Investment Monthly:
Viewpoint

Acknowledging near-term risks and becoming more cautious

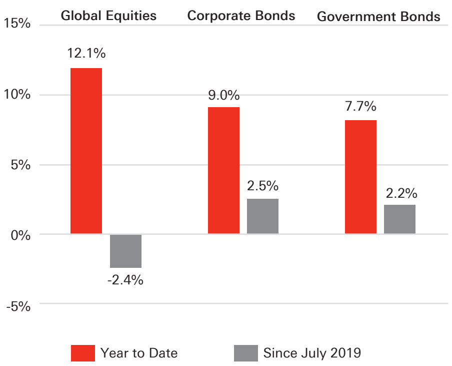
In the last few months, the global economy has stumbled amid worsening sentiment around US-China trade tensions, geopolitical risks and general late-cycle malaise. The global stock market, despite still having returned 12% this year, dipped in August. Although still positive on equities long-term, we advocate a more cautious stance for now.

Xian Chan
Global Head of Wealth Insights

Jan-Marc Fergg, CFA
Deputy Head of Group Wealth Management

We've written a lot since last year about the need to ignore market "noise" and stay invested in equities. It's proved a good call so far: global equities have delivered solid returns in 2019. This positive performance has come despite a meaningful pickup in volatility and a slowdown in global growth, in large part due to the ongoing US-China trade war. Most notably, Germany's economy shrank by 0.1% in Q2, while Singapore and South Korea, whose export-heavy economies make them bellwethers for the global economy, have also faced challenges. Singapore suffered a 3.3% contraction in Q2 while South Korea barely avoided recession in the first half of 2019[1].

Chart 1: Equities and Bonds performance 2019



Source: Refinitiv Datastream; Global Equities: MSCI AC World; Corporate Bonds: Barclays Global Aggregate Corporate USD; Govnt Bonds: FTSE World Government Bond Index
Performance as of 30 Aug 19

We expect volatility to persist in the coming months, as the chess-game of trade tensions and geopolitics is hard for markets to predict.

Our four-point approach to portfolio strategy in the current climate:

1. **Monitor risk and don't over-reach.** With volatility likely to persist till year-end, clients should review their exposure to risky assets like equities and high-yield bonds, ensuring risk levels are appropriate.
2. **Diversify by mixing in high quality bonds or switch into multi-asset strategies.** Even though interest rates are unattractive, high quality bonds can provide downside protection for your portfolio. Multi-asset portfolios are an easy way to make sure appropriate diversification and risk-levels are maintained.
3. **Consider safe-haven currencies that perform well amid volatility.** "Safe-haven" currencies like US Dollars, Japanese Yen and Swiss Francs have historically done well in volatile periods.
4. **Investing is a long-term undertaking and equities are currently more attractive than cash & bonds.** Focus on low-volatility equity strategies that offer some protection from short-term volatility. These have the added benefit of sometimes providing attractive dividend yields that compound effectively **over the long-term.**

[1] South Korea's economy barely avoided a recession by growing slightly by 1.1% in Q2 after shrinking in Q1

Quarterly GDP contractions are always a cause for concern, since two in a row officially constitutes a recession. As Chart 2 shows, global manufacturing activity has slowed, and in some cases begun to shrink.

Central banks have been quick to respond. The US Federal Reserve showed its reactiveness with a 0.25% interest rate cut at the end of July, with a further cut in September considered a foregone conclusion by markets. Other central banks have also cut rates or signalled a willingness to do so. If monetary policy isn't enough to mitigate the effects of the trade war, governments stand ready to invest money in their economies as well.

Will stock markets continue to rally?
That's a tricky question. One could argue that the markets have already factored in the above-mentioned interest cuts earlier this year, prompting the rally we've seen so far. Given the near-term risks and the unpredictability of global trade, it's hard to fault investors for being cautious.

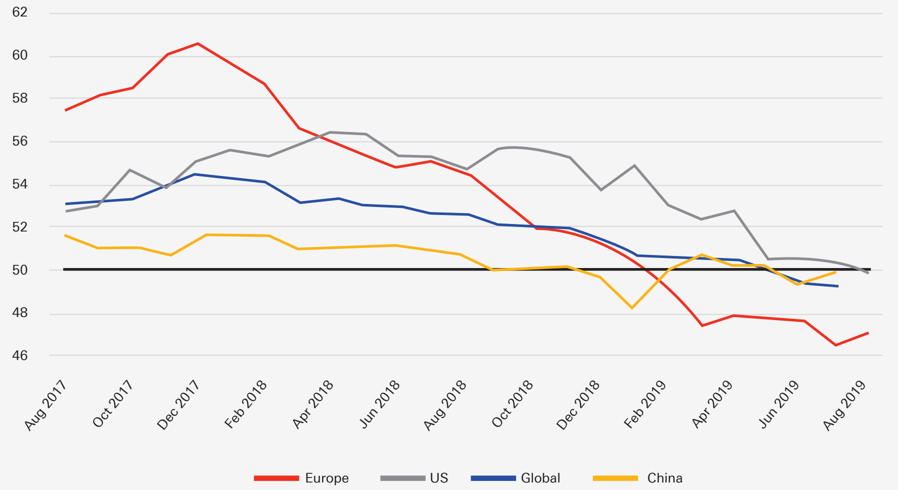
Why cash still isn't the best option
While some may be tempted to sell up and move into cash, it's important to remember that interest rates are rock bottom, or even negative. In some parts of the developed world, cash rates are below the rate of inflation, meaning that the purchasing power of cash savers will diminish over time.

Bonds yields remain sparse
Yields on government and investment grade corporate bonds are still unattractive. For example, in Japan and many parts of Europe, negative government bond yields mean investors actually have to pay for the privilege of parking their money in this asset class.

Where does that leave equities?
As a result, we're still overweight on equities relative to cash or bonds, especially in the long term. Recent volatility also means that from a valuation perspective, equities are now even more attractive than high quality bonds, which have rallied recently.

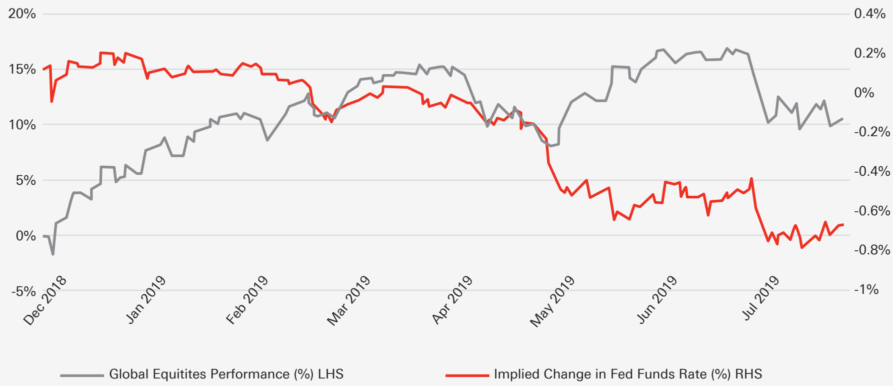
But this is very much a long-term positioning. Think a year or more. In the shorter-term, investors should be more cautious when considering higher-risk assets, especially in an economy that's vulnerable to downside shocks, jittery sentiment and heightened geopolitical risk.

Chart 2: Global manufacturing activity since August 2017 (a fall below 50 indicates a contraction)



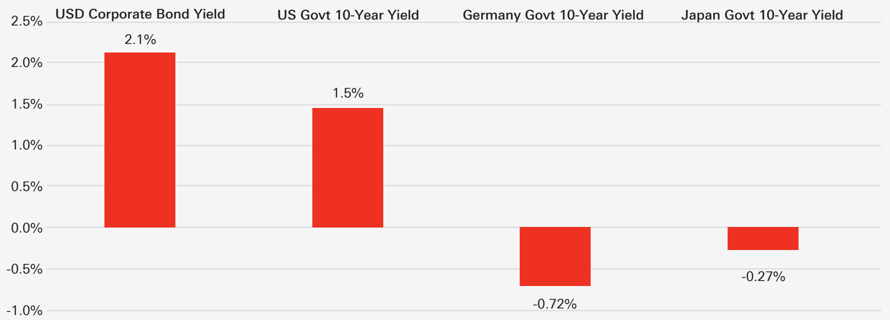
Source: Refinitiv Datastream; Latest PMI Data

Chart 3: Equities have already rallied on expectations of interest rate cuts



Source: Refinitiv Datastream: Global Equities: MSCI AC World

Chart 4: Bond yields are low to negative



Source: Refinitiv Datastream; Yields as of 28 Aug 19