PLURIGESTION
INVESTMENT ADVISOR

Investment strategy

MARCH 2018

Strategy

Hold on to your hat!

Courtesy of central banks' repression of volatility, greed gradually overcame fear, namely for yield hungry investors. ¨Crypto-maniacs¨ first took the tall, as policymakers (in Asia) and financial sector (in Anglo-Saxon countries) joined forces to strangle this ¨corrosive and dangerous¨ means of speculation. This was considered sort of adventures as being a confidential / speculative corner of the investment universe.

Then came short-volatility products, growingly popular also among retail clients. In January only, inflows into the two most ¨liquid¨ products (XIV and SVXY) reached about $700mios! The unwinding of these trades is much more unsettling for markets. Indeed, they come in many forms, like combinations of puts and calls in derivative markets, or OTC tailor-made structured products. They are not only linked to equities, but also to other asset classes (which have stayed pretty calm so far…). Global size is enormous.

Complacent / greedy retail and qualified investors have both been caught on the back foot
The ruthless lesson is that crowded trades appear dangerously stable, until they… spectacularly break

- *In this context we maintain our asset allocation unchanged*
- *Equity bull market is not invalidated, but a digestion period is needed*
- *Watch for expensive assets which are interest sensitive (Anglo-Saxon property, US Reits)*

Strong winds are developing

¨One must guard when everything is (too) rosy, right!?¨. As developed in our latest Monthly (re: Minsky moment), greed and complacency have been nurtured by the very long absence of surprises. Calm made investors lazy and complacent. In this *former* regime, advanced economies' central banks repressed volatility, ad nauseam. It took a cocktail of toxic developments i.e. a weaker USD, much higher yields and oil to finally shake investors' confidence. The cherry on the cake was probably the latest spike in US wages, triggering a brutal wake-up call for deflation apostles.

The sudden rise of volatility fuelled, in two days, enormous liquidation of positions in the largest ETFs: about $7bn in US equities, $1bn in emerging debt, $1,2bn in US high yield… A cohort of sophisticated managers using extensively algorithms (risk parity, variable annuity), are now under alert. The upsurge in cross-asset correlation is a symptom of very large flow-driven liquidations. This has little to do with deep fundamentals. This rather features a serious change in psychology, sort of a come-back of realism.

This time is not different: changes in inflation regimes are always significant for financial markets

A painful repricing, coupled to low short-term visibility

Sentiment indicators have collapsed lately, breaking out from exuberant level a couple of days ago. Market's versatility is not new, though pretty spectacular this time! This does not make durable trends. We don't expect advanced economies' central banks to come to the rescue, this time. Quite the opposite. Indeed, they will irrevocably be engaging, one after the other, in quantitative tightening. There are three main reasons for that: extravagant size of their balance sheets, concerns over financial stability (speculation / bubble formations), and a need to build dry powder (restore positive real rates ahead of next downturn).

This will spell more unstable financial markets' developments. Even if they will never admit it, central bankers welcome the resurgence of volatility, which may help contain leverage and speculation… For now, volatility was contained to equity markets. A contagion to other asset classes is far from unlikely. A pursuit of the soft ongoing correction of bond markets – say US 10y government bond climbing markedly above 3% - is likely.

Higher yields finally forced investors to reconsider positions taken in an era of easy money
The gradual reconstruction of risk premiums across asset classes is likely. Valuation metrics will probably be less generous in the future

Rue François-Bonivard 12 ♦ 1201 Genève
t +(41) 22 906 81 81 ♦ f +(41) 22 906 81 82

Chemin du Midi 8 ♦ 1260 Nyon
t +(41) 22 906 81 50 ♦ f +(41) 22 906 81 51

Rue Pré-Fleuri 5 ♦ 1950 Sion
t +(41) 27 329 00 30 ♦ f +(41) 27 329 00 32

info@plurigestion.ch
www.plurigestion-finance.ch

PLURIGESTION
INVESTMENT ADVISOR

Overweight

Cash

Neutral

Fixed Income
Equities
Alternative Investments

Underweight

MACROECONOMY

Why such a buzz on inflation come-back?

Wise investors should better watch out before calling a regime change, as featured by (so) many false starts over past years. Indeed, US realized inflation figures have proved benign so far. More, the ¨weakish¨ long term drivers of price trends, i.e. demography and productivity, have not changed at all. Automation, robotizing, if not globalization remain also severe structural headwinds for a slippage in global prices. And finally, the latest most credible supranational forecasts for 2018/9 (by IMF and OECD) remain pretty quiet. For sure, the US will experience some *cyclical pick-up* in inflation, as a weak USD will favor more expensive imports. But this is a marginal factor, as the US economy is not so open actually. Oil price rise will also percolate into higher input prices for corporate and possibly impact output prices. But this is a transitory phenomenon. And the mechanics is not linear, as companies could decide to take some share of that burden out of their margins. Who knows… Oil is not a permanent / important inflationary factor, because its spike would ultimately provoke an economic slowdown.

So, what's up actually? Are markets, again, overplaying the inflation risks?

- *The disinflation regime will be further challenged over coming weeks. That's good per se*
- *But a too successful ratchet effect of the fiscal reform on US firms' capital investment may spark more durable inflation pressure*

Still, there are good reasons to reconsider the entrenched scenario of disinflation

Let's consider for a while a handful of factors that may, significantly, change the global picture:

- *US tax's plan stimulatory impact is definitely front-loaded* with its provision to allow for full capex expensing in the next 5 years. An acceleration of corporates' capex from an already reviving base would help restore productivity and sustain wages (the missing link for higher inflation over past decade).

- A new wave of *protectionism* is underway in the US. Day after day, Trump administration imposes new tariffs to imports, withdraws from global trade agreements. The crucial risk for the global economy is obviously a direct confrontation with China. We will have insights pretty soon, with the soon-to-be-published results of the US enquiry on undue transfers of intellectual property. Other likely - and more convenient as less prominent - sources of confrontations are Germany, Canada and Mexico. Protectionism results mechanically and administratively in higher prices. This is a pervasive process, fueling retaliation, impacting also on companies input costs. This is not a classical demand or supply driven inflation (i.e. not ¨good¨ inflation).

- China rebalancing is going on. *China is* starting to *export inflation* instead of deflation. Wages will remain on the rise for secular reasons (ageing of the working population) and because of the recalibration of the economic model towards services, innovation, etc. The internationalization of the Renminbi prevents it from falling durably, quite the opposite: Beijing favors now a stable, if not a stronger currency to achieve its objective of becoming a genuine reserve currency medium term. And China remains a major, global, export force.

Rue François-Bonivard 12 ♦ 1201 Genève
t +(41) 22 906 81 81 ♦ f +(41) 22 906 81 82

Chemin du Midi 8 ♦ 1260 Nyon
t +(41) 22 906 81 50 ♦ f +(41) 22 906 81 51

Rue Pré-Fleuri 5 ♦ 1950 Sion
t +(41) 27 329 00 30 ♦ f +(41) 27 329 00 32

info@plurigestion.ch
www.plurigestion-finance.ch

PLURIGESTION
INVESTMENT ADVISOR

- *Global wages will keep on rising*... Too high inequalities, rising populism and very tight labor markets (US, Germany, Japan for instance) are good political reasons to move in that direction. In Germany, IG Metal obtained 4% rise in wages as well as a reduction in hours worked. The future governing coalition, under the influence of SPD, will be keener to grant better global wages to German employees across an extensive share of the economy. A likely fiscal stimulus package will come, like in the US, in the late stage of a long prosperity phase. About €50bn of budget surplus could translate into more than 1% additional GDP, bringing the country closer to overheating.

Currencies

Lose sight of the North

The latest US job report added fuel to the fire for the current hawkish market sentiment. The financial conditions have fallen from recent highs but remains favorable and very supportive for growth. Recent gyrations in financial markets should have a limited impact on the Fed outlook, unless they become more persistent. If financial markets stabilize and financial conditions do not deteriorate further the Fed should be able to look through recent volatility and remain on track to raise rates in March and beyond. This sentiment was echoed by NY Fed President Dudley, who indicated that the recent bump in stocks does not affect his outlook, though it could be if it were sustained.

ECB President Draghi failed on its own to stem the upward trajectory of the EUR. He did not step up his rhetoric enough. Investors sentiment and market consensus remain so convinced that a stronger EUR will not derail the eurozone recovery that they have still increased, to record high, their long EUR. Long term rates relationship are no longer working for months. However, even based on a short-term dynamic, the current EUR valuation looks extreme and represents a major risk for the euro area recovery.

Since last November, the JPY/USD correlation with US interest yields has sharply broken down. While the yield differential has significantly widened to 2.7% from 2.3%, the cross fell to 109 from 114. Initially, the JPY strengthened on US tax cuts and rate hikes expectations but failed to break the 115 level. Then, it entered in a corrective phase. The USD/JPY is in a consolidation period. It is trading on its long-term technical support around 106 and need to exceed 112, to turn bullish. Wait and see.

While the relationship between rate differentials and FX has broken down sharply between the USD and some of the main currencies, monetary policy remains very relevant for the GBP. The cross is perfectly fitting the 12-month sterling overnight forward contracts. To compensate investors for the UK's negative net foreign liabilities, a weaker GBP and/or higher yields are needed to finance the current account. Monetary policy remains very relevant for the GBP outlook.

Based on the sight deposit data, the SNB seems to be back in the market, trying to prevent the CHF from strengthening again. The strengthening pressure against the USD has been significative this year – and the CHF has not weakened in trade-weighted terms in the beginning of 2018, in contrast to SNB wishes. Also, against the EUR, the CHF has gained momentum in the recent weeks. The SNB would step up the fight if this continues.

Based on its key drivers, the AUD seems to be the less aligned with yield spreads, commodity prices and risk sentiment. With the US 10-year yields spread on the verge of becoming negative, higher US (real) yields could do considerable damage to foreign investors' appetite for Australian bonds, with flows historically drying up in the absence of some yield pick-up. From a pure domestic stand point, the bubbling property market represents another source of risk like the already very stretched long positioning in commodities.

Overweight

Neutral

USD, EUR, CHF, GBP
JPY, AUD, CAD
EMFX

Underweight

Rue François-Bonivard 12 ♦ 1201 Genève
t +(41) 22 906 81 81 ♦ f +(41) 22 906 81 82

Chemin du Midi 8 ♦ 1260 Nyon
t +(41) 22 906 81 50 ♦ f +(41) 22 906 81 51

Rue Pré-Fleuri 5 ♦ 1950 Sion
t +(41) 27 329 00 30 ♦ f +(41) 27 329 00 32

info@plurigestion.ch
www.plurigestion-finance.ch

PLURIGESTION
INVESTMENT ADVISOR

Bonds

Still some upside yields pressures/risks

Jerome Powell just took office as Fed chairman. In the short term, he will stick to the current monetary policy plan by raising gradually the Fed funds this year and being committed to remain behind the curve to let inflation and expectations migrate to Fed's projections. Latest job report reinforces the ongoing need for a gradual Fed tightening. Easier financial conditions and the prospect of a greater role for fiscal and regulatory easing warrant higher yields. The term premium has drifted modestly higher albeit to levels observed just before the sharp decline in late 2017. However, it is still too low. The December-early February yields spike was expected. The pace of the current episode is below average in terms of duration and magnitude.

By most measures, US yields are too low and the term premium still too negative. Given the rapid central banks purchasing programs slowdown, if not exit (Fed), and expected supply/demand imbalances, the term premium should be in positive territory. The Fed term premium can turn positive and yields can still climb further. Foreign inflows are not expected yet. Overseas buyers are facing mounting costs to protect their bond positions from swings in foreign exchange markets. And given the potential for trade conflicts and monetary-policy shifts, there are plenty of reasons to have that insurance. Hedge costs are more likely to rise on the back of the widening rate differentials, which should make it even harder to buy Treasuries. We maintain our US 10-years yield forecast at 3.00/3.25%. A Fed falling modestly behind the curve would mitigate downside risks for fixed income risky assets. On the Euro side, the room for more aggressive front-end pricing is likely to be limited. It should be difficult to price more than the slightly above 50% likelihood of a 25bps hike by March 2019.

the view that inflation conditions will normalize in the coming quarters, and this should imply further medium-term upside for breakevens. In the near-term, the market and macro backdrop could however turn less supportive as EUR strengthening effects have turned negative.

Rates volatility is testing spread resilience

Concerns over inflation and rising rates lead to a pick-up in market volatility and sharp correction in equities, putting credit spreads under widening pressures. As spreads are still trading around their cyclical tights, the appetite for low-quality balance sheets has also been visible - even for secularly challenged sectors. The bifurcation between HY and IG fund flows picked up steam, with large HY outflows, and significant IG inflows on the opposite.

Since the beginning of 2017, subordinated financial bonds have had a very impressive run. At current levels, the spread compression in subordinated financials has likely run its course and a consolidation is expected.

Overweight

- Investment Grade,
- High Yield, Hybrid/Sub,
- Emerging hard currency

Neutral

- US Treasury, Inflation
- Peripheral

Underweight

- German Bund
- Emerging local currency

Equities

Regime change in process

The stock markets are coming out of a long period of liquidity support from central banks. This liquidity had not been reinvested in the real economy because of the need for commercial banks to strengthen their own capital and of a lack of opportunities in the real economy. Today, the real economy offers more opportunities thanks to the acceleration of economic growth, which is global and synchronized. Companies report bottlenecks due to increased demand. Wage increases appear through union negotiations or the effect of US tax reform. The fundamentals of a recovery in inflation are therefore being put in place. The Fed is adopting a less accommodative monetary policy - other central banks will follow suit.

So, some consequences for the stock markets. Unfavorable: 1) a more attractive real economy and less generous central banks will reduce liquidity for risky assets, 2) expectations of a return of inflation will have an impact on stock market valuations, downwards.

PLURIGESTION
INVESTMENT ADVISOR

Favorable: 1) The growth of corporate profits will be up sharply with an annual growth of at least 10% for the next 2 years. In 2018, the favorable and unfavorable factors may offset each other; in any case in the first half. The table below incorporates a readjustment of the S&P 500's P/E ratio of 22x to 19x due to the expected inflation increase and earnings per share of $155 in 2018. We calculate an S&P 500 that could reach 2,945 in 2018, with a more volatile path. The potential of the stock markets therefore seems to be lower in 2018 than in 2017. Moreover, they will be torn between a tightening of the Fed's monetary policy, which has often been historically favorable to equities, and the arrival of a new boss at the Fed which has often been celebrated by a stock market correction.

Our central scenario. Calculation of the S&P 500 level in 2018

Inflation US 2018	PER S&P 500 2017	EPS S&P 500 in 2018			
		145	150	155	160
2,0%	20	2900	3000	3100	3200
2,5%	19	2755	2850	2945	3040
3,0%	18	2610	2700	2790	2880
3,5%	17	2465	2550	2635	2720

Inflation : economists' consensus / EPS : consensus Bloomberg

In the United States, while the relationship between bond yields and earning yield is still favorable to equities, the ratio between bond yields and dividend yields has risen above the historical average of the past 14 years, to the detriment of equities.

A weak dollar has favored US and emerging equities, as well as oil and industrial metals. We think the US currency should appreciate, not much, but enough for investors to favor European equities. The United States offers good earnings growth potential through the tax reform and the next infrastructure spending program, and in general by the Donald Trump's very pro-business approach. But Europe also has strengths thanks to the dynamism of President Macron and his desire to make Europe evolve more efficiently. Stock market valuations are also in favor of European equities. We are overweight discretionary, energy, financials and healthcare sectors which are benefiting from economic growth, from companies' ability to adjust prices up and a surge in investment in capital goods.

Overweight
- Switzerland
- Japan
- Large Caps
- Value
- Discretionary, Energy, Financials, Health Care

Neutral
- US
- Europe
- Emerging, China
- Small/Mid Caps
- Growth
- Staples, Industrials, IT, Materials

Underweight
- UK
- Telecommunications, Utilities

Emergings

Emerging currencies have had a good past quarter, being on average up by more than 5% vs. the USD. Higher US rates have clearly been counterbalanced by the strong commodity prices, good domestic macro data and weaker USD. However, as the long positioning in commodities is already very stretched, there is a risk of experiencing a corrective phase.

The Indian stock market remains one of the most interesting among emerging countries. In 2017, the Sensex index rose by 28%. The bancarization of the economy pushes the middle class to buy financial assets, especially equities, while before the demonetization, gold and real estate were the main sources of savings because the Indians paid all in cash. In January, Indian equities corrected due to the introduction of a capital gains tax. But the bulls point out that the structural trend of Indian savings to financial assets is solid. After the demonetization and harmonization of the VAT, the government is tackling another major project: agriculture and rural policy. An important topic ahead of the general elections in India in 2019. The budget of the Minister of Finance gives a large place to farmers, the distressed people, the elderly, infrastructure and education. The rural world is important

Rue François-Bonivard 12 ♦ 1201 Genève
t +(41) 22 906 81 81 ♦ f +(41) 22 906 81 82

Chemin du Midi 8 ♦ 1260 Nyon
t +(41) 22 906 81 50 ♦ f +(41) 22 906 81 51

Rue Pré-Fleuri 5 ♦ 1950 Sion
t +(41) 27 329 00 30 ♦ f +(41) 27 329 00 32

info@plurigestion.ch
www.plurigestion-finance.ch

for the government to win the 2019 elections and farmers have suffered considerably from two years of drought. In agriculture, the government wants to move from a centralized organization to a decentralized system, and double the wages of farmers within 2022, year of the 75th anniversary of India's independence. The consequence will be a budget deficit of 3.5% of GDP. After estimating GDP growth between 7.2% and 7.5%, the finance minister expects GDP growth to exceed 8% in 2018.

China is doing well. Fears of an economic slowdown did not materialize in 2017, on the contrary: the increase in GDP was 6.9% compared to +6.5% in 2016. In January, imports jumped by 36.9% and exports by 11.1%; imports were certainly affected by the Long Lunar New Year holidays starting mid-February, pushing companies to increase their inventories. Nevertheless, domestic demand begins the year 2018 on a strong dynamic. Coal imports are at their highest since 2014. Nevertheless, the FTCR China Business Activity indicator is down for the 3rd month in a row, affected by the appreciation of the renminbi, the more restrictive monetary conditions and more restrictive regulation for local governments. The CSI 300 index fell 8% with the stock market correction. The strength of the renminbi is not favorable to Chinese equities, but low stock valuations are a good support for the Chinese indices: 13.4x 2018 for the CSI 300 and 7.8x for the Hang Seng China.

The evolution of the dollar is an important component for the evolution of emerging indices. They took advantage of it when the dollar falls. Today, the US currency is recovering and corrects an oversold situation. If the dollar's recovery is confirmed, emerging markets should underperform. Before buying the emerging stock markets, we will wait for the dollar to stabilize.

Commodities

The decline in the dollar had benefited to industrial and precious metals, as well as oil. The US currency is correcting its bearish excess. Technically, the USD index has made a double bottom and is starting a rally. This trend of the USD should be a factor of underperformance of metals and oil. Speculative positions are high. Closing long positions could lead to a correction in the prices of metals and oil.

More volatility and the severe correction of cryptocurrencies confirm the gold quality as safe haven and good asset of diversification. The price of gold fell with the recovery of the dollar, but also after profit taking to deal with margin calls on equities. The likely increase in volatility on the financial markets following the gradual withdrawal of monetary stimulus will increase turbulence and benefit to gold.

Demand is strong and supply remains under control after years of under-investment. There are many infrastructure projects and we are waiting for Donald Trump's infrastructure spending program. Copper, zinc and nickel are the preferred metals of analysts. The development of the electric car will accelerate the need for lithium, cobalt and manganese to make batteries. The price of platinum has suffered from the drop in sales of diesel cars, being used in catalytic converters. In contrast, palladium benefited from higher sales of gasoline cars; the rise in the price of palladium is also explained by a supply deficit. But analysts believe it's time to take profits on palladium with the revolution of the electric car that is running.

The oil price is benefiting from the global and synchronized economic growth and production agreement between OPEC and some non-OPEC members such as Russia. But it can also induce some indiscipline of some producers like Nigeria and Venezuela. The other supply risk is the rise in unconventional production, particularly US shale oil. The US production is running at full speed: the latest data show that the United States produced 10.25 million barrels/day and thus exceeded the previous record of 10.04 million b/d dating from 1970. The possibility for US producers to exploit new areas released by Donald Trump could help increase global supply. Estimates of US production are at 10.6 million b/d in 2018 and 11.2 in 2019. Today, the additional supply is largely offset by strong demand.

Overweight

- Precious metals
- Industrial metals

Neutral

- Energy
- Real Estate
- Hedge Funds

Underweight

Rue François-Bonivard 12 ♦ 1201 Genève
t +(41) 22 906 81 81 ♦ f +(41) 22 906 81 82

Chemin du Midi 8 ♦ 1260 Nyon
t +(41) 22 906 81 50 ♦ f +(41) 22 906 81 51

Rue Pré-Fleuri 5 ♦ 1950 Sion
t +(41) 27 329 00 30 ♦ f +(41) 27 329 00 32

info@plurigestion.ch
www.plurigestion-finance.ch

PLURIGESTION
INVESTMENT ADVISOR

MARCH 2018

www.plurigestion-finance.ch

Disclaimer

This document is solely for your information and under no circumstances is it to be used or considered as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. All information and opinions contained herein has been compiled from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to their accuracy or completeness. The analysis contained herein is based on numerous assumptions and different assumptions could result in materially different results. Past performance of an investment is no guarantee for its future performance. This document is provided solely for the information of professional investors who are expected to make their own investment decisions without undue reliance on its contents. This document may not be reproduced, distributed or published without prior authority of Plurigestion SA.

Rue François-Bonivard 12 ♦ 1201 Genève
t +(41) 22 906 81 81 ♦ f +(41) 22 906 81 82

Chemin du Midi 8 ♦ 1260 Nyon
t +(41) 22 906 81 50 ♦ f +(41) 22 906 81 51

Rue Pré-Fleuri 5 ♦ 1950 Sion
t +(41) 27 329 00 30 ♦ f +(41) 27 329 00 32

info@plurigestion.ch
www.plurigestion-finance.ch