TRAMONDO
INVESTMENT PARTNERS

QUARTERLY

Tramondo's take on markets, monetary policy, politics and economics. And resulting investment opportunities that successful individuals, families, and institutional investors need to be aware of today.



CLIMBING THE WALL OF WORRY



SUMMARY

- We experienced difficult summer months with elevated volatility spiced up by trade war headlines
- Global growth is expected to rebound towards year-end
- In such an environment, we expect risky assets to perform well in the last quarter of 2019
- We are constructive on real assets for which we see further tailwind thanks to supportive monetary stimulus
- While the environment stays favourable for global equites, downside risk management will be the most important factor in the next months
- We stick to a strategic position in gold and would even increase the exposure into sharp dips

THE BIG PICTURE

MARKET REVIEW

TYPICAL SUMMER MONTHS

WITHIN EQUITY MARKETS, WE HAVE EXPERIENCED THE SHARPEST STYLE ROTATION SINCE THE GLOBAL FINANCIAL CRISIS.

This year's summer months were difficult for risky assets, especially in August. Towards the end of the quarter, a more optimistic mood pushed equities higher, leaving global equities broadly unchanged for the quarter. However, within equity markets, we have experienced the sharpest style rotation from growth into value stocks since the global financial crisis.

Moreover, the quarter was dominated by a continued slowdown in global economic data and intensifying trade discussions between the US and China. These negative factors were both mostly offset by further monetary easing by the the US Federal Reserve (Fed) and the European Central Bank (ECB).

MONETARY POLICY

FURTHER STIMULUS

In the US, the Fed lowered interest rates in July and September, following a slowdown in the pace of growth and hiring.

Its European counterpart, the ECB, tackled the further weakening economic outlook by lowering interest rates deeper into negative territory, resuming quantitative easing and committing to continue buying assets until it reached its inflation target of 2% (current inflation in the Eurozone stands at 1.0%).

This announcement is significant as it could lead to a sharp increase in the total volume of assets acquired by the central bank in the coming years.

Although asset purchases com-bined with negative rates may be less effective than in the past, this re-activitation of monetary stimulus should, in combination with a more accommodative stance in fiscal policy, support GDP growth in the quarters to come. However, the timing of such a fiscal stimulus in the Eurozone remains highly uncertain. Globally speaking, we are observing increasing monetary stimulus, which should find its way through to the economy and, thus, be supportive for equity markets.

Chart 1: Global asset returns in loc. ccy Q3/YTD 2019

Index	Q3 2019	YTD
MSCI World	0.5%	18.4%
Barclays Glo-Agg. Bond	0.7%	6.6%
S&P 500	1.7%	19.8%
SPI	2.1%	24.5%
STOXX 600	2.7%	16.9%
Nikkei 225	3.0%	8.7%
Hang Seng	-7.5%	5.7%
Gold	4.5%	14.7%

Source: Bloomberg

POLITICS

TRADE WAR RELATED VOLATILITY

Global equity markets got hit by several news related to the US-China trade dispute.

Particularly, the month of August was a battlefield of news-drivenness, tweets and statement infected volatility. Nevertheless, markets held up quite well despite the elevated volatility due to the negative headlines.

WE STILL EXPECT THE GEOPOLITICAL ENVIRONMENT TO REMAIN CHALLENGING IN THE SHORT-TERM BUT MARKETS SHOULD CLIMB THE WALL OF WORRY.

Turning our heads towards Europe, we still have Brexit on the table. The seemingly endless story dragged on as parliament passed laws that will force the government to apply for an extension if it cannot agree with the EU. Neither an escalation in the US-China trade dispute nor a Hard-Brexit reflect our base case scenario.

ECONOMICS

LEADING INDICATORS WEAK, BUT EXPECTED TO IMPROVE

Overall, economic data came in with a negative bias over the summer. Specifically, the survey data in September raised some questions.

The PMI data were worse than expected in Europe as well as in the US. Still alarming is the low manufacturing reading in Europe with numbers below 50. This lifted some cautiousness among investors. There were also some releases which calmed down the situation. Among others, consumer spending in the US is still very robust also the housing sector came up with improving data.

This is important as consumption accounts for around 70% and housing for 10% of US GDP, respectively. Although PMIs are on the weak side, there is legitimate doubt that we will enter in a sustainable economic downturn.

Chart 2: IHS Markit vs. ISM US Manufacturing PMI



Source: Bloomberg, ISM & IHS Markit Manufacturing PMI

In fact, there is a big divergence between the US ISM manufacturing and the US IHS Markit manufacturing reading as shown in – chart 2. In our economic analysis, we get some comfort from this oberservation as the IHS Markit reading historically demonstrated better prediction power.

IN FOCUS

FACTORS

VALUE VS. GROWTH & LARGE VS. SMALL

VALUE AND SMALL CAP STOCKS HAD BEEN LEFT FOR DEAD THE MOST RECENT TIME.

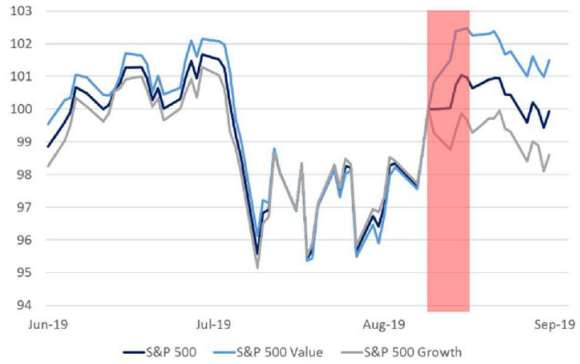
Is the great value-rotation finally upon us and are small caps finding their charm again? Beginning of September, we have experienced the sharpest factor rotation since the global financial crisis between value and growth stocks while small caps still lag.

The small caps' underperformance during the last 12 months seems a bit puzzling, considering many macro factors have been fairly positive for the group such as:

1. less exposure to the international market leaves them more protected from escalating trade tensions;
2. a strong US-Dollar should affect them less; and
3. an accommodative monetary policy, which should support high yield and floating rate issues from smaller companies.

A weakening economy - and the expectation for further deceleration down the road - might be the culprit and, thus, partially explains the shift to and outperformance of large cap stocks.

Chart 3: S&P 500 / Value / Growth



Source: Bloomberg, sector rotation shaded

Historically, value tends to outperform when macroeconomic data start to recover from depressed levels as well as when corporate profit growth reaccelerates. Also, the most positive scenario for small caps would be a combination of lower short-term yields and a steepening yield curve, where longer-term yields rise as investors become more optimistic about the economy's future.

That would then also help financial companies - the biggest sector in the Russell 2000 - making more profits from their money-lending businesses.

Hence, if we see the anticipated re-acceleration of growth, we could indeed see a strong performance of value and small cap stocks, at least in relative terms.

Moreover, stock returns may be superior outside of the US, especially if the pendulum does finally swing in value's direction.

Most of all, European equities would look particularly attractive due to their undemanding valuation, sector composition and overweight in cyclical stocks compared to the US.

POSITIONING IN A GLOBAL GROWTH REBOUND

Looking forward, and as mentioned in the last "Quarterly", we are still gathering macroeconomic data to see signs of a rebound in global growth. We believe that regardless of what happens to the trade negotiations, China particularly - but also most of the rest of the world - is stimulating its economy.

NORMALLY, MONETARY STIMULUS TAKES SIX TO NINE MONTHS TO BE FELT IN THE SYSTEM, HENCE, THE REMAINING MONTHS OF THE YEAR ARE CRUCIAL MACROECONOMIC DATA POINTS.

If a rebound of global growth will be visible, we would overweight Eurozone equities as well as cyclical stocks, but we are not yet there. Additionally, the Eurozone should outperform its peers as trade frictions will be reduced somewhat and as it appears that some kind of Brexit deal is in the making.

Although it is difficult for us to grasp, if Europe revives, depressed European financials with dividend yields of 7-8%, low or no PEs and a new president of the ECB, would be the home run ball..

Observing recessionary fears, the market faces a manufacturing cycle in deep contraction (especially in Germany, which is mainly driven by auto sales). This sector of the economy usually accounts for 10-30% of global GDP depending on the country, but it has not infected the much larger service sector (approx. 70% of US GDP).

WHILE A SELF-FULFILLING CRISIS OF CONFIDENCE AND A SPIRALING OUT OF CONTROL TRADE WAR THAT PLUNGE THE GLOBAL ECONOMY INTO RECESSION CANNOT BE EXCLUDED, IT IS NOT OUR BASE CASE.

Moreover, indicators such as housing or residential activity (approx. 10% of US GDP, a leading indicator of the last 9 out of 11 recessions) show signs of an uptick with homebuilders performing very well. In addition, due to further rate cuts and continuing wage growth the disposable income should increase and boost consumption ultimately supporting the economy. With respect to our positioning, we remain constructive on risky assets (equities and credit) for the thime being.

However, in order to navigate successfully through the current market environment, we will remain focused on active management of the downside risk and a disciplined selection of high-quality stocks.

ALTHOUGH THE POSITIONING IS VERY LONG AND LOTS OF OPTIMISM IS ALREADY REFLECTED IN THE CURRENT RALLY, WE WOULD STICK TO A STRATEGIC POSITION AND LOOK FOR SHARP DIPS TO INCREASE THE POSITION.

Central banks will remain dovish, but yields will nevertheless rise modestly on the back of stronger global growth. Favor high-yield corporate credit over government bonds.

Lastly, in a world full of negative yielding debt, even lower real yields and uncertainty, gold could become increasingly attractive. We could argue that we are likely on the cusp of a multi-year bull market for gold. Its historical positioning, the long-term store of value, the role as an effective portfolio diversifier and lack of default are several of its compelling characteristics.

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