoY.

It is still a positive factor but uncertainty is the main issue with Geopolitics, Trade war, Brexit and global slowdown.

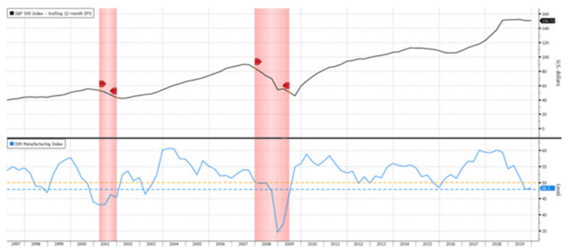
Negative factors (8):

- **Economic momentum**: Morgan Stanley widely followed proprietary US Cycle Indicator model has predicted the beginning of the downturn for the 1st time since 2007 already three months ago. This phase-change has historically meant a worse backdrop for returns and higher chances of recession or a bear market.

US CYCLE INDICATOR

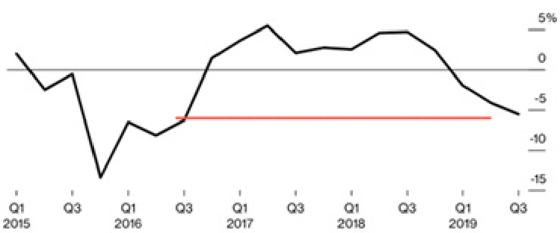
S&P 500 Index earnings weakness may extend when considering leading economic indicators like the US ISM. Recessions in 1998 and 2015 saw dips in the ISM to below 50.

S&P500 TRAILING 12-MONTH EPS (BLACK) VS ISM MANUFACTURING (BLUE)



Weakness is seen on other important areas which are not shown on main economic indicators. As an example, the US railroad industry has seen a decline in carloads volumes for Q3 down 5.5%, a new 3-year low indicating that the economy continues to decelerate. Most of the shipment declines were seen in autos, coal, grain, chemicals, and consumer goods, but there was a small improvement in crude oil shipments.

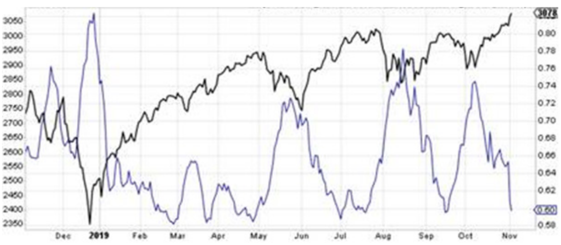
US CARLOAD VOLUMES QOQ



- **Poor market protection**: while there is a considerable amount of cash on the sideline, it is true that the recent melt-up of markets is also coming along with extremely low bearish protection. The chart is showing the S&P (black line) vs the 10-day Moving Average of the Put/Call ratio.

The number of puts vs the number of calls is the lowest since January 2018 and the 10-day average (blue line) is indicating a potential top for the markets.

S&P500 (BLACK) VS US 10-DAY MOVING AVERAGE PUT/CALL (PURPLE)

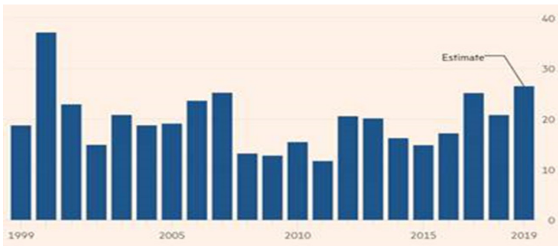


The same message is given by the number of short contracts on the Volatility Index (histogram) vs the the S&P (line). **They are both very powerful contrarian indicators**.

S&P500 (BLACK) VS POSITIONING VIX, US VOLATILITY (HISTOGRAM)

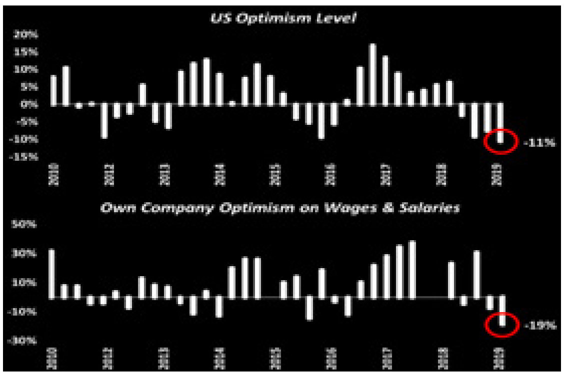
- **Insider sellers / CEO - CFO surveys**: Executives across the US are selling stock in their own companies at the fastest pace in 20 years on concerns that the long-lasting bull market is reaching its final stages. They are selling at a strong pace with a possible number at the end of year close to $26 billion similar only to the number reached at the highs of the dotcom bubble in 2000.

US INSIDER SELLING



These CFO surveys couldn't be more bearish, now plunging the most in the history of the data. At the same time, CEO confidence is falling the most since the Great Financial Crisis (2008).

CFO SURVEY YOY CHANGE



- **Cash spending**: Low yields have helped a shift toward taking on more debt. More than a year on from the tax reform, Goldman reports that non-financial S&P500 cash balances have declined by $185 billion, or 11%, during the past 12 months, the largest percentage decline since at least 1980. Meanwhile, S&P500 firms increased debt by $410 billion, or 9%.

TRAILING 12-MONTH CHANGE S&P500 EX-FINANCIAL: DEBT (LIGHT) VS CASH (DARK)

The corporate sector isn't acting as politicians wanted, and indeed is thwarting their policies. Governments' ability to make companies do things they don't want to do is limited. More concerning, there may be a common cause at work. Companies are acting this way because executives lack confidence in the economic outlook.

US consumer: Nominal growth of consumer spending in 2019 has slowed to its weakest growth rate in three years, with many traditional retailers seeing no growth in top-line sales. And yet large commercial banks indicate that their consumer finance arm shows a "healthy consumer".

The difference in the direction and tone of business is very straightforward; retail is counting how much consumers are spending at their establishments, while commercial banks are counting how much consumers are paying in interest when they borrow to spend. Banks are happy (for now) as consumer interest payments at record levels are rising more than twice as fast as consumer spending.

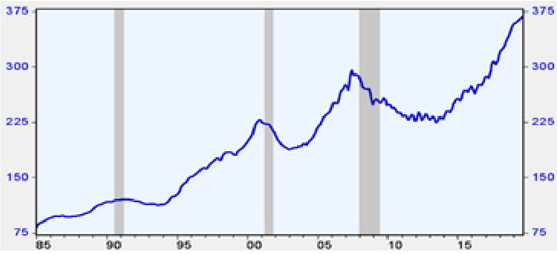
Through the first 9 months of 2019, nominal consumer spending (which includes all goods and services and traditional and e-commerce retailers) is running less than 4%, a drop-off of roughly 125 basis points from the 2018 performance.

On the surface, the growth of consumer borrowing is not excessive, but what is excessive is how much it costs consumers to borrow. Personal loan rates at commercial banks stand at 10%, and average credit card rates stand at 15%. However, the Federal Reserve has estimated the true cost of credit card borrowing. The assessed interest rate charges on all credit card accounts averaged 17% in 2019 and represent the highest assessed rate since the Federal Reserve started measuring the all-in-costs of credit card borrowing in 1995.

COMMERCIAL BANKS ASSESSED INTEREST RATE ON CREDIT CARDS

According to the Bureau of Economic Analysis, consumer interest rate payments hit a new record high of $368 billion in Q3 2019, more than one third above the peak of the 2008 financial crisis, and 10% above what consumers paid in 2018.

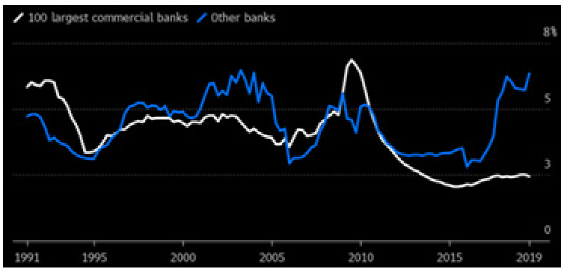
CONSUMER INTEREST PAYMENTS FOR PERSONAL LOANS AND CREDIT CARDS



In short, rising interest expenses are sucking the "spending power" out of the consumer. Retail is already seeing the impact and banks will soon see it as well.

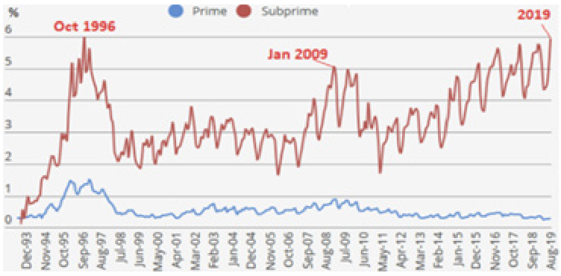
At the same time, it is important to note that US consumer credit-card delinquencies, the precursor of charge-offs, rose to a 16-year high in the second quarter among smaller commercial banks. Federal Reserve data show that delinquency rates (those that are 30 days past due) climbed to 6.3%, double the level of three years ago.

DELINQUENCY RATE: LARGE BANKS (WHITE) VS SMALL BANKS (BLUE)



There are some issues even on Subprime auto loans which in August have broken an all-time high.

AUTO LOAN 60+ DELINQUENCY INDEX: PRIME (BLUE) VS SUBPRIME (RED)



IPOs: Investors have had an extremely difficult time stomaching big IPO throughout 2019. Out of the eight IPO offerings of $1 billion or more, the median return from the IPO offering price has been a decline of 6.6%.

The most clear and easy way to gauge investor risk propensity is seeing how new issuances have traded. From the end of July, the Renaissance IPO Index has underperformed the S&P by a massive 15%! Among others, Lyft and Uber are down 40% since they listing (respectively in March and May), Peloton -18% since IPO in September, Slack Technologies -25% since IPO June 2019 and Chewy flat since IPO June 2019 but -35% from the first days of trading.

We are now waiting for the biggest IPO in history, Saudi Aramco. Net profit would be the same we had in 2018 for Apple, Alphabet and Exxon Mobil. The pricing will be on the 5th of December. Analysts' valuations of the company have varied from $1.2 trillion to $2.3 trillion. Saudi Aramco also confirmed plans to pay annual, aggregate cash dividends of at least $75 billion starting in calendar year 2020, in addition to any special dividends.

Market concentration/liquidity: The Dax is now up more than 25% YTD and despite this move, the market value of all listed German companies, at $2.2 trillion, is smaller than that of the 2 largest US corporations. Apple and Microsoft have a combined market Capitalization of $2.27 trillion.

In US, it should not be a surprise that leading Tech are the most contributing, considering that Apple up 66% YTD, Facebook up 44% YTD and Microsoft up 44% YTD. Just two companies (Apple + Microsoft) are now worth almost as much as the entire Russell 2000 Index of Small Caps.

If we split a large global universe of 17000 stocks into market-cap grouped portfolios and measures their median annual performance over the last 12 months. The mega-cap group (above $100 billion) is powering ahead whilst those in the sub-1 billion market cap range are still struggling to make back last year's loss. Among the more remarkable numbers, (+)100 billion firms represent just 77 companies in the portfolio but 27% of the global market cap. Meanwhile (-)1 billion firms represent 7% of the market capitalization yet over 11,000 companies, or 65% of total numbers. And this is the problem, our increasing focus on a few large cap indices populated by just a fraction of the world's companies is giving investors a false impression.

Is the market concentration too high in US? The percentage of revenues of the 5 biggest companies of every sector is the equivalent of 60% of the whole sector. The reason is of course that these 5 companies have greatest revenues. Inequalities, decreasing productivity, loss of consumer power are all direct effects of this concentration. Are we sure that capitalism is sustainable without competition?

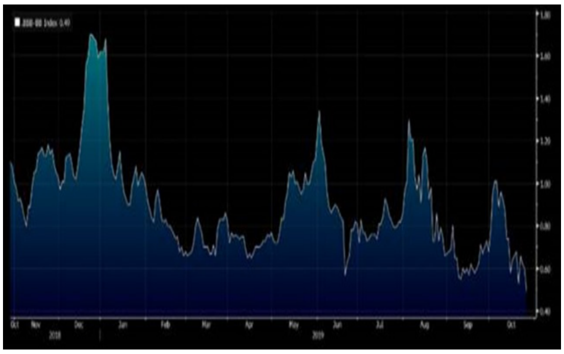
Dow Jones is now up 50% since election day in 2016! What about if Warren would win the presidential elections next year? We could start to witness the opposite process and the market fragmentation could start favoring Europe vs US.

Increasing issuance on Credit vs Quality of debt: we are experiencing a rapid increase in issuance volumes and it will likely put some strains on Credit spreads over the next months.

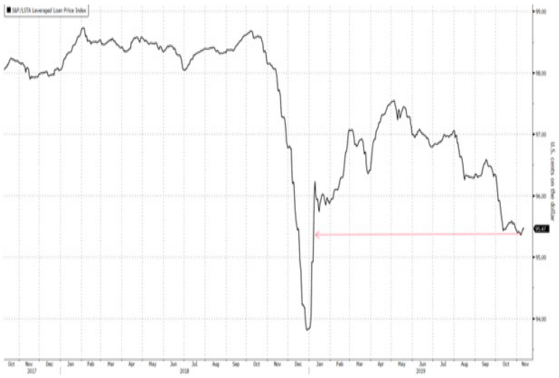
The Wall Street Journal is claiming that the main rating agencies (S&P, Fitch, Moody's) are overvaluing the credit quality of BBB rating companies, on average, potentially leading to a massive category downgrade. It's like the history is repeating again, we saw how the subprime story ended though.

So far, BBB rated debt accounts for 60% global Investment Grade (was 38% in 2009 before the crisis), as much as twice of Junk rated bonds. While Central Banks continued to buy debt and reduce spreads, non-financial corporate debt and financial leverage sharply increased. The former jumped from $6 trillion in 2009 to $10 trillion today while the latter rose from 2 to 3X in Investment Grade, and from 2 to 3.3X in Speculative, during the last 10 years. The difference between BBB and BB US corporate bond spreads collapsed further to just 49bps as investors continued chasing yield in the highest-rated junk bonds. The compression is making it so investors may have to start reaching even further down the ratings spectrum to find value.

DIFFERENCE BETWEEN BBB AND BB US CORPORATE BOND SPREADS



S&P/LSTA LEVERAGED LOAN PRICE INDEX



According to the latest comments from FMI boss, Kristalina Georgeva, $19 trillion of corporate debt is at risk of default, almost 40% of the whole G8 Countries debt.

The junk-rated leverage loan market, currently $1.2 trillion, starts seeing its first signs of a massive debacle. Apparently, global growth slowdown, investor flight to quality, rating downgrades and deteriorating conditions in a high leveraged firm, are currently weighing on the riskiest part of the leverage loan market. It seems that $40 billion of leveraged loans have lost at least 10% of face value in just a quarter. Among the most hit sectors, energy and consumer discretionary. Without any doubt, the situation is set to worsen if we don't see an improvement in Macro, Geopolitics in next quarters.

The benchmark US leveraged loan price index hit its lowest level since 6th of January, as Federal Reserve officials mull the need for interest-rate cuts amid growing risks to the economy. The S&P/LSTA index has been dragged down by lower-rated debt, with more than three weeks of consecutive declines.

The main point here is, if credit rating companies were wrong (overvaluing firms), then we would assist at a falling angels sell-off process (the market is selling BBB due to weakening financial conditions, turning into Junk rating).

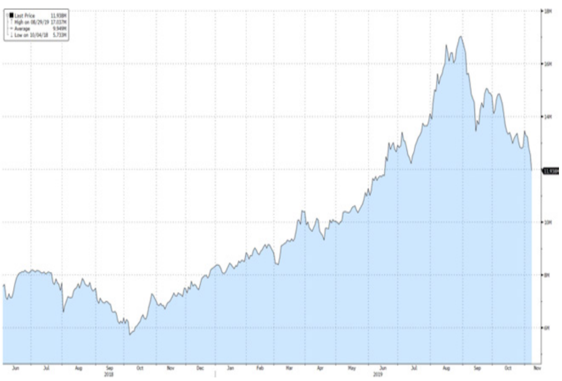
Macro

As mentioned in our last update, we were expecting some sign of stabilization in global growth and were proven right, although we are still far from saying that the global Macro picture is improving. The latest available global CAI (current activity indicator) is running at 2.6% in October, in-line with the average since the re-escalation of the trade war in May, and still well-below 3.6% in April. If Phase 1 were to be signed (market already pricing 80/90% odds), the situation should in theory start to stabilize leading to a gradual labor market improvement and modestly higher inflation.

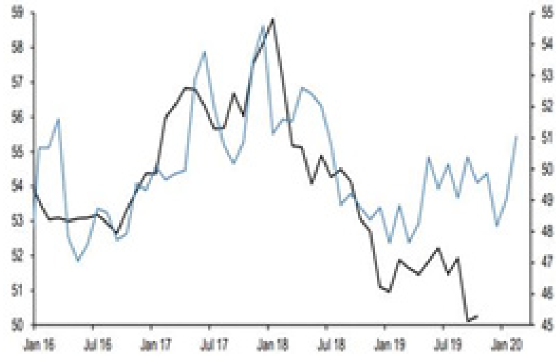
The global manufacturing PMIs touched a new low, down to 48.7 in October, the fifth consecutive month below the expansion threshold, mainly driven by further weakness in Emerging markets. But it's not all doom and gloom, the most recent US, Caixin China PMI and European PMIs improved, possibly signaling a trough, along with two key-subcomponents of the global PMIs, respectively new orders and employment rising marginally.

Some signs of stabilization...

GLOBAL MANUFACTURING PMI (BLACK) VS. GLOBAL INTEREST RATE YIELDS (BLUE)



EURO COMPOSITE PMI (BLACK) VS) CAIXIN CHINA PMI NEW EXPORTS 4-MONTH FORWARD (BLUE)



Europe

CAI (current activity indicator), the closest measure to GDP, is still stagnating (+0.1% in October) but there is a large contrast between Germany and Italy (both at 1% annualized rate) versus France and Spain (both growing at 1.5% rate). Quite striking to assess how the German manufacturing PMI have fallen from 51.5 to 41.7 in September, the longest downturn since 2009.

Positive

EU Q3 GDP QoQ 0.2% vs 0.1% consensus
European Sentix Investor Confidence -4.5 vs -13.8 consensus (the largest gain since August 2009)
October IFO expectations 91.5 vs 91 consensus (closest to GDP measure)
October Eurozone Manufacturing PMI 45.9 vs 45.7 consensus
October Germany Manufacturing PMI 42.1 vs 41.9 consensus/prior (still weak but improving)
October Eurozone Composite PMI 50.6 vs 50.2 consensus
October Germany Composite PMI 48.9 vs 48.6 consensus
September Germany Factory orders MoM 1.3% vs 0.1%

Negative

October Zew Survey current situation -25.3 vs -23.3 consensus/ -19.9 prior

October IFO current assessment 97.8 vs 98 consensus

October Spain Composite PMI 51.2 vs 51.4 consensus

United States

CAI (current activity indicator), the closest measure to GDP, has reached 1.3% in October, higher than its 2019 summer lows but still lower than 1.8% in January. In October, US Q3 GDP came stronger. Among the leading contributor, strength of the household sector remains the key growth driver due to still strong consumer spending. Also, to underline a strong ISM Non-Manufacturing.

Positive

Q3 GDP QoQ 1.9% vs 1.6%

Q3 Personal Consumption QoQ 2.9 vs 2.6%

October ISM Non-Manufacturing 54.7 vs 53.5 consensus

October Nonfarm payrolls 128k vs 85k consensus

Negative

October ISM Manufacturing 48.3 vs 48.9 consensus

October Manufacturing PMI 51.3 vs 51.5 consensus/prior

October Services PMI 50.6 vs 51 consensus/ prior

October Composite PMI 50.9 vs 51.2 prior

September Retail Sales -0.3% vs 0.3% consensus

Consumer Confidence 125.9 vs 128 consensus

September Personal Spending 0.2% vs 0.3% consensus

China

CAI (current activity indicator), the closest measure to GDP, bounced back to 5.9% annualized from 5.7% on better industrial production growth. China Q3 GDP came slightly weaker.

Positive

September Industrial Production 5.8% vs 4.9% consensus

September Retail Sales 8.2% vs 8.1% consensus

Caixin China PMI Manufacturing 51.7 vs 51 consensus

Caixin China PMI Composite 52 vs 51.9 consensus

Negative

Q3 GDP China 6% vs 6.1% consensus

October Manufacturing PMI 49.3 vs 49.8 consensus

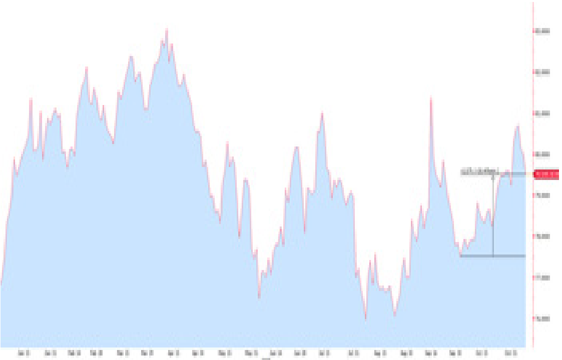
October Non-Manufacturing PMI 52.8 vs 53.6 consensus

Commodities

The pro-cyclical and reflation trade led a rally in commodities in October. As mentioned in our previous update, we are **still neutral-positioned in the short-mid run** until global growth rebounds significantly. Since early October the Bloomberg Commodities Index is up 2.5%, rising to 4% year-to-date and recovering the steep 5% September drawdown, mainly supported by the outperformance of oil, natural gas and metals. Interestingly, the October risk-on appetite drove the outperformance of industrial metals such as copper +5.5%, zinc +8% and aluminum +6%, while dragging down precious metals such as gold -2.2% and sliver -3.5% (it makes sense due to the inverse correlation vs real rates).

We correctly called the gold market in the past few months, as we decided to unload our positioning close to the September peak, obtaining a positive 24% performance (started a long position in October 2018 until the end of July/mid-August). Since September the gold market lost approximately 14%. So far, we are waiting for a more favorable entry point, around 1450$ level in order to rebuild a position. As previously stated, gold is a must-to-own asset class for the next year as well.

BLOOMBERG COMMODITY INDEX



Oil

We maintain our **neutral stance**. Still one of the best asset class year-to-date with WTI up 24% and Brent +14%.

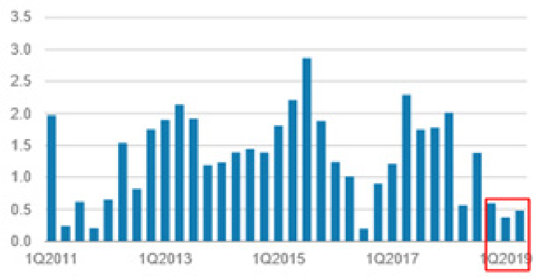
October's oil positive performance, +6.5%, was mainly driven by renewed trade optimism between US and China. An official announcement on a completed phase one trade deal would send oil prices higher as oil demand would eventually increase with global demand.

Some volatility was created by the recent rumors that OPEC+ will likely keep output steady at its next meeting on the 5th of December in Vienna. Several analysts expect OPEC+, which represents almost half of global supply, would cut production to stabilize the market. Also expect output from OPEC+'s rival to expand as fast as global consumption in 2020 as the ongoing surge in US shale oil (40% of the whole market by 2025) is supplemented by new supplies from Brazil and North Sea (we don't instead). OPEC+ sees demand for its oil to slump almost 16% by the end of 2023. Despite these projections, some OPEC+ members may not agree to the next output curb as some countries have not yet delivered the cutbacks agreed to the start of the year (Iraq and Nigeria increased output instead). In addition, Russia sounded cautious about stronger intervention.

Excluding unexpected events, several factors should support oil prices on current levels. The oil market was 1.3mb/d undersupplied in Q3, while refinery runs are set to accelerate sharply in the next quarter. In addition, a potential USD downturn would be a tailwind for oil.

NON-OPEC EXPECTED SUPPLY GROWTH MB/D

YOY OIL DEMAND GROWTH



Gold

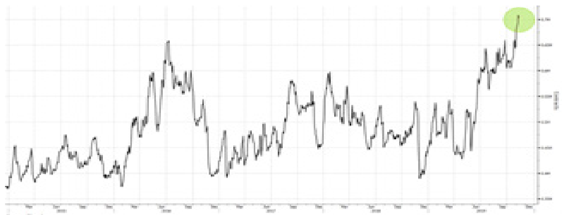
We called the market very well. Started a long position in October 2018 until the end of July/ mid-August, achieving a positive total return of 24%. We sold it. Since then, gold price is down 6.5%. We are currently waiting for a more favorable entry point, around 1450$ level. We are **bullish on the asset class for the mid-run**.

Precious metals performed well this year, with gold up 14% and silver up 9% year-to date. Although not invested now for tactical purposes, we should remind you that gold is a **must-to-own asset class** in each portfolio, with a potential allocation between 3-5%.

Broadly speaking, the Street is now consensually bearish. Bullion posted its largest weekly decline since November 2016 amid fluctuating sentiment over how soon the US and China could conclude the first phase of an accord.

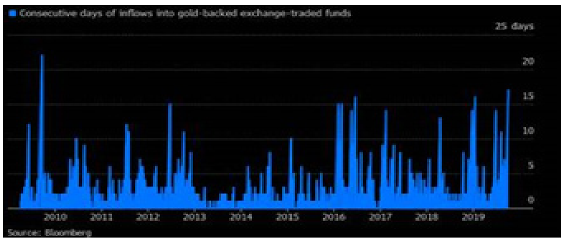
Current future positioning looks extreme to us...

COMEX GOLD FUTURE CONTRACTS OPEN INTEREST



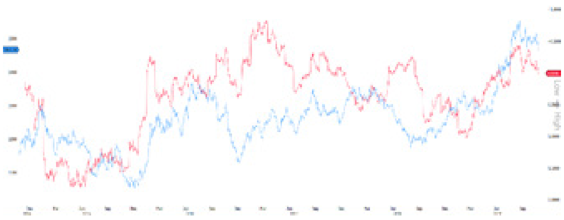
Worldwide, until few weeks ago, holdings in bullion-backed exchange-traded funds expanded for 17 days in a row, the longest run of inflows since 2009!

CONSECUTIVE DAYS OF INFLOWS INTO GOLD BACKED EXCHANGE TRADED FUNDS



And, we still see a strong inverse correlation between real rates and gold...

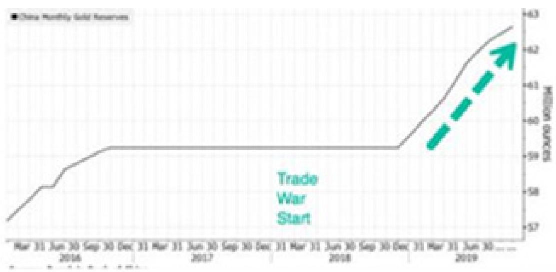
INVERTED US 5-YEAR REAL RATES (RED) VS GOLD PRICE (BLUE)



We would now like to focus on the recent record purchases of gold from Central Banks. Is this the beginning of Gold being the new tool for geopolitical threats in an era of continuous QE? We believe that it is not a coincidence that both China and Russia are offloading US Treasuries and at the same time buying gold.

From 2008-2009 no Central Bank in the world has sold gold and over the last months the purchases have reached record-levels and they don't seem to be stopping soon. In the last 9 months, China has bought 5.9 tons of gold taking their entire reserves to 100 tons. The pace of increase has steepened after the beginning of Trade war.

CHINA MONTHLY GOLD RESERVES



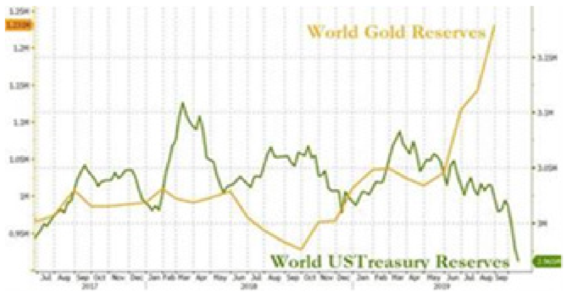
Over the last few years, Russia has been one of the main buyers and they have now reached $108 billion of countervalue for their gold reserves. For the 1st time in 21 years Germany has openly bought gold into its reserve holdings.

GERMAN GOLD HOLDINGS MOM

The Dutch Central Bank has openly been bullish on gold (DNB's Gold Stock article) as they think it will be the only starting point from a structural crisis as a collateral. They own 615 tons of gold and have recently announced that they moved their gold reserves from the DNB building into a military venue. The DNB has started to repatriate their gold reserves in New York since November 2014. We recently had the news of Bundesbank and Austrian CB moving their respective gold reserves from some international locations into their national spots.

Worth to note that on the last 26th of July, the European Central Banks have cancelled the "Central Bank Gold Agreement" signed in 1999 in order to stabilize the gold market. Now every Central Bank will be able to trade gold without the need to coordinate with other European CBs.

WORLD GOLD RESERVES (YELLOW) VS WORLD US TREASURY RESERVES (GREEN)

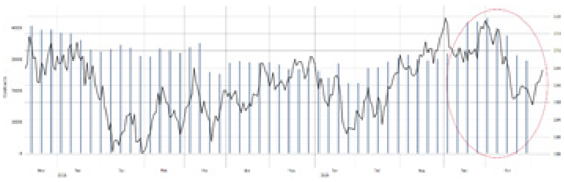


Forex

The current reflation trade, which means improving global data, is driving a reduction in USD's yields advantage as foreign yields (ex-US) are rising more in relative terms than US yields. All this creates some pressure for investors to move capital out of **USD-denominated** into others cheaper and undervalued currencies. We are not saying that we are bearish USD though. We believe it is a very difficult call very data-dependent and event-dependent.

Since increased optimism in trade deal, USD positioning is weakening...

USD FUTURE POSITIONS (HISTOGRAM) VS USD INDEX (BLACK LINE)



The **Euro** is still weak on historical average, mainly due to ECB's easing measures, negative rates, weak inflation and slowing Macro Euro-area momentum. In October, the EURUSD jumped 2.5% in the first few weeks, to give back more than half of the gains. So far, it is hovering around 1.10 level.

It seems that EUR short positioning is slowly fading...

EUR FUTURE POSITIONS (HISTOGRAM) VS EURUSD INDEX (BLACK LINE)

Trade Ideas

CURRENT CONVICTIONS

Call replacement on Single Names/Sectors

It proved to be a good call. Given the current low volatility environment and the leverage effect, switching cash positions into derivatives seems to be one of the best opportunistic moves so far. For instance, on our products/portfolios we took some cheap out of the money calls on the Eurostoxx 50 with large nominal value. The higher the market rises, the larger the net delta-adjusted exposure becomes. Then, it is possible to follow the market, reaping some profits, with a very limited downside (the premium).

Long European oil sector, SXEP

A really decent call! The Oil Sector has started to outperform the market (we have been pushing this idea lately), with the European SXEP Index sector breaking to the highest levels since July. Since our last update, the SXEP index jumped almost 9.5%, WTI and Brent rose 12%.

The key upside catalysts were the positive data emerging on demand (market expectations too bearish) and slowing rate of non-OPEC growth. The OPEC+ is set to meet on the 5th of December in Vienna, should consider to further cut its output in order to balance the market and support the oil price. Current oil prices, just above $60, are too low for many OPEC+ countries which are unable to cover their government costs at this level, among which the Saudis. The Aramco IPO will possibly bring not enough to the Government as the Kingdom is currently running a budget deficit of 6.5% with a Debt to GDP that will rise to 28% in 2020 (from just 1.4% in 2014).

The European Oil sector has a FCF yield for 2020 of 9% and dividend yield of 6% vs Aramco rumored yield of 5%.

As you know **we have been bullish on the Energy sector and we continue to believe in some decent returns**.

Global appetite for the sector has reached a new low and we see the following catalysts on oil price:

I. Positive data points emerging on demand (in the context of what we have observed on the buy side as rather bearish expectations already);

II. Slowing rate of non-OPEC/US growth from 2020 putting an end to a decade of credit-fueled shale oil hyper-growth. The structural tightening of financial conditions for new oil projects and deceleration in non-OPEC supply will be key positive drivers of oil prices in the medium term;

III. Deeper OPEC cuts at the next 5th of December meeting are likely.

While Q3 numbers have been decent QoQ, we think that the headwinds are well flagged and is a nice contrarian entry point as negative '19/20 consensus EPS revisions at 60$ per barrel are something from the past.

Improving discipline on cash breakeven (below 50$ for the 1st time since 2014), attractive valuations and yields (sector average 2020 FCF at 8.7% and dividend yield at 6.1%) are making the story very compelling.

Long European Auto sector, SXAP

Another very decent call! Since our last update, the European SXAP index is up almost 20% mainly buoyed by the reflation trade (higher yields, Macro improving), short covering and rumors about US Commerce Secretary Wilbur Ross saying US tariffs may not need to be placed on European cars. Considering this positive outperformance, **we would recommend to reduce the exposure to the sector**.

The SXAP index is still at a massive level up here, firmly in over-bought territory, 14-day RSI >70 with momentum driving the recent strength, coupled with M&A last week (Fiat/ Peugeot) and positive US commentaries on tariffs. Each time RSI >70 over the last 18 months the SXAP index had a pullback!
Daimler, weights 20% in the SXAP index, up 25% since early October. Next key event Capital Market day on 14th November. Volkswagen, weights 15% in the SXAP index, up 24% since early October as well. Our best top pick in the industry. No upcoming key event until 2020. BMW, weights 10% in the SXAP index, up 12% since early October. Weak data after disappointing badly in 2018. No upcoming key event until 2020.

NEW CONVICTIONS

Long European Banking sector, SX7E

So far European banks are up 9% year-to-date, after having rallied 25% since August lows. Overall European Banks are down 42% since July 2015 highs and down 33% since March 2018 highs.

Last week there were some articles about the potential creation of an **EU Banking Union**. The latest proposal might carry more weight vs previous iterations also because of the European bank deposit "re-insurance" system. It is not an immediate game changer but the promotion of this concept is the key missing piece before we can see more (any) M&A amongst European Banks.

Given German historical resistance to such a scheme and that this is coming from the Finance Minister, it is a positive news. The only issue is that it could be politically motivated (heading into SDP elections), implementation might be years away and aversion from a number of EU member states could be meaningful.

Interesting to note that on European banks we had 85% of beats so far on Q3 earnings. This is an important prerequisite for some stability going into 2020. Over 60% of banks have beaten profit before tax expectations, clearing the revised bar. Misses were concentrated in Scandinavia and the UK, while 85% of Eurozone banks beat the street's profit before tax numbers, on average by ~3%.

Valuation may have bottomed following a wave of negative revisions and with lower political risk and stabilization in depo rate expectations we could potentially see a gradual re-rating in the sector.

Long Gold

As you might remember after the strong call we made in September last year, we suggested to sell Gold/Gold miners and since then the Gold has retraced 6/7%.

It was a consensual long position and we feared of some capitulation. This hasn't happened and Gold price has held quite well despite the benign, risk-on market environment. As we have explained above, Central Banks are buying gold and in a rising uncertain environment we **would start buying a new long position on Gold, around $1450 level**, using any potential deep to increase the position further.

We start buying a 1% long position for our clients.

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