Investment Management

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Investment Strategy Q2

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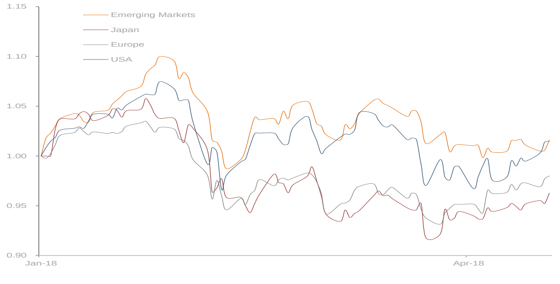
INVESTMENT TEAM PRESENTATION

	Name	Function	Professional background		Education
			In the industry	At ABS	
	Alain Dargham	Chief Investment Officer	17 years	9 years	Ph.D. in Management, Finance at IAE de Paris, France Executive MBA at IMD Business School, Switzerland
	Cyrille Flichy	Head of Investment Advisory	10 years	8 years	MSc. in Finance at Edhec Business School, France MSc. in Finance at European Business School, Germany
	Daniel Deléchat, CFA	Head of Portfolio Management	24 years	4 years	Chartered Financial Analyst
	Johnny Pugliese	Senior Portfolio Manager	28 years	7 years	International & Swiss Certificates, Switzerland
	Arnauld de Lassus	Investment Advisor	4 years	3 years	MSc. in Management - Finance Track at ESSEC Business School, France
	Anne-Lorraine de Malliard	Portfolio Manager	4 years	3 years	MSc. in Management - Real Estate Track at ESSEC Business School, France
	Wadih Manneh, CFA	Senior Portfolio Manager	19 years	2 year	Chartered Financial Analyst; MBA and BS at American University of Beirut
	Yasmina Dahlin, CFA	Investment Advisor	7 years	2 year	MSc. in Finance & BSc. in Economics, HEC Lausanne Chartered Financial Analyst
	Karl Chammas	Portfolio Manager	1 year	1 year	Master degree in Civil Engineering from Ecole Polytechnique Fédérale de Lausanne

Global stock markets

Optimism spread among investors in the first few weeks of the year. The leading US indices made new record highs supported by corporate earnings surprising to the upside. However by late January dark clouds were gathering and a thunderstrom unleashed its force upon financial markets over the ensuing two weeks. It was not that things have turned upside down overnight, in fact qualitative and quantitative measures showed an impending pullback was overdue. The rout in global capital markets was a liquidity event. The short-volatility trade blew up spectacularly. The spike in the VIX, a volatility index reflecting the markets estimate of future volatility, was the result of extreme positioning rather than fundamentals. Add to this the stronger-than-expected increase in US inflation expectations which just intensified the woes of financial markets.

MSCI World Equity Indices *(Source: Bloomberg L.P.)*



FacebookAppleNetlixGoogle

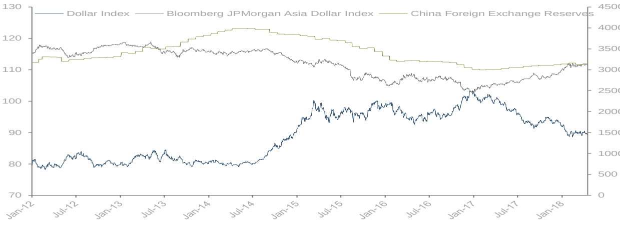
The big tech companies continue to be a dominant driver. This rise to the top by the FANG over the past ten years has been accompanied by the same rise to the top of passive investing and algorithmic strategies. This has not only caused a historic capital concentration in the tech sector, this has also created a co-dependence between the two. This is depriving some of passive investing's brilliance, where ETFs offer diversifcation. Facebook's data scandal also exposed the risks these tech giants face from political and regulatory backlash.

FacebookAppleNetflixGoogle *(Source: Bloomberg L.P.)*

The U.S. Dollar Index, China Fx Reserves

The US Dollar remains the name of the game, whether it goes up or whether it goes down for whatever reason. At the beginning of 2017 the widespread view was that the US Dollar would continue to go up on all the possible measures the new Trump administration could enact. The Dollar did the reverse of that last year. This time around many investors again would see a continuation of the prevailing trend; whereby the synchronized global growth would continue to support the rebound in the major currencies. This is, however, contrary to our view. We think that the synchronized global growth has peaked, and that this thesis has rendered its service. That the trade-war has become the focal point around the globe, in fact, expresses the very absence or lack of it – trade growth. The US Dollar Index made its low so far in mid-February and has remained on firm footing since. We see the US Dollar substantially higher over the coming 12-24 months.

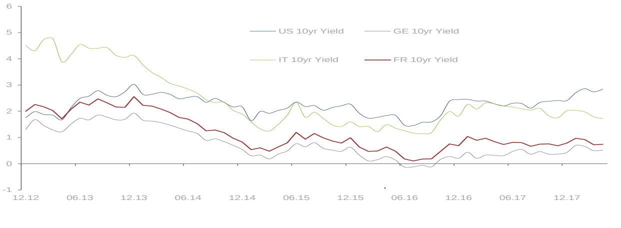
The U.S. Dollar Index, China FX Reserves *(Source:Bloomberg L.P.)*



Global Fixed Income Markets

Bond markets faced the headwinds from this general anticipation of higher inflation. The FED raised the Federal Funds target rate to a range of 1.50% to 1.75% at its March meeting and remained on course for another two hikes. The pick up in volatility in equities and the uncertainties over the ramifications from the new trade policies sparked some risk aversion causing the US Treasury 10yr yield to retreat slightly. Still the UST 10yr was 33bps higher in Q1, closing at 2.74%, UST 5yr was at 2.56%, while the UST 2yr moved above the 2% for the first time since 2008. It closed Q1 at 2.27%.

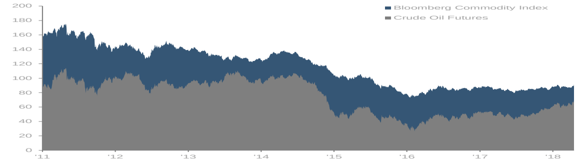
Global Fixed Income Markets *(Source: Bloomberg L.P.)*



COMMODITIES

The global oil market has continued to move further towards a more balanced situation between supply and demand. Our expectation that oil would continue to move higher has been met again. WTI was up 7.5% during the first quarter. The agricultures sector, which we see at the beginning of a long-term bull market, did a very strong and first upside run into early March before giving back some of the gains. Still, the Bloomberg Agriculture Subindex finished the quarter up 3%. As we were expecting, commodities outperformed on a relative and absolute basis. On the other hand, rising commodities will only provide a wrong sense of returning inflation to mainstream economists.

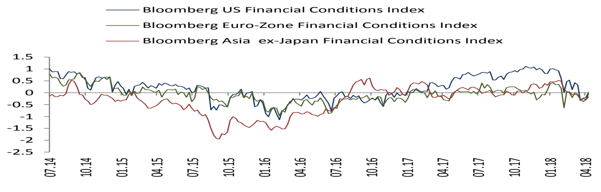
Bloomberg Commodity Index (*Source: Bloomberg L.P.)*



GLOBAL FINANCIAL CONDITIONS

The Bloomberg Financial Conditions Indices track the overall level of financial stress in the money, bond and equity markets to assess the availability and cost of credit. Conditions had started to deteriorate, firstly in the Eurozone, and over the course of the quarter were followed suit, by the US and in Asia. Clearly, the US market does not currently reflect the same positive conditions witnessed at the beginning of the year.

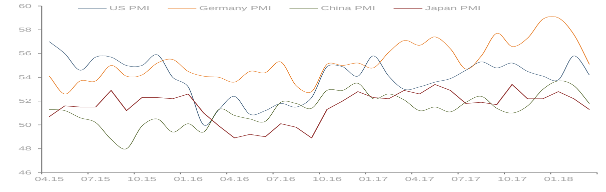
Gobal Financial Conditions *(Source: Bloomberg L.P.)*



GLOBAL PMI, US CREDIT GROWTH

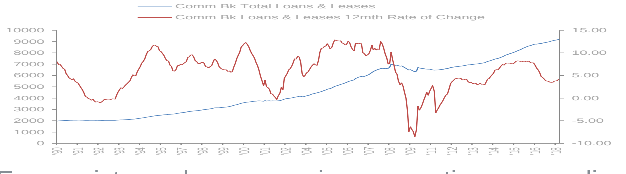
The survey based global PMI data had backed off from historical levels that have always preceded an economic slowdown.

Global PMI Data *(Source: Bloomberg L.P.)*



We wrote in our Q1 report, that the synchronized global upturn is going to disappear. We elaborated that after the pivotal 19th Party Congress in China last October the Chinese credit growth will slow down as a natural consequence, resulting in some bigger EM countries, that rely on Chinese demand, to drop away from the global growth picture and see their economies lose momentum. Meanwhile, the People's Bank of China unexpectedly cut the required reserve ratio by 1 percentage point. A move what many see as an attempt at improving overall liquidity conditions and to cushion the economy amid a weaker growth outlook and elevated trade-war risks. The Chinese 10yr government bond yield has fallen from 3.9% to 3.5% since the start of the year, reflecting these economic concerns.

US Commercial Banks Loans & Leases
(Source: Bloomberg L.P.)

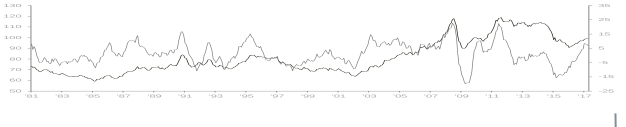


Economists make economic assumptions according to models, where an economy that is expanding must also be growing. While global growth data has improved since the cyclical downturn into 2015/16, it has lacked accelaration, or momentum since. The uptick in growth data in 2017 demonstrates positive numbers but not robust growth. The «credit impulse» has stopped from slowing down. The rate of change in credit has improved somewhat over the past two quarters, but is still a far cry from supporting synchronized global growth.

IMF WORLD IMPORTS

In its latest World Economic Outlook, of April 17th, the IMF left its 2018 & 2019 global GDP forecast at 3.9% unchanged from its January report. It sees the US to grow 2.9% this year, China 6.6%, India 7.4%, Japan 1.2% and the Eurozone 2.4%. The IMF, however, projects global growth to soften beyond the next couple of years. The risk of the World moving into a recessionary phase on decreasing consumer demand over the next 1-3 years is still high. The risk that the US enters full blown recession over the next 12-24 months have not abated.

IMF World Imports *(Source: Bloomberg L.P.)*

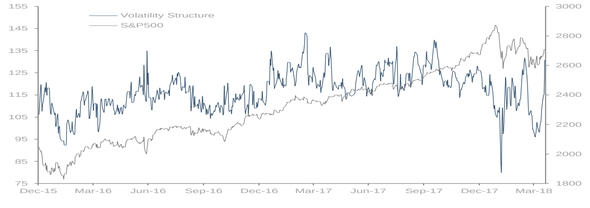


INVESTMENT STRATEGY

S&P500 & VOLATILITY

Markets trade on narratives, while valuation and sentiment measures, among others, help investors to master risk. Depending on the narratives, new correlations between assets may develop or long-serving analysis on existing correlations may well be used. From a tactical point of view, currently equity markets are on the search for a new narrative once again, after the strong momentum in the big tech stocks has broken. From a strategic point of view however, the mainstream is still betting on continuation of growth. In our view, there is room for surprise and negative adjustments.

Volatility Measures *(Source: Bloomberg L.P.)*

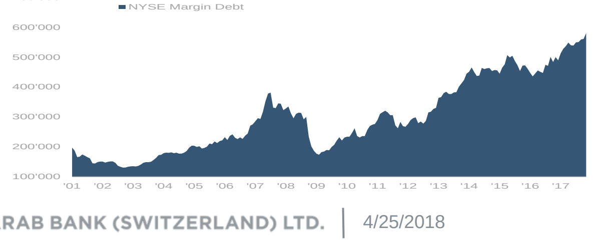


We have warned in our recent investment strategy reports, that too many market participants had been trying to capitalize on ultra-low volatility, while ignoring actual risks. The conclusion is drawn that a correction is likely, but ultimately the bull market is probably not over yet. It remains best to have a pragmatic approach. The current market environment can last into the Summer months. The former pivotal level of 2750 in the S&P500 will remain a decisive point. For now the next pivotal level is at 2640. A break would have us turn cautious again.

LEVERAGE

It was correct to question the bullish sentiment and complacency at the beginning of the year. Yet, still critical issues remain clouded and new questions arise: How will central banks react to a continued rise in commodities? What's behind the rise in Libor? Have leveraged assets delevered enough? What's happening with US fiscal policy? Will the China-US trade showdown worsen? Brexit? How sound are the European Banks? Etc.

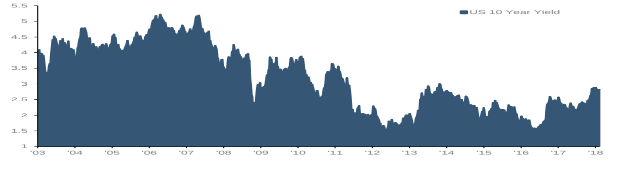
NYSE Margin Debt (*Source: Bloomberg L.P*)



US10YR YIELD, U.S. PCE & INFLATION EXPECTATION

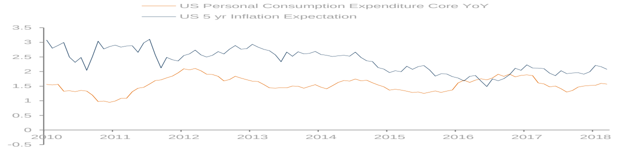
Despite rising rates and a brief stint of rising bond market volatility during the market rout in February, the fixed income markets are generally still experiencing a complacency regime. The MOVE, an US Treasury volatility index by Merrill Lynch, is hovering around historic lows. Similar low levels of volatility can be seen in the JP Morgan Global FX Volatility Index. Developments in these two volatility measures need close monitoring. The US 10yr yield has reached the level of January 2013, where it last traded at 3%. Moving beyond the 2.6% has led some of the most notable bond fund managers to call out for a bear market in fixed income, so far so good. Breaching the 3% will have more join the chorus. Yet, the all important level, unfortunately, lies above at 3.3%. Only by moving beyond this level a structural shift in the US bond markets would be confirmed.

US 10yr Yield *(Source: Bloomberg L.P.)*



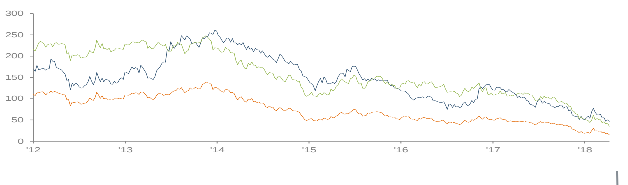
The FED has routinely downplayed low inflation readings as transitory. But then again the FED also saw the labor force participation to pick up on the assumed economic recovery. Despite a lot of talking wage growth is missing while the official unemployment rate remains at 4.1%.

US PCE & Inflation Expectations *(Source: Bloomberg L.P.)*



Since the Great Financial Crisis there were 4 cyclical upturns. Everytime investors had hoped that these reflationary periods were signs that the structural deficiencies were overcome. However, the continuing flattening of the yield curve has confirmed that is just not the case. The really big issue is that 2017 was just another cyclical upturn.

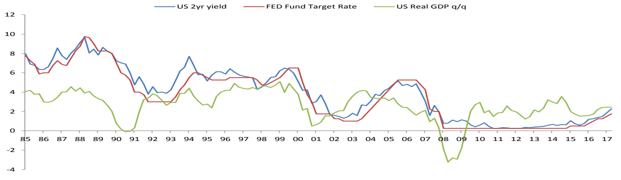
US Yield Curve *(Source: Bloomberg L.P.)*



US 2YR YIELD, GDP, FED FUND TARGET RATE

New FED Chair Jerome Powell has long seen shortcomings in interest rate forecasts. In his first press conference Powell advised investors against reading a lot into the FEDs interest rate projections. He is a bit more willing not to subscribe to the same model of his predecessor Janet Yellen. At any rate, markets have a tendency to "test" new FED chairs early in their tenure.

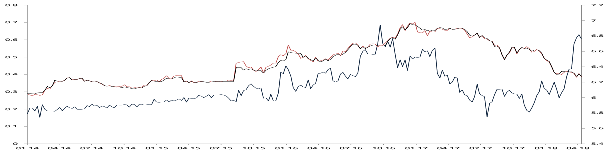
US 2yr yield, US GDP q/q, FED Fund Target Rate *(Source: Bloomberg L.P.)*



3MONTH TED-SPREAD & CHINESE YUAN

There has been a debate as to what is behind the continuous rise in Libor rates and credit risk spreads. It is not really just because of an increased issuance of T-Bills in the US. The TED-spread is the difference between interbank rates and short-term US government debt. A rise in this indicator reflects higher awareness of credit risk, often related to funding stress in the global USD money markets. This time it is confirming exactly this; that liquidity is not flowing as it used to.

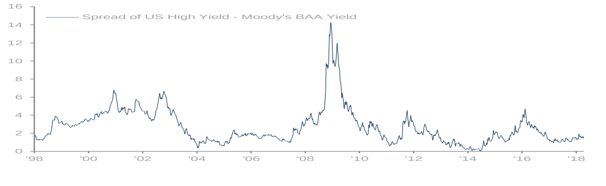
3month TED-Spread & Chinese Yuan *(Source: Bloomberg L.P.)*



YIELD SPREAD U.S. HIGH YIELD – MOODY'S BAA

Spreads remain low by historic standards. However, not all credit spreads have narrowed back to the tight levels of Summer 2014 in the wake of the rally in global equities of 2017 and January 2018. Today the high-yield market only presents name specific opportunities. Over all it remains vital to have a pragmatic approach and an open mind.

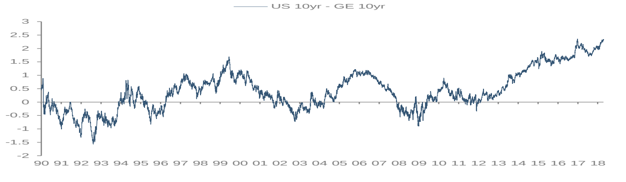
US High-Yield & Moody's BAA *(Source: Bloomberg L.P.)*



KEY CALLS

- USD asset-allocation trade is to remain intact
- US equities to outperform
- Energy, Health Care, Consumer Discretionary to outperform
- Agricultures at the beginning of a long-term bull market
- Oil to continue to go higher, but prone setback
- Volatility, VIX, to revisit 20s
- Risk of recessionary tendencies high on weak global demand
- Peak of synchronized global growth
- Convergence of global yields
- US – German 10yr yield spread from 235bps to 100 over coming 12-18 months

US 10yr yield – GE 10yr yield *(Source: Bloomberg L.P)*



		Change			
Country Allocation	**Recommendation**	Q1	Q2	Q3	Q4
USA	Overweight	➚	➔		
Europe	Neutral	➔	➔		
United Kingdom	Underweight	➘	➔		
Switzerland	Neutral	➘	➔		
Japan	Overweight	➔	➚		
Emerging Markets	Neutral	➔	➘		
Asset Allocation					
Cash	Neutral	➔	➔		
Bonds	Neutral	➔	➔		
Fixed Coupon	Neutral	➔	➔		
Floating Rate	Neutral	➔	➔		
Sovereigns	Underweight	➔	➔		
Corporates	Overweight	➔	➔		
Equities	Neutral	➔	➔		
Consumer Discretionary	Overweight	➚	➚		
Consumer Staples	Underweight	➔	➘		
Energy	Overweight	➔	➔		
Financials	Neutral	➔	➔		
Health Care	Overweight	➔	➔		
Industrials	Neutral	➘	➚		
Information Technology	Neutral	➔	➔		
Materials	Neutral	➔	➘		
Telecoms	Underweight	➔	➘		
Utilities	Neutral	➘	➚		
Alternative Investment	Neutral	➔	➔		
Commodities	Overweight	➔	➔		

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