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Monthly Market Update

Monthly focus on Financial Markets

Contents

ASV/ASWM Alliance of Swiss Wealth Managers

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"A positive de-escalation of the two extreme risks for global markets, respectively the trade war and no-deal Brexit, and their positive externalities on the real economy, will probably be the most important market drivers in the early part of 2020."

Market Analysis

Over the last newsletter, we described the market saying that we were surprised about the persistent strength and "melt up" during October and continuous positive attitude during November, reflecting a huge shift in investor sentiment on market perception of much lower political tail risk.

US and Europe are having their best year since 2009, and it has been the most successful year for a benchmark balanced fund since the late 1990s.

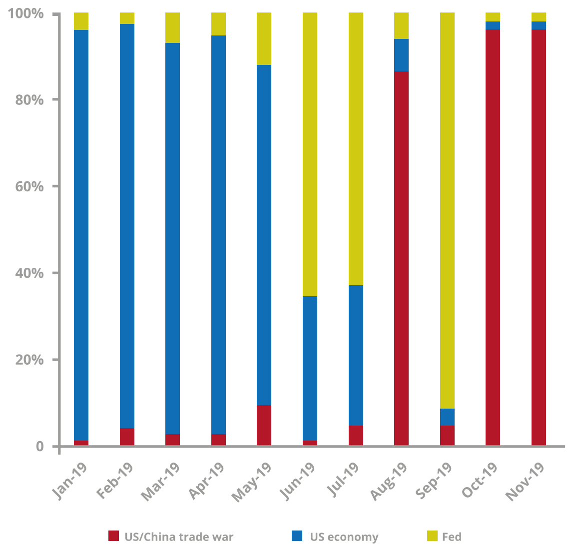
The rally has been definitely helped by Central Banks, with some statistics showing that about half of returns in equity markets were driven by the contribution of Central Bank actions, while the rest was generated by some mixed factors with the inclusion of multiple expansion driven by a repositioning of EPS estimates.

We have been one of the first spotting and explaining how the Macro picture would have stabilized and possibly improved in H2.

<u>A better Macro narrative and Central Bank continuous intervention is positive for equities in general; however, with markets up 10% in the last three months and with tactical sentiment metrics elevated, there is a valid question as to whether much of the good news is already in the price.</u>

On the first day of this month, the Eurostoxx has lost 3% intraday (top to bottom), erasing all the gains made in the month of November. We should be wary that Equities are now pricing in an economic rebound and the market is only expecting a 3% growth on earnings in Europe for 2020, 6% in US and 11% in Asia.

MARKET MOVEMENTS ON US-CHINA TRADE WAR TWEETS (RED)



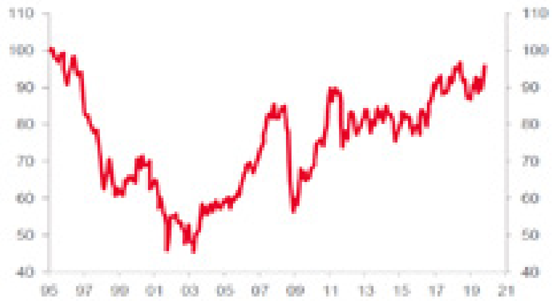
An improving global Macro picture and decreasing fears of recession have triggered a rise in bond yields from record lows reached in August, despite the beginning of a new QE in Europe, Fed cutting rates and intervening on Repo market in a "similar QE" and dovish BOJ (Bank of Japan).

It is a market of hopes and tweets (chart), with movements exacerbated by low volumes and algorithmic trading.

The outcome of the US-China trade deal is essential to confirm the re-pricing in global growth.

Within European markets, the cyclical portion of the market (Basic resources, Industrials, Consumer Discretionary and IT) have been outperforming the Defensive sectors in the past months (Oil, Consumer Staples, Healthcare, Real Estate, Telecom and Utilities) and is almost back to an all-time high.

EUROPEAN CYCLICALS VS DEFENSIVES – ALMOST TO ALL-TIME HIGH



EUROPEAN CYCLICALS VS DEFENSIVES – DISCOUNTING A HIGHER PMI

European markets are pricing in a return of the Eurozone Manufacturing PMI to 55 (from 46 now). The last time there was such a degree of dislocation between the market vs PMIs was in 2006/7. Again, US-China trade deal is critical to confirm this positive trend.

We should continue to monitor the PMI components in order to better understand if this recent move could go ahead further. We suspect most of the recent factor turmoil has to be related with excessive positioning, as we have mentioned over the last newsletter.

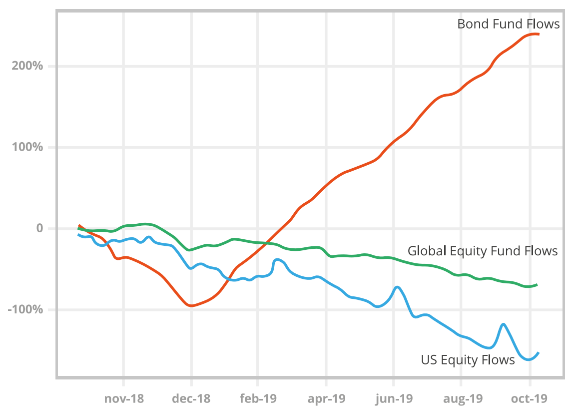
An easy comparison YoY points to a continued positive data trajectory into the first quarter. Global manufacturing PMI improved for the first time in seven months in a broad-based manner, with 57% of the economies reporting an improvement for November.

It is interesting to note that historical relationships between those leading markets, manufacturing data, and global bond yields suggest yields are likely to rise in the months ahead.

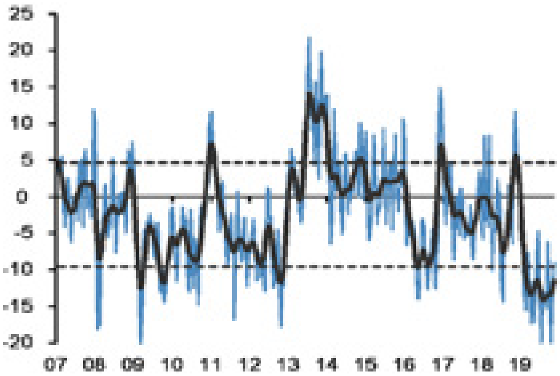
<u>In terms of market positioning, we have continued witnessing inflows into Bonds while, on Equities, after a few week small inflows, we have yet to prove that the situation has changed.</u> Ytd there have been a combined $147 billion in US equity fund outflows, (of which $100 billion alone in Europe), $47 billion in international equity fund redemptions, and $386 billion in bond fund inflows.

The most recent data are showing a stabilization on European equities flows, after 85 consecutive weeks of outflows while US equity fund flows have started to be net negative in spite of rising markets.

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



**EQUITY VS BOND FLOWS
DIFFERENCE BETWEEN FLOWS INTO EQUITY AND BOND FUNDS**



In fact, the chart highlights how little traditional fundamental investors have been driving the market in 2019. Equity flows and performance have decoupled Ytd.

DM EQUITY FUND FLOWS (LIGHT) VS MSCI WORLD PERFORMANCE (DARK)

One of the major flow puzzles of this year has been the extremely cautious stance of retail investors. Despite the strength of the equity market this year, retail investors have been unwilling to participate in the equity rally. In fact, they have acted as a drag for equity markets so far this year by selling equity funds in the worst outflow for a calendar year since the financial crisis of 2008.

Cash and bonds yield significantly less than before and significantly less than equities, following this year's rate cuts by central banks, <u>so if cyclical or policy risks recede into 2020, it would be difficult for asset allocators not to accept higher equity weightings, perhaps even higher than those seen at the peaks of previous equity cycles.</u>

By contrast, bond overweight among global non-bank investors are markedly higher, suggesting a greater vulnerability in the event a "Phase 1" agreement is reached.

ISM MANUFACTURING PMI – CHINA MANUFACTURING PMI

As the market is uncertain about the potential roll-back of the tariffs planned for December 15, the latest official PMI surveys of manufacturing suggest that American producers are losing the trade war so far.

The spread of the ISM US purchasing manager index over the Chinese equivalent (where both are set with 50 as the dividing line between expansion and contraction) shows the worst relative performance in a decade.

<u>Is Europe likely to outperform US in 2020?</u> It is always a difficult question as Macro picture and earnings have a different pace, but

it is also true that European equities are becoming increasingly attractive with some key catalysts emerging like a drop of political uncertainty, valuations and positioning/flows.

In term of positioning it is also worth to highlight that Systematic funds continue adding positions while leverage is increasing.

Global CTA funds equity leverage has now reached the 83th percentile since 2011, while Volatility Target have reached their 80th percentile. These levels are the highest since June last year.

Just to give you an idea of their recent daily buying interest, it is estimated that over the last couple of weeks of November, the combined buying interest of Volatility Target funds ($450 billion AuM), Risk Parity ($500 billion AuM) and CTAs was an $8/10 billion of daily equity purchases. Considering their current weight, it is not difficult to predict that their buying contribution should slowdown.

At the same time, the amount of puts on Eurostoxx has decreased from a 2-year high in September to a very low level at the end of November with the Put/Call ratio that has gone below 0.5x, the lowest reading over the last few years.

While the S&P had a pull-back of just 6.8% peak to trough in 2019, (one of the smallest in recent memory), we have already highlighted over the last newsletter how the different sentiment indicators were overheated and how volatility was too low showing a very complacent market.

<u>We said already last month that “there was little room for a negative surprise from these levels” and as always happens, a few-day correction could easily erase the little gains made in a long time.</u>

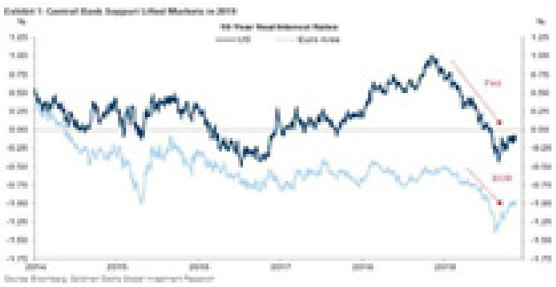
A complicated and volatile geopolitical landscape has added further complexity to investors’ decision-making and a potential near-term reduction of geopolitical uncertainty wouldn’t negate concerns around the increasingly late cycle nature of the global economy and more immediate risks of a spate of further earning downgrades.

While we appreciate a better than expected Q3 earning season and 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.

Central Banks

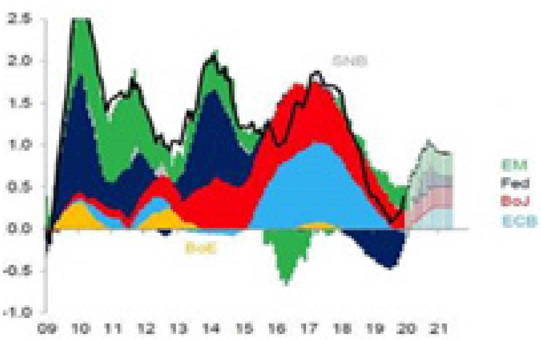
Central Banks are sustaining the market. Without the tailwinds from the Fed (and the ECB) easing, the upside in markets is likely to be more limited.

US 10Y REAL RATES (BLUE) VS EU 10Y REAL RATES (LIGHT)



The chart underneath shows a projection from Citigroup for total Central Bank purchases in 2020 and 2021, the current situation seems just the beginning of a new trend higher that will last for most of 2020.

TOTAL CENTRAL BANK PURCHASES



The **FED** has reduced the balance sheet by $4.5 trillion in just 18 months from 2018 to 2019 ($40 billion per month), while over the last months (because of "Non-QE" on Repo's tensions) has re-expanded the balance sheet above $4 trillion ($120 billion per month).

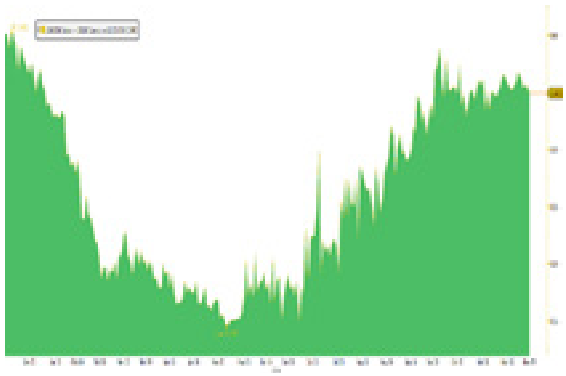
Interestingly, the Fed added $19.6 billion to the Fed's not-QE balance sheet last week making the total to $270.4 billion from the 11th of September, with an average of $5.87 billion a day vs. an average of $2.79 billion a day during QE3 (buying more than double).

The Fed intervention, which will inject liquidity into the system for the next 6 months, has caused the acceleration in US money supply over the recent weeks.

As far as the **US Repo crisis** is concerned, let's briefly recap the latest moves of Powell: 17 September, Fed starts to inject $53Bln, then $75Bln per day in the short-term funding market, after the Repo rate skyrocketed up to 10%; 24 October, Fed increases daily liquidity from $75Bln to $120Bln, provides 14-day repo and starts to purchase $60Bln T-Bills per month; 25 November, although the Fed injects daily liquidity and increases repo-operations, liquidity problems still arise.

The worrying situation is that despite the important efforts by the Fed, the LIBOR / OIS spread has continued to widen as shown on the chart.

3-MONTH LIBOR/OIS SPREAD



The LIBOR-OIS spread consists of LIBOR, which represents the interest rate at which banks may borrow unsecured funds within the interbank market, and the Overnight Index Swap Rate (OIS).

The OIS is the fair, fixed coupon for an interest rate swap in which the floating leg is linked to the Fed Funds Effective Rate.

LIBOR-OIS spread is referenced when gaging cash scarcity among banks, as well as bank credit risk. And, more importantly, with year's end approaching, corporate taxes deadline, regulatory issues and further US treasury issuance will dry liquidity from the market.

The **ECB** has resumed its Quantitative Easing from November at a rate of €20 billion for as long as necessary. It seems that the ECB has been more skewed to buying Corporates than Sovereign/ Covered bonds.

ECB WEEKLY NET PURCHASES

Ultimately, we should see the ECB owning the bulk of the Eurozone-domiciled Corporate market.

Next ECB meeting on December 12 is likely to be a non-event. Given the lack of any easing signal and the time it takes the ECB to build a consensus, (many ECB members do not like sub-zero rate policies), it's increasingly difficult to see the ECB cutting in December.

The **PBOC** has not formally restated QE yet, but it is injecting liquidity in the market through one-off open market operations (most recent 7-day reverse repo of Yuan 120 billion and Yuan 180 billion) or cutting interest rate on 7-day repo (most recent cut from 2.55% to 2.5%).

The **BOJ** is currently adopting a different measure than QE, called yield curve control or interest rate peg to combat deflation. In addition, it is also preparing a massive fiscal stimulus of as much as JPY 10 Trillion ($90 billion), the highest in more than 5 years. Worries relate to the massive amount of government debt.

Trade War/Geopolitics

US-China Trade war: US-China relationship clearly deteriorated. It seems that there will be no "phase one" meeting until the beginning of next year. December 15 tariffs, 15% levies on $160 billion of Chinese imports, are looming. No decision has been taken so far. If tariffs were to implemented, it would be a strong hit to market consensus (remember, December 15 tariffs would seriously harm US consumers as well).

Until a week ago, Chinese seemed to be pretty open to a deal, wanted to avoid a trade war but vowed to retaliate if necessary. Liu He, senior government executive, was "cautiously optimistic" while Xi Ping, Chinese president, said "we want to work for a 'phase one' agreement on the basis of mutual respect and equality". In addition, China promised to raise penalties on violations of intellectual property rights in an attempt to address one of the sticking points in trade talks.

Then something happened. Trump signed the Hong Kong Human Rights and Democracy Act bill. According to this pro-democracy law, the US should examine annually Hong Kong's status and impose sanctions on anyone who has suppressed human rights, a clear limitation to Chinese authorities. Furthermore, the US House of Representatives approved a bill pro-Uighur minority which would impose sanctions on Chinese officials over human rights abuses against Muslim minorities.

The situation remains very complex. Now, the market is very volatile on tweets and rumors. After the tariff man said that he was in no hurry for trade deal, according to the most recent headline US and China are moving closer to deal despite heated rhetoric.

Latam Trade war: Trump set to to reinstate tariffs on steel and aluminum from Argentina and Brazil, mainly because both states cheapened their currencies too much, harming US farmers. Both Brazil and Argentina were exempted from 25% steel and 10% aluminum tariffs last year when Trump was attempting to avoid a trade war with those countries.

Europe Trade war: The US department of trade representative set to impose taxes on $2.4 Billion of French good, mainly wine and cheese. This move is coming into retaliation to the proposed France's digital service tax which discriminates against US companies such as Google, Apple, Facebook, Amazon etc.

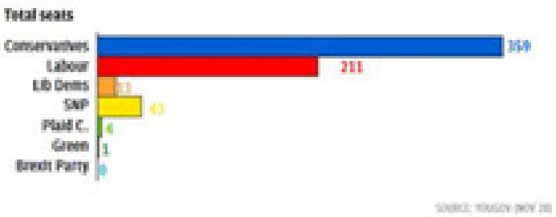
For the same reason Trump is also considering to tax a still-undefined amount of goods from Turkey, Italy and Austria. Here the problem seems to be more European than Country-specific; the European Union has long debated about tax evasion from Dublin/Luxembourg-based US tech giants.

Brexit: it's all about the upcoming election, December 12, the third election since 2015. The market is hoping for a Boris Johnson victory that would be leading to a smooth orderly exit (bullish for sterling and domestic UK).

The UK has a "first past the post" voting system, which allows the parties with below 50% of the national vote to take power. The candidate with the most votes in each constituency is elected to the House of Commons, and any party with a majority of MPs in the House forms the government.

So far, a Conservative majority still looks likely. According to the most recent YouGov MRP poll, 68 seat majority is indicated for the Conservative party.

YOUGOV MRP POLL



Executive Summary

Over the last newsletter, we warned investors to start being more cautious as the market was "priced for perfection", valuations were stretched (in just 11 months, S&P forward P/E going from 13.5x to 18x and MSCI World to 16x), positioning was no longer as light as over the last summer and there was too much complacency measured through volatility and different sentiment indicators.

As it happens always, it didn't take long for a quick market adjustment. In just two days we had more than erased the November gains.

Even on the Macro side, we have been right calling for a stabilization but the market has possibly gone too ahead of itself as, aside from a small tick up in PMI's, data remains lackluster and most forward-looking indicators are still weak while backward-looking indicators such as employment and consumption are still strong.

<u>Looking at 2020, the situation seems to be quite favorable for Equities at least in H1 but we would progressively be more cautious on equities for the second part of the year</u> while on Bonds we are keen to strategically invest on names linked to inflation and low duration. <u>As you know, we have already 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.</u>

Despite the rally, 2019 has clearly been a "risk-off" year. Globally, Ytd flows amount to $553 billion into cash positions, $353 billion into credit, $51 billion into government bonds, and $188 billion went out of equity funds.

We would therefore accumulate Equity exposure on the downside as it is very unlikely to witness a US recession in H1. Further, the TINA factor (There Is No Alternative) is going to push for some equity inflows. Earnings are possibly not going to be as strong as the consensus is now expecting, but there will be a bottoming out phase which is enough to avoid major disappointments. PMIs are expected to rebound and the positive impact from recent Fed cuts and global Central Banks is likely to filter into the economy in H1. Let's not forget that 2020 is the US election year and markets typically advanced strongly in the run-up to the presidential elections.

We should not expect a significant economic growth and Governments are unlikely to be able to use fiscal capacity and stimulate domestic spending. Lower activity growth is not going to drive wage growth and consequently suppress core inflation.

Political noise, a complicated Trade-war deal and new elections risk with fragile coalitions in Germany, Italy and Spain cannot be ignored and are likely to fuel a much higher volatility of what we witnessed this year.

With credit so expensive, sovereign bonds provide much better protection than corporate bonds against the anticipated higher volatility in equities.

After an easy year, asset allocators are going to have few difficulties 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.

As we mentioned over the last newsletter, 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 traditional schemes.

Of course, a positive de-escalation of the two extreme risks for global markets, respectively the trade war and no-deal Brexit, and their positive externalities on the real economy, will probably be the most important market drivers in the early part of 2020. Relief on those two fronts could lead to a further reallocation from bonds to equities, and reinvestment in Asia and China.

A final consideration on Bonds as all the policy stimulus into the bond market seem to have reached the top. One of the signatures of this potential "Bond bubble" is the price insensitive buyers and at the top of the list, of course, we find the different Central Banks. This is the area where we would focus our fears as it could potentially generate a serious risk off.

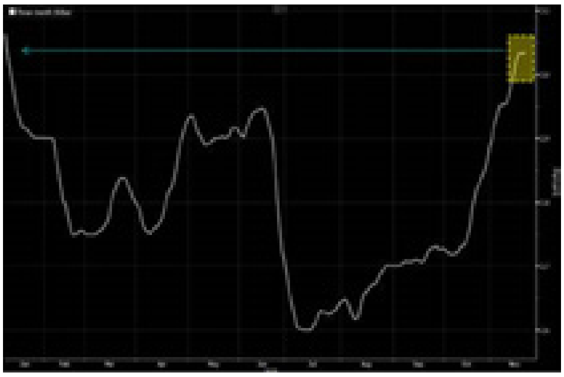
Let's now analyze the **current positive vs negative factors for the market** (please note that these factors are not all comparable in terms of timing, some factors are short-term while others mid to long-term oriented):

POSITIVE FACTORS (8):

- **Central Banks trying to stabilize global growth** and sustaining equity markets. Global Central Banks are having the most synchronized global easing cycle in a decade with the majority of Central Banks participating. The only difference vs the past is that this time the stock market is close to an all-time high.

% CENTRAL BANKS CUTTING RATES

3-MONTH SHIBOR



The latest help is coming from China where the PBOC is trying to stimulate the economy, lowering the LPR (loan prime rate) but as you can spot from the chart, the 3-Month interbank borrowing costs, known as Shibor, climbed to its highest since January.

The actual combined effect of FED, ECB, PBOC and BOJ since October is very powerful now and is helping the markets to continue trending higher to new highs every day.

The balance sheet of the major central banks rose to levels never seen before, with the Bank of Japan at 100% of the country's GDP, the ECB at 40% and the Federal Reserve above 20%.

- **Macro numbers getting better from very deep levels**: we started paying attention to this point already 3 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.

  Global manufacturing PMI improved for the first time in seven months in a broad-based manner, with 57% of the economies reporting an improvement for November.

MSCI WORLD (LIGHT) VS YOY CHANGE GLOBAL PMI (DARK)

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.

Equities appear to be pricing in a 2-point increase in the global PMI already.

Growth rates have been coming down pretty much across the board. Look at Apple's numbers for example where annual gross profits are down over the past 12 months, yet the stock is up 64% Ytd.

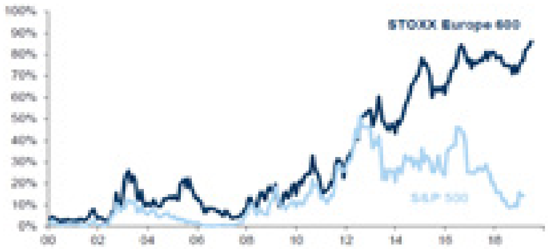
- **Attractiveness of Equities (TINA)**: as flagged several times, there is a massive amount of liquidity on the market. Negative-yielding debt makes up 25% of global debt, with the Euro area driving the most recent rise in negative-yielding assets. In contrast, the earning yield on SXXP is above 7% 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.

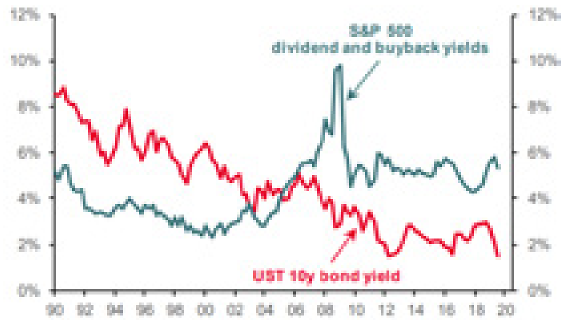
  The S&P 500 dividend and buyback yield is at 5.3%, vs the 10y UST's yield of 1.7%: the spread of 3.6pp is, for now, acting like a support for the S&P 500.

  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)



S&P DIVIDEND/BUYBACK YIELDS (GREEN) VS. US 10Y YIELD (RED)



The gap between equity dividend yields and bond yields across key regions is at present much larger than typical.

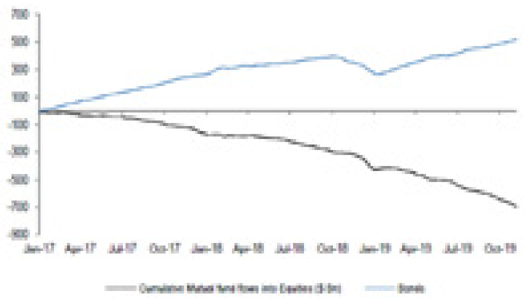
	Dividend yield	10Y Bond yield	DY minus BY	Average since '00	Gap (bp)
US	1.9%	1.9%	0.0%	-1.5%	152
Japan	2.3%	0.0%	2.4%	0.7%	171
Eurozone	3.2%	0.0%	3.2%	0.2%	301
UK	4.6%	0.8%	3.9%	0.3%	359

Source: Datastream

- **Positioning / Flows**: aggregate investor positioning is not as cautious as it used to be this year. According to EPFR data, there has been $149 billion of outflows from European equities over the last 3 years, equivalent to 12% of AUM.

  According to ICI data, US bond mutual fund inflows have totalled over $500 billion since January '17. Over the same period equity-focused US mutual funds have witnessed outflows to the tune of $700 billion.

MUTUAL FUND FLOWS IN EQUITIES (GREY) VS FLOWS IN BONDS (BLUE)

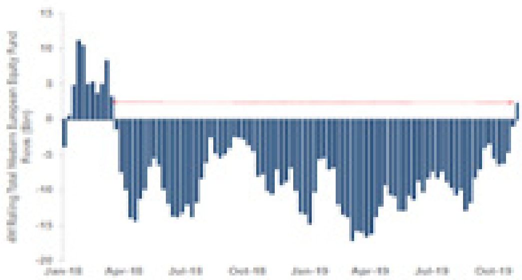


Important to note that despite the very strong equity markets, money continues to pour into money-market funds, with assets standing at $3.5 trillion now, up from $3.05 trillion at the start of the year.

The last time so much money went into cash was in 2008 as the financial crisis was heating up.

Europe has seen the largest outflows over the last two years. After 85 consecutive weeks of persistent outflows, we have now seen 1 month of inflows, supporting our view that global investors are beginning to consider increasing their (low) exposure to the region.

EUROPEAN EQUITY FUND FLOWS (HISTOGRAM)

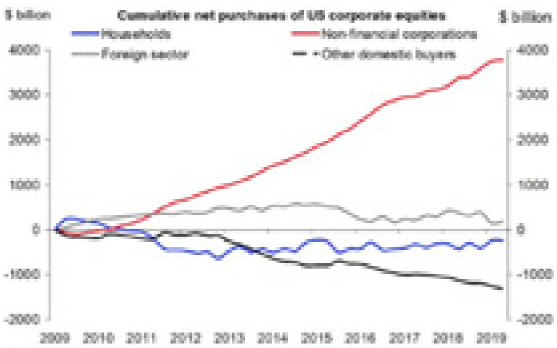


<u>We believe that over the next year we could see a period of outflows from bonds and some inflows into equities.</u>

- **Q4 reporting season not as negative** as expected as explained above.

- **Buyback should continue to support markets in 2020**: 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.

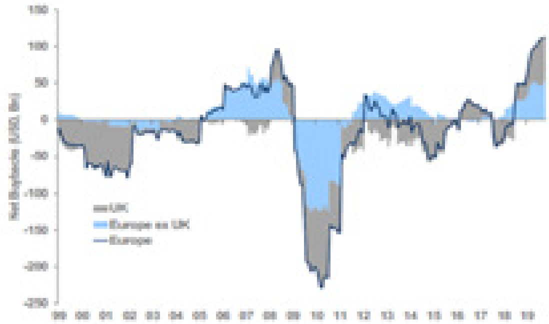
CUMULATIVE NET PURCHASES OF US CORPORATE EQUITIES



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 but it is still a very important factor for markets as the buyback effect as been one of the biggest drivers of the rally on equities since 2009 as shown on the chart.

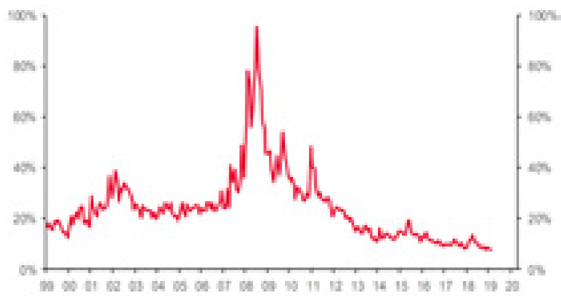
European net buybacks have already reached a record high, and European Private Equity activity recently reached its highest level in a decade. Other M&A activity has been very muted, but a modest improvement in the earnings backdrop and reduced European political risk suggest plenty of scope for this to increase.

NET BUYBACKS $ BILLION UK (GREY) VS EUROPE (BLUE)



Furthermore, the lack of market liquidity, as measured by S&P 500 turnover (the ratio of trading volume vs free float market capitalization) has exacerbated the impact of share repurchases on US equities. Trading volume has been on a downtrend since 2008, and we expect this to continue.

US TRADING VOLUME



Reduced trading liquidity in US equites for the S&P, an all-time low!

A recent analysis from JPMorgan is showing that just 10% of US equity markets' trading volumes now comes from fundamental stock investors with most of the rest coming from index derivatives and passive funds.

- **Seasonality**: looking back over the past 10 years, December and January have been historically a two very positive months.

- **Global M&A**: Since our last meeting we saw an intense M&A activity in Europe and US:
  Proposed deal value of $30Bln, Sanofi, healthcare sector, is considering to sell its consumer-health business.
  Proposed deal value of $26Bln, Charles Schwab, US financial services sector, announced the acquisition of TD Ameritrade, US competitor.
  Proposed deal value of $18Bln, Louis Vuitton, luxury sector, announced the acquisition of Tiffany, jewelry specialist.
  Proposed deal value of $7.5Bln, Novartis, healthcare sector, announced the acquisition of The Medicines, US biotech.
  Proposed deal value of $5.3Bln, Aroundtown, European Real Estate, announced the acquisition of TLG Immobilien, German competitor, to create the biggest Germany's commercial landlord.

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.

Weakness is seen on other important areas which are not shown on main economic indicators.

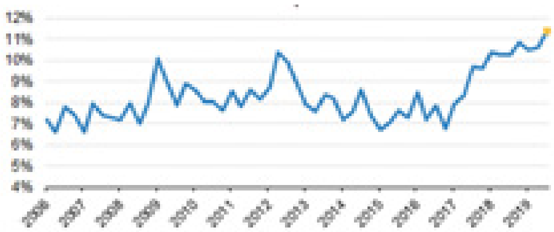
- **Poor Technical**: bearish shooting star signal showed that a bearish technical pattern was possible in the short run. Also combine this with stretched sentiment measures and increased equity positioning (US Street Prime Brokerage nets in 94%-tile on 12-month basis). As we said over our last updates, positioning has been shifting from light to heavier.

- **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.

  We showed over last newsletter the chart of the S&P vs the Put/Call ratio indicating that was the lowest level since January 2018 indicating a potential top for the markets.

The same message was given by the record number of short contracts on the Volatility Index.

HEDGE FUND CROWDING

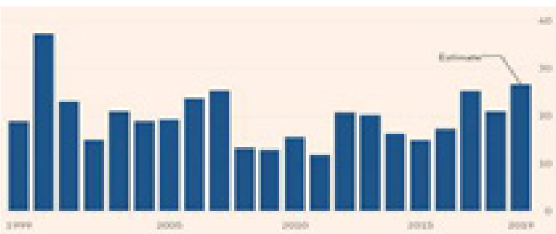


Another important aspect is about crowding. Look for example at the recent statistics about crowding between Hedge Funds which is at an historical high.

This means that most Hedge Funds have a similar portfolio and if there is a de-risking, only few funds could lead to a contagion like negative feedback.

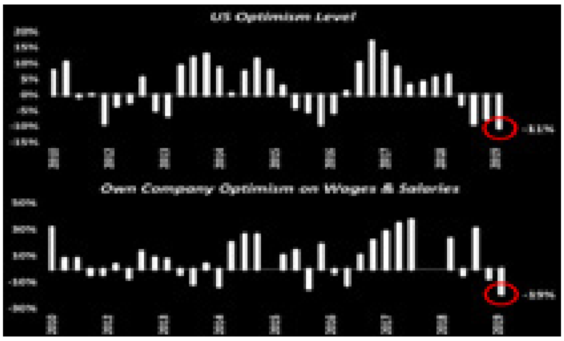
- **Insider sellers / CEO – CFO surveys**: executives across the US are selling stocks in their own companies at the fastest pace in 20 years on concerns that the long-lasting bull market is reaching its final stages. They are selling at a strong pace with a possible number at the end of year close to $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. Ability of Governments to urge companies doing things they don't want to do is limited.

- **Some concerns on 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.

  While we had record online sales for Thanksgiving/Cyber-Monday, we have also recently witnessed some profit warnings on US major listed retailers.

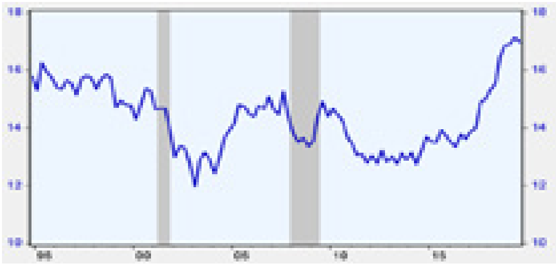
  And yet large commercial banks indicate that their consumer finance arm shows a "healthy consumer".

  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.

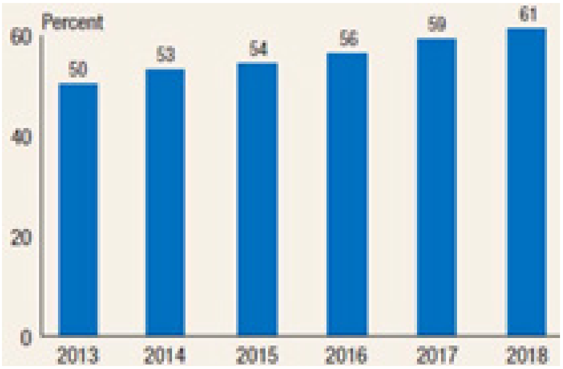
  On the surface, the growth of consumer borrowing is not excessive, <u>but what is excessive is how much it costs consumers to borrow.</u> Personal loan rates at commercial banks stand at 10%, and average credit card rates stand at 17%, at 25-year highs.

  In 2018, the percentage of people that would cover 400$ of emergency expenses using a credit card has increased to 61% from 50% in 2013.

COMMERCIAL BANKS ASSESSED INTEREST RATE ON CREDIT CARDS

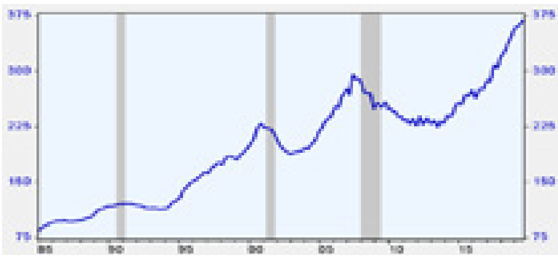


% PEOPLE COVERING 400$ EMERGENCY EXPENSE USING LEVERAGE



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 drying the "spending power" 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.

At the same time, Auto Loans delinquencies have reached a 7-year high.

% AUTO DELINQUENT AUTO LOANS

Us consumer is still strong but there are reason to expect that strength to slacken. There are signs of dancer in corners of the market and this measure, like so many others, suggests a danger for next year's elections.

- **IPOs**: investors had extremely difficult time stomaching big IPOs 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%.

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 12%! Among others, Lyft and Uber are down 30% since they listing (respectively in March and May).

The biggest IPO in history, Saudi Aramco, should complete its pricing procedure on December 5. Net profit would be the same we had in 2018 for Apple, Alphabet and Exxon Mobil. 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.

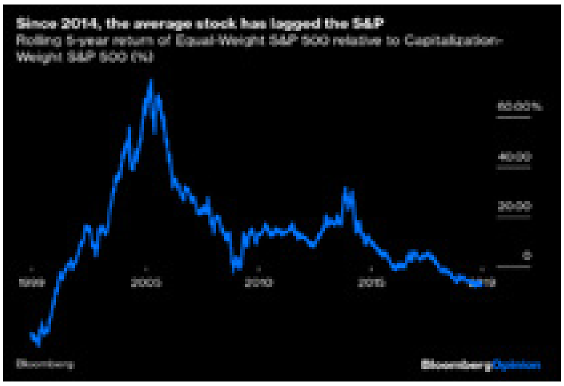
- **Market concentration/liquidity**: the Dax is now up more than 24% YTD and despite this move, the market value of all listed German companies, at $2.2 trillion, is smaller than that of the 2 largest US corporations. Apple and Microsoft have a combined market Capitalization of $2.25 trillion.

In US, it should not be a surprise that leading Tech are the most contributing, considering that Apple up 66% YTD, Facebook up 52% YTD and Microsoft up 47% YTD. Just two companies (Apple + Microsoft) are now worth almost as much as the entire Russell 2000 Index of Small Caps.

Since 2014, the average stock has lagged the S&P. The chart is showing the rolling 5-year performance of the equal weighted Index vs the main Index. When it is below 0 it means that the average stock is doing worse than the Index. Not an easy environment for Active Managers.

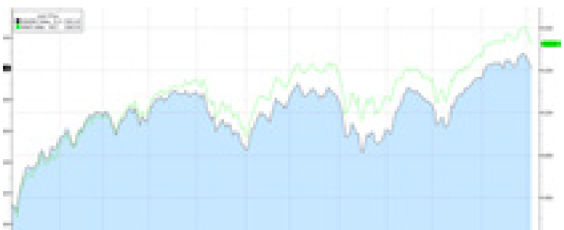
It is not rhetoric when Active Managers complain about the difficulty of this year.

ROLLING 5-YEAR RETURN OF EQUAL WEIGHT S&P500 VS CAPITALIZATION-WEIGHT S&P500 (%)



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?

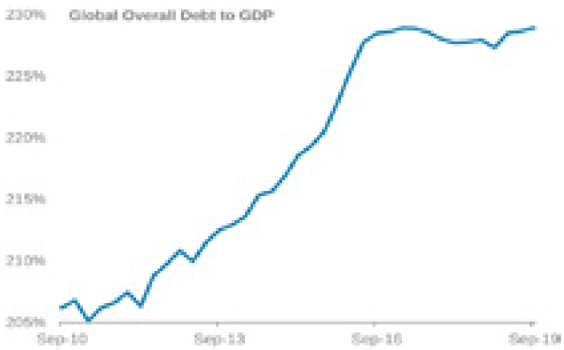
MSCI WORLD EQUAL WEIGHTED (BLACK) VS MSCI WORLD (GREEN)



- **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.

We saw some recent statistics on global debt which got us scarred. **Global debt will hit $255 trillion by the end of 2019**. Just for your information, 2018 US dollar GDP accounted for $20.5 trillion, while China dollar GDP around $14 trillion. Over the last 9 months, global debt surged by $7.5 trillion, of which China and US accounted for 60% of the increase (US deficit to increase further). Eventually, Emerging market debt hit a new record high of $71.4 trillion (220% of EM GDP).

GLOBAL OVERALL DEBT TO GDP



A decade of easy money has left the world with a record $250 trillion of government, corporate and household debt. That's almost three times global economic output and equates to about $32,500 for every man, woman and child on earth.

The Global debt to Gdp ratio has continued to rise reaching 230%, the same all-time high levels seen in Q1 2017.

IMF recently warned that $19 trillion, almost 40% of global corporate debt are at risk of default in case of a massive crisis.

American companies alone account for around 70% of this year's total corporate defaults even amid a record economic expansion. And in China, companies defaulting in the onshore market are likely to hit a record next year, according to S&P Global Ratings.

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. The difference between BBB and BB US corporate bond spreads collapsed further as investors continued chasing yield in the highest-rated junk bonds. The compression is making it, such that investors may have to start reaching even further down the ratings spectrum to find value.

BBB is the last credit rating before an issuer is kicked out of the Investment Grade bond index. Being removed from IG and getting delegated to the High-Yield (HY) index is like getting sent down to the minors, your debt costs rise and the available pool of buyers shrinks.

In practical terms, once this happens, index-based investors, that can't own HY by mandate, typically have to dispose of the bonds. If only two rating agencies rate the security and one of them downgrades to HY, then some mandates may also have to sell.

Over the past year, triple BBB issuers have done a remarkable job of dealing with market participants' concerns but the longer this BBB bid lingers, the bigger will be the ultimate problem.

When the next recession occurs, a significant portion of this debt will be downgraded to junk. Credit spreads for this debt will rise because of the deterioration in quality. Forced selling will generate significant congestion within the corporate debt market.

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).

The junk-rated leverage loan market alone, currently $1.2 trillion, starts seeing its first signs of a massive debacle.

Macro

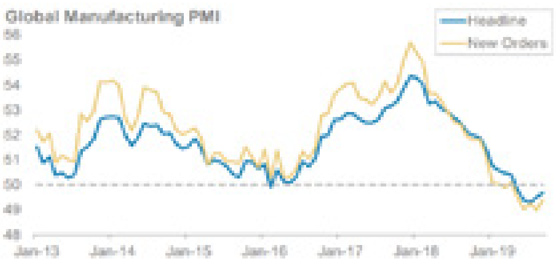
There is a re-pricing in growth expectations with Macro numbers improving but still weak on historical average.

The key takeaway from November PMIs data is that forward-looking components look healthier.

The global economy needs a sustained period of improving Macro numbers to support higher interest rates and momentum in global growth. We are still quite far from saying that the worst is behind.

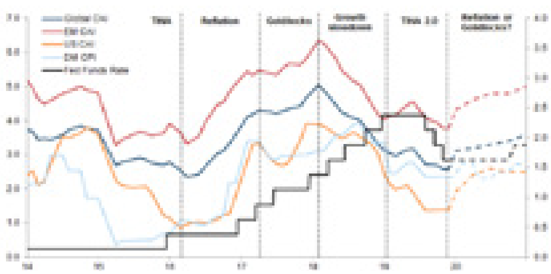
Although the Street consensus currently sees a rebound in Q1 2020 (chart), mainly buoyed by Emerging markets, Central Bank easing effects, and trough in global manufacturing, we believe the US-China trade deal's outcome (tariffs removal) will be critical for a positive outlook in 2020.

GLOBAL MANUFACTURING PMI CYCLE HAS STARTED TO TROUGH HEADLINE PMI (BLUE) VS NEW ORDERS (YELLOW)



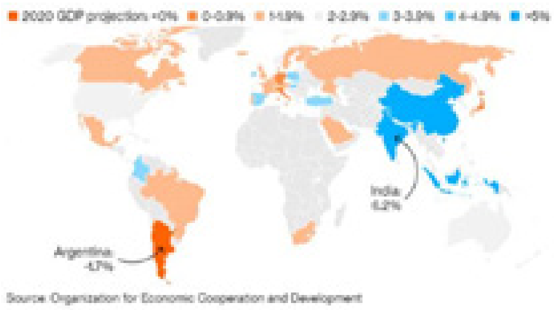
Interestingly, several OECD executives are warning that current global synchronized monetary and fiscal stimulus may not be enough to prevent a massive crisis in the next decade. The point here is that the US-China trade war, the global slowdown, low/negative interest rates etc. are just small parts of more systemic challenges from climate change, to technology, and new shifts in the global order.

AFTER 2 YEARS OF SLOWING GLOBAL GROWTH THE STREET EXPECTS A PICK-UP IN Q1 2020



Central Banks seem to be more concerned to fix cyclical issues now, rather than addressing much more important structural changes in the future. In the short run, the OECD sees global growth stuck at 2.9% in 2019/20, rising slightly to 3% in 2021.

GLOBAL GDP PROJECTIONS



Europe
Still weak...

Positive
Q3 Germany GDP QoQ 8bps vs -10bps consensus (no technical recession, still very weak)
Q3 Euro-area GDP YoY 1.2% vs 1.1% consensus
Nov. Markit Spain/Italy/France/UK manufacturing PMI all above consensus
Nov. Markit Germany manufacturing PMI 44.1 vs 43.8 consensus (still contraction)
Nov. Markit Germany/Eurozone services and

composite PMI all above consensus

Negative

Nov. Zew survey current situation -24.7 vs -22 consensus
Nov. Germany IFO expectations 92.1 vs 92.5 consensus
Nov. Markit Italy/France services and composite PMI all below consensus

US

Some mixed numbers, although consumer spending remains strong…Among main risks, weakness spreading from manufacturing to services…Remember spending is the principal component of US GDP, approx. 60%.

Positive

Q3 GDP revision QoQ 2.1% vs 1.9% consensus
Nov. manufacturing PMI 52.6 vs 52.2 consensus/prior
Oct. Durable orders 0.6% vs -0.9% consensus
Oct. Capital goods orders 1.2% vs -0.2% consensus
Oct. Retail Sales 0.3% vs 0.2% consensus

Negative

Nov. ISM manufacturing 48.1 vs 49.2 consensus
Nov. ISM employment/price paid/new orders all lower than consensus
Nov. Empire manufacturing 2.9 vs 6 consensus
Nov. Consumer confidence 125.5 vs 127 consensus
Nov. ADP Employment change 67k vs 135k consensus

China

Chinese real GDP growth has slowed to the lowest level in almost 30 years. After months of weakness, November saw a rebound…Undoubtedly, 2020 outlook remains strongly related to the trade war saga's outcome

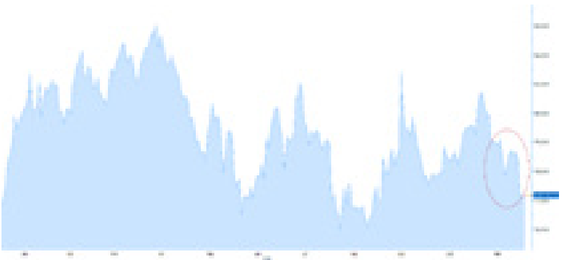
Positive

Nov. manufacturing PMI 50.2 vs 49.5 consensus (expansionary, 1st time in 7 months)
Nov. Non-manufacturing PMI 54.4 vs 53.1 consensus
Nov. Caixin manufacturing PMI 51.8 vs 51.5 consensus
Nov. Caixin China services PMI 53.5 vs 51.2 consensus (the highest reading since April 2019)
Nov. Caixin China composite PMI 53.2 vs 52 prior

Commodities

We are still **neutral-positioned** in the short-mid run until we see further confirmation of growth.

BLOOMBERG COMMODITY INDEX



Since our last update 13/11, the Bloomberg Commodity index is down 1.5%, almost flat-tish year-to-date, with a 6% drawdown since its April highs. Among its main detractors (index weight order), Corn -2%, Natural Gas -8%, Soybean -4%.

Interestingly, Gold lost 3.3% in November, the most since 2016, mainly due to investor risk-on mood (trade war de-escalation), lift in interest rates (inverse correlation), stronger dollar and too crowded long positioning.

Again, we would like to remark that 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 gold is down 4%. So far, we are waiting for a more favorable entry point, around 1450$ level in order to re-build a position. As previously stated, gold is a must-to-own asset class for the next year as well.

Oil

We maintain our neutral-stance. Still one of the best asset class year-to-date with WTI +28% and Brent +17%.

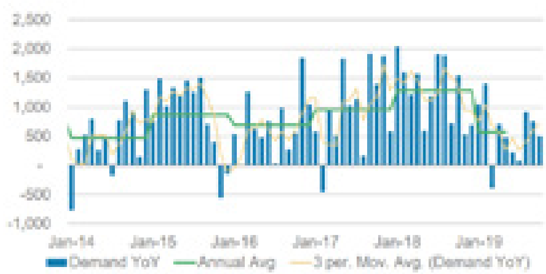
November's positive performance, +1.85%, was mainly driven by rising interest rates, reflation and renewed trade optimism between US and China.

We saw some steep drawdowns during the month following larger EIA/API inventories and increased Geopolitical tensions. On November 29, oil lost 5%, the most in more than two months, amid rumors that OPEC and its allied were not cutting output at the December meeting.

Interestingly, the US became net exporter in September for first time in decades (since the 1940s). US exported 89,000 more barrels of crude oil and refined petroleum products a day than it imported.

During the December 5/6 meeting, OPEC+ should decide the optimal production target. It seems that Iraq and some other oil-exporting nations will support deeper production cuts, increasing the current 1.2 million barrel a day to 1.6 million barrel a day. And it's also a very convenient move for Saudi Arabia as Aramco, the Gulf energy giant, will probably complete its initial public offering at the top end of a marketed range on December 5 (expected to become the largest IPO ever). In favor of the opposite thesis, there is no urgency in extending the cuts which are set to run through 31 March 2020. The major oil producers could suggest to wait for the end of the cuts to decide the appropriate next steps, a position supported by Russia, as there is a lot of uncertainty on the state of Q2 oil balance. In addition, several OPEC+ members are not complying with previous quota limits (Nigeria, Iraq and Kazakhstan), along with Russia, which is pumping more than pledged.

OIL GLOBAL DEMAND HAS BEEN SLOWING...

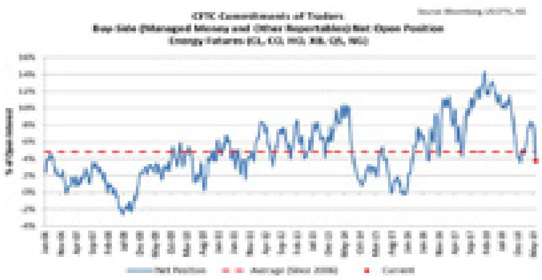


CHINA IS CURRENTLY LEADING TOTAL OIL DEMAND...

The buy-side bought $6.6 billion notional across the major hydrocarbon futures, primarily driven by adding new longs in Brent, Heating Oil, and RBOB Gasoline futures and covering notable shorts in WTI and Gasoil futures.

As a % of total open interest, this was the largest weekly buying from the buy-side in hydrocarbon futures since the week ended Tuesday, September 10th, 2019 (and August 1st, 2017 before that).

POSITIONING HYDROCARBON FUTURES AND OPTIONS

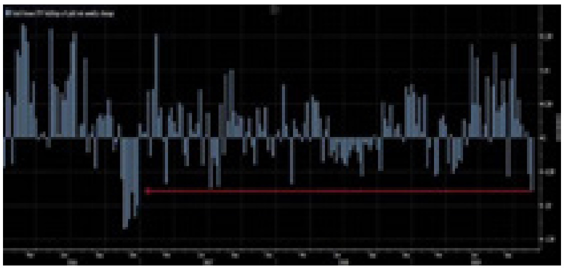


Gold

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 September, gold price is down 4%. 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 15% and silver up 10% 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%.

ETF HOLDINGS OF GOLD NET WEEKLY CHANGE



As we mentioned previously, the market was too long consensus gold and positioning was too heavy.

The buy-side liquidated $5.3 billion notional of longs through futures last weeks and their current net long position is now the smallest it has been since June 2019.

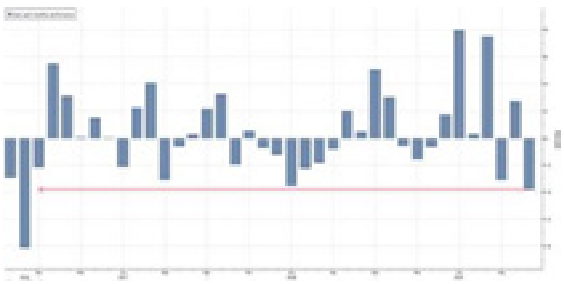
As a % of total open interest, the buy-side's net long position in Gold futures is now 0.6 z-scores greater than average since 2006.

A similar move could be seen on ETFs where holdings has been reduced by 788,065 ounces last week, the biggest drop in volume terms since December 2016! The gold ETF holdings had hit their highest level in more than six years just before the decline and as you know we were predicting a retracement as positioning was too crowded.

Also note that gold has started with a weak note even in December extending a retreat from a six-year high set in September. We would continue to accumulate on further weakness.

As extensively discussed in our previous updates, precious metals are becoming a powerful tool for Central banks.

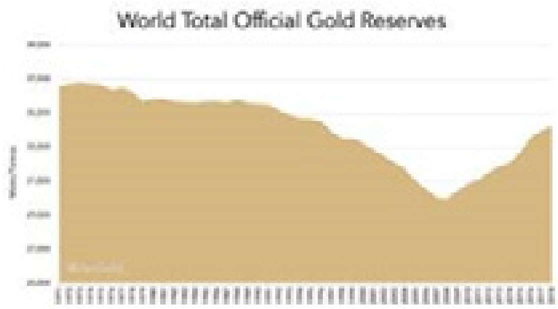
GOLD MOM PERFORMANCE, NOV. STEEPEST LOSS SINCE 2016



Since the Great Financial crisis, 2008, there has been a renewed interest in gold from reserve managers. At the end of H1 2018 Central banks collectively owned US$1.36 trillion of gold, around 10% of global FX reserves among which China and Russia are some of the most important net buyers. Interestingly, gold demand has skyrocketed since the most recent crisis (chart).

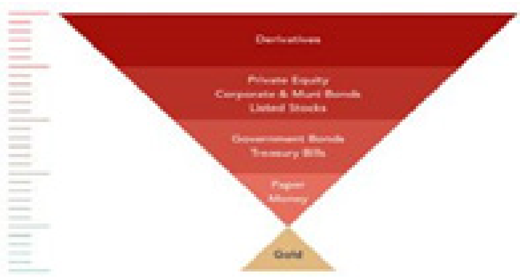
According to some researchers, when the debt pyramid growths in excess and become unstable, bubbles burst. And it seems that we are on the right path as the world has never been so in debt and forecasts are for even more debt in the next decades, as we already seen.

GLOBAL GOLD RESERVES



From the riskiest to the safest asset as shown below, investors will climb down the ladder increasing holdings towards the ultimate store of value, gold. Among its main properties, it preserves its purchasing power overtime and is a global means of payment. That’s why Central Banks are accumulating tons of gold in their balance sheets.

DEBT PYRAMID



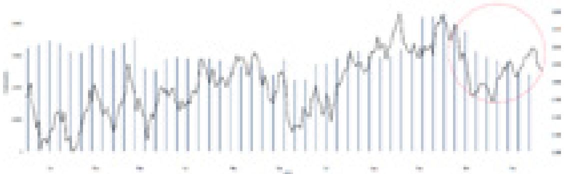
In addition, several Central Banks among which Germany, Austria, Holland are repatriating gold mainly from the Bank of England and Federal Reserves. Most of them also enhanced the entire vaulting infrastructure building new military bases and upgraded their gold stashes to current industry standards (i.e London Gold Bullion) to be able to trade frictionless if necessary.

Forex

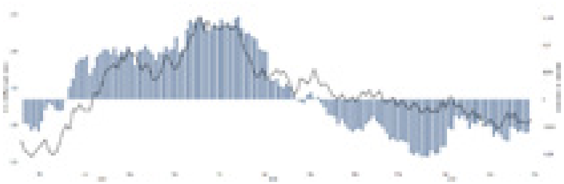
Since our last update 13/11, USD positioning has been weakening. It makes sense if we consider what we said over our previous update. The current reflation trade is pushing foreign investors to move capital out of USD-denominated into others cheaper and undervalued currencies. We still reiterate our neutral stance.

USD positioning weakening in November as well...
Euro still weak on historical average and positioning...

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

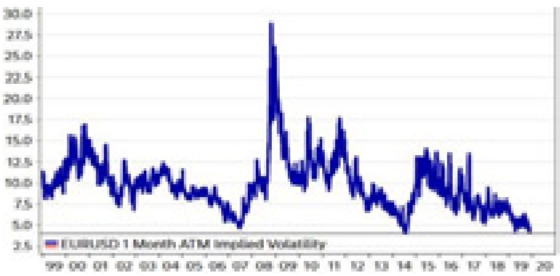


EUR FUTURE POSITIONING (HISTOGRAM) VS EUR INDEX (BLACK LINE)



EURUSD 1-month implied vol at all-time lows. We have essentially reached the point when an analysis is no longer needed. Implied vol can only go higher from here.

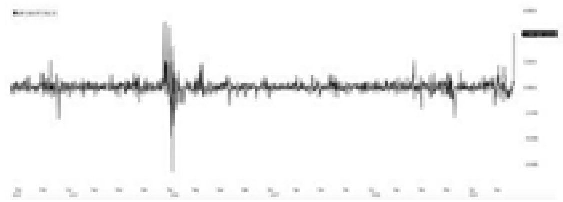
EURUSD ON-MONTH IMPLIED VOLATILITY



GBP short positioning is close to a multi-month low as elections are approaching. The market expects a Conservative victory according to future positioning. Also, interestingly, One-month implied volatility in the GBP currency has surged the most since the June 2016 Brexit referendum.

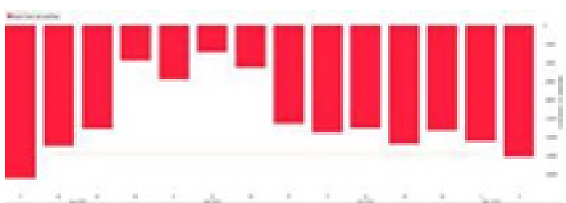
GBP FUTURE POSITIONING (HISTOGRAM) VS GBP INDEX (RED LINE)

GBP ON-MONTH IMPLIED VOLATILITY



Along with the Organization for Economic Cooperation and Development gauge of purchasing power parity, several brokers are turning cautions on the Swiss Franc, which look to many overvalued against the dollar. Interestingly, futures positioning has turned increasingly bearish since this summer. We actually believe that some consolidation could be do only in cash of an effective and solid agreement between US and China

NET SHORT POSITIONING CHF



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. It is possibly the cheapest way to follow the market in this binary environment with a very limited downside (the premium).

Long European oil sector, SXEP
The Index is back to the levels we had in mid-October, it has FCF yield for 2020 of 9% and dividend yield of 6%.

Global appetite for the sector has reached a new low and we believe that investors might have downplayed the sector in order to leave some space for the Saudi Aramco IPO.

We see the following catalysts on oil price:

1. Positive data points emerging on demand (in the context of what we have observed on the buy side as rather bearish expectations already);
2. 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;
3. 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 Banking sector, SX7E
So far European banks are up 6% year-to-date and overall European Banks are down 45% since July 2015 highs and down 36% since March 2018 highs.

The promotion of the Banking Union 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 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%.

There are no more deposit rate cuts, European curves are steepening and of course, a further macro stabilization are all positives for the sector.

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 continue increasing our long position on Gold, started around the $1450 level, using any potential deep to increase the position further.

NEW CONVICTION

Long Copper
It is the only commodity that has strong fundamentals among the base metals with a tight market poised to move higher on any demand recovery.

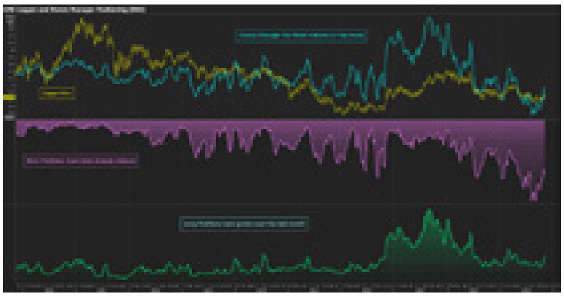
The price dropped recently despite some issues in Zambia, second-largest world producer. It is down 20% from the highs reached in June last year. The largest producer remains Chile where the anti-government protests are starting to disrupt the production and could start to pose a serious risk as multiple mine labor contract renewals are due for next year.

If Global macro will continue to improve, the short positioning on Copper will need to reverse.

Copper price will benefit from an agreement between China and US and at the moment it seem to be discounting almost no chance of an agreement if compared to other assets.

Some investors have started to go long on Copper over last month. Much of the CME short positioning this year has been driven by systematic funds.

COPPER POSITIONING
COPPER PRICE (YELLOW) VS. MONEY MANAGER NET SHORT (BLUE)
SHORT POSITIONS (PURPLE) VS LONG POSITIONS (GREEN)



It is also interesting to spot from that options are underpricing risk in the copper market making it cheap to get exposure to a sudden positive news.

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