

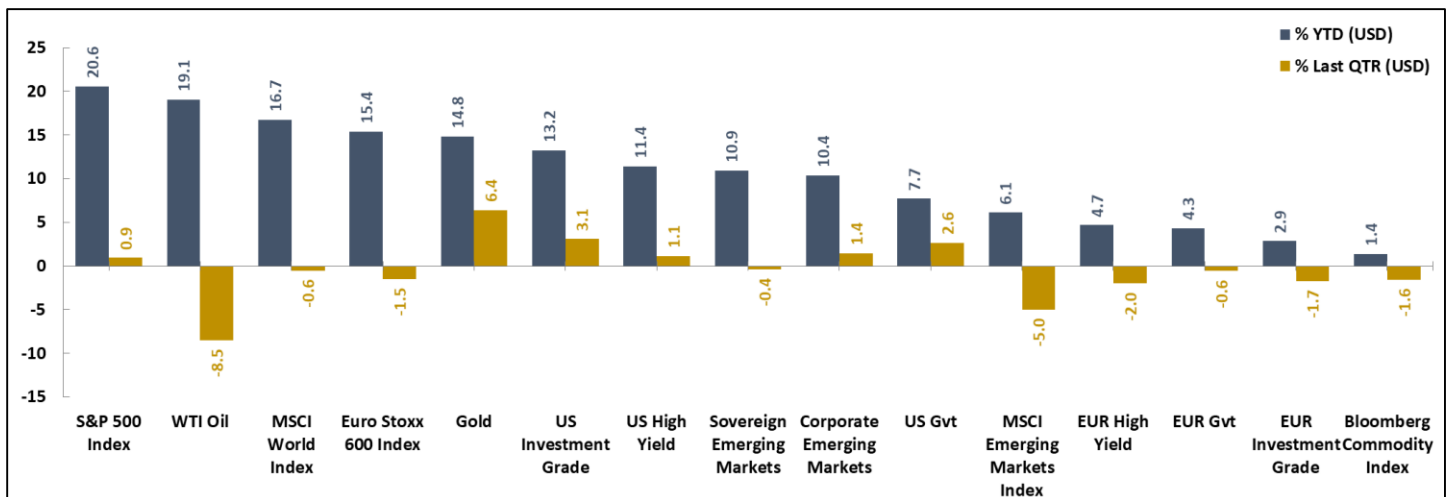
# MONACO ASSET MANAGEMENT

Investment Outlook  
Q4 2019

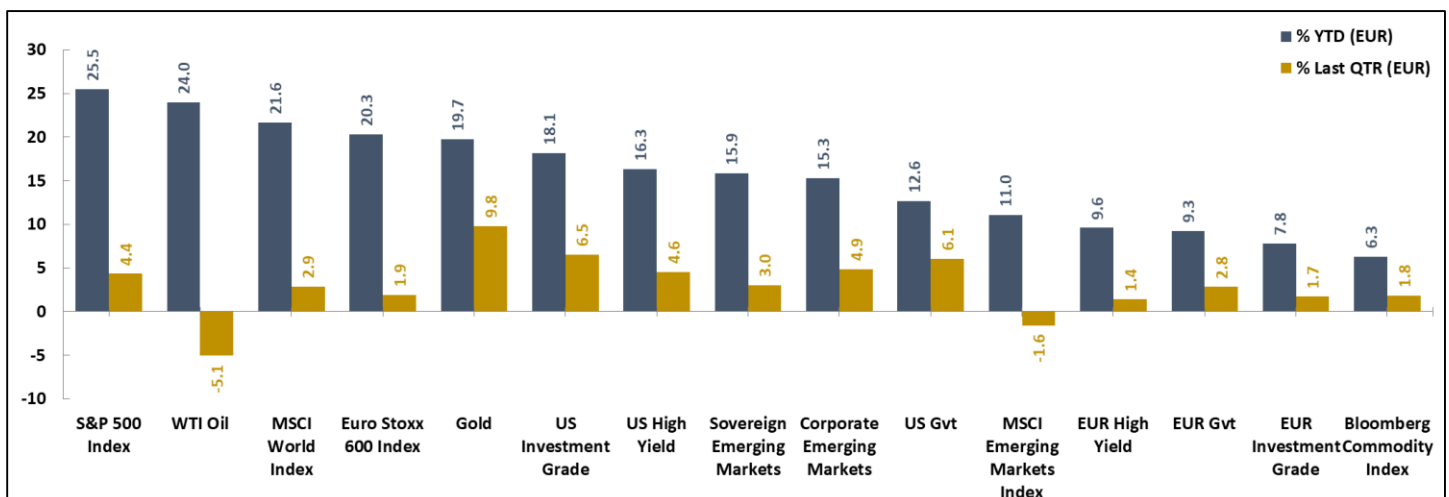
# ASSET CLASS RETURNS

- Looser monetary policies globally leading to a potential late-cycle economic recovery similar to 1995, 1998 and 2015 have propelled equity and bond markets higher in 2019. The S&P 500 Index is the best performing asset with a YTD return of +20.6%; US Investment Grade bond are not far behind with a YTD return of +13.2%.
- Gold has been one of the best performing assets with a YTD performance of +14.8%. We have been Overweight Gold all year based on heightened geo-political conflicts, a global economic slowdown and an increasingly attractive value proposition in light of the amount of negative yielding assets. Interestingly, Gold has managed to rally despite the relentless USD rally and broad commodity market underperformance. 40% of Gold's YTD returns were generated in Q3 2019 as investors turned increasingly concerned about the global economic outlook.
- In Q3 2019, some pockets of risk assets were hit hard as liquidity started pulling out. Continued appreciation of the USD, global economic slowdown, increased protectionism, and low commodity prices led to the underperformance of Emerging Market Equities down -5.0% over the period.
- In Q3 2019, WTI oil prices fell -8.5%. This is somewhat surprising considering the rising tensions in the Middle East and the disruption of production at Aramco. The impact of a slower global economy on oil demand and inventories more than compensated for any supply side concern.

USD – Denominated Returns



EUR – Denominated Returns



# INVESTMENT STANCE OVERVIEW

**Conclusion:** In Q4 2019, our overall asset allocation did not change dramatically. Policymakers are walking a tight rope between managing the economic slowdown in part created by divisive political agendas and managing diminishing monetary policy ammunition. The current economic slowdown is met with pro-active monetary policy intervention. While risks of a US recession over the next 12-18 months cannot be minimized, our base case remains for a late-cycle economic pick-up in Q1 2020. This supports our tactical bullish view on equities which remains one of the few investment alternatives, considering the amount of negative yielding debt globally. That short-term optimism requires a flexible mindset as markets can turn sharply lower in this late-cycle phase. Elsewhere, we continue to be very positive on commodities and precious metals in particular.

There are some mild changes to our views from Q3 2019:

- Tactically bullish (from Neutral) on US and EU equities based on the expectation that Central Banks easing globally will lead to a pick-up in global economic activity and that lower expected returns in fixed income markets will push investors to increase stock market exposure.

	Investment Stance					Quarterly Change*
	Very Bearish	Bearish	Neutral	Bullish	Very Bullish	
SOVEREIGN BONDS						
US						-
Europe (Core)						-
Europe (Periphery)						-
EM						-
CORPORATE BONDS						
US High Yield						-
US Investment Grade						-
EUR High Yield						-
EUR Investment Grade						-
EM						-
CURRENCY						
USD						-
EUR						-
EM						-
JPY						-
GBP						-
EQUITIES						
US						↗
Europe						↗
Japan						-
Emerging Markets						-
COMMODITIES						
Gold						-
Oil						-
ALTERNATIVES						
Real Estate						-
Hedge Funds						-
Private Equity						-

\* Change compared with previous months. One arrow means the stance has moved one place to the left or the right, two arrows means a move of two places, etc.

# MODEL PORTFOLIO

## USD Based Portfolio

Asset Class	Last Price	Perf 5D	Perf MTD	Perf YTD	MAM View	Asset Allocation
Currencies						
EUR	1.10	0.8%	0.8%	-4.0%	Bullish	10%
USD	98.79	-0.6%	-0.6%	2.7%	Bearish	80%
Other Currencies	1.23	0.3%	0.3%	-3.3%	Bullish	10%
Equities						
		-1.1%	-1.1%	13.0%	Bullish	40%
Europe	3454	-3.2%	-3.2%	15.1%	Bullish	30%
North America	2952	-0.3%	-0.8%	17.8%	Bullish	42%
Emerging Markets	997	-0.4%	-0.4%	3.2%	Bullish	20%
Thematics	515	-1.1%	-1.1%	13.0%	Neutral	8.0%
Fixed Income						
		0.8%	0.8%	7.1%	Underweight	30%
Europe						
Sovereign	223	0.0%	0.0%	4.7%	Bearish	0%
Investment Grade	251	-0.1%	-0.1%	8.8%	Bearish	0%
High Yield	401	-0.6%	-0.6%	8.9%	Bearish	0%
North America						
Sovereign	2590	1.0%	1.0%	10.8%	Neutral	0%
TIPS	75	2.0%	1.8%	19.9%	Bullish	17%
Investment Grade	3229	0.8%	0.8%	14.1%	Neutral	20%
High Yield	2117	-0.5%	-0.5%	10.9%	Bearish	0%
Emerging Markets						
Local Currency	396	0.5%	0.5%	11.5%	Bullish	17%
Hard Currency	1190	0.4%	0.4%	11.3%	Neutral	0%
Convertible	91	1.3%	1.3%	6.8%	Bullish	13%
Other (Trade Finance, Short-Term Loans..)					Bullish	33%
Commodities						
		0.3%	0.3%	1.7%	Overweight	7%
Precious Metals	204	1.1%	3.7%	33.6%	Bullish	71%
Other Commodities					Bullish	29%
Alternatives						
		-0.1%	-0.2%	5.7%	Overweight	20%
Alternatives		-0.1%	-0.2%	5.7%	Bullish	50%
PE & Real Estate					Bullish	50%
Cash						
					Neutral	3%

## EUR Based Portfolio

Asset Class	Last Price	Perf 5D	Perf MTD	Perf YTD	MAM View	Asset Allocation
Currencies						
EUR	1.10	0.8%	0.8%	-4.0%	Bullish	90%
USD	98.79	-0.6%	-0.6%	2.7%	Bearish	5%
Other Currencies	1.23	0.3%	0.3%	-3.3%	Bullish	5%
Equities						
		-1.1%	-1.1%	13.0%	Bullish	40%
Europe	3454	-3.2%	-3.2%	15.1%	Bullish	36%
North America	2952	-0.3%	-0.8%	17.8%	Bullish	36%
Emerging Markets	997	-0.4%	-0.4%	3.2%	Bullish	20%
Thematics	515	-1.1%	-1.1%	13.0%	Neutral	8%
Fixed Income						
		0.8%	0.8%	7.1%	Underweight	24%
Europe						
Sovereign	223	0.0%	0.0%	4.7%	Bearish	0%
Investment Grade	251	-0.1%	-0.1%	8.8%	Bearish	0%
High Yield	401	-0.6%	-0.6%	8.9%	Bearish	0%
North America						
Sovereign	2590	1.0%	1.0%	10.8%	Neutral	0%
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Emerging Markets						
Local Currency	396	0.5%	0.5%	11.5%	Bullish	21%
Hard Currency	1190	0.4%	0.4%	11.3%	Neutral	0%
Convertible	91	1.3%	1.3%	6.8%	Bullish	17%
Other (Trade Finance, Short-Term Loans..)					Bullish	62%
Commodities						
		0.3%	0.3%	1.7%	Overweight	7%
Precious Metals	204	1.1%	3.7%	33.6%	Bullish	71%
Other Commodities					Bullish	29%
Alternatives						
		-0.1%	-0.2%	5.7%	Overweight	20%
Alternatives		-0.1%	-0.2%	5.7%	Bullish	50%
PE & Real Estate					Bullish	50%
Cash						
					Neutral	9%

# MAM ACTIONS

## Equities

Based on our tactically bullish view on equities we used market weakness to add exposure via funds such as the Morgan Stanley Global Brands.

## Commodities

We increased exposure to precious metals via the purchase of Silver using currency instruments.

# EVENTS

**Conclusion: The Fed, Europe, Brexit, and Argentina.** Q4 will continue to be political news heavy with the continuation of the US-China trade talks, new leadership at the head of the ECB, Brexit October 31<sup>st</sup> deadline approaching rapidly, and Argentina presidential election. With already two rate cuts at the July and September meetings, an additional 25bps rate cut by the Fed is expected with a high level of certainty by the market. After the recent policy adjustments, we do not expect Christine Lagarde to derive from current policies in the short-term. The Brexit outcome remains uncertain. The Argentina post-election talks with the IMF and cabinet appointments will be crucial to see where the country's markets are headed.

## Fed Update

Between July and September 2019, the Fed decided to cut its interest rate on excess reserve by 25bps on two occasions lowering the target range to 1.75-2.0% from 2.25-2.5%. Following the recent economic data published, there is a fairly strong probability the board of the FOMC will be voting to cut rates once or twice throughout the quarter. As expressed by chair Power in July, these are mid-cycle adjustments which mean the central bank is likely to wait for newer economic data before making further decisions.

## ECB Update

On September 12<sup>th</sup>, the ECB decided to launch a new quantitative easing program on top of cutting its interest rate on deposit facility by 10 bps to -0.50%. The policy change is hoped to bring fresh stimulus to a slowing Eurozone economy as GDP growth forecast has been revised down to 1.1% from its latest 1.2% estimate. However, investors are beginning to doubt the long-term effectiveness of QE on the EU economy and are instead increasingly more focused on head of states working towards a greater fiscal integration of the union to boost its economy. On November 1<sup>st</sup>, Christine Lagarde will be replacing Mario Draghi as president of the ECB, but we do not expect her to change policy directions in the short-term.

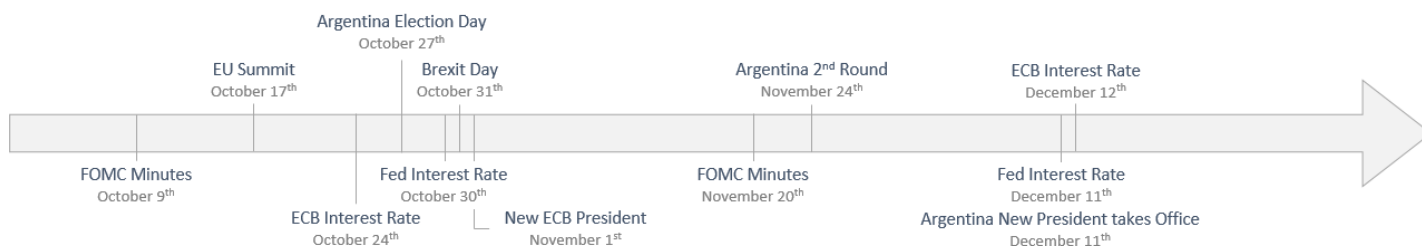
## Brexit Update

On July 24<sup>th</sup>, Boris Johnson was appointed as U.K.'s new prime minister. Since then, a deal is no closer to being reached ahead of the October 31<sup>st</sup> deadline. The PM, who is willing to leave the union without a deal, has recently been accused of playing the "blame game" by the president of the EU council, Donald Tusk. A resolution was newly quoted as "nearly impossible". However, we continue to believe that a no-deal is an unlikely outcome. If talks fail, Mr. Johnson could be forced by law to seek a third extension unless the parliament approves a deal or vote in favor of leaving with no deal. We will remain closely attentive to the outcome of the EU summit on October 17<sup>th</sup>, which will be the last occasion for governments to agree on a new deal.

## Argentina Update

In mid-August, Argentina's president Macri lost in the national primary election. The predictive nature of the election suggest the "market friendly" government is almost out of the picture and a "less-friendly" one is in the frame. The results led the massive sell-off in equity and bond capital markets. The results of the negotiations with the IMF to obtain the remaining \$5bn of a \$15bn disbursement with the new government as well as the new government's cabinet appointment will be key to gain a clearer picture of where the country's markets are heading post-election on October 27<sup>th</sup>.

## Upcoming events



# ECONOMICS & RATES

**Conclusion: Neutral.** Overly tight monetary conditions in 2018 and continued trade tensions contributed greatly to the economic slowdown observed in 2019. The world economy remains weak with the global manufacturing PMI anchored under 50 for the past 5 months. Policymakers have been pro-active with the Fed cutting interest rates on two occasions so far, the ECB launching a new bond purchasing program, and China accelerating its reflationary efforts. While global activity is likely to remain subdued in Q4 2019, we expect a late-cycle economic recovery in Q1 2020 as aforementioned policies start taking effect. Engineering these late-cycle economic recovery is complex. The last occurrences were 1995, 1998 and 2015. We should not minimize the risk of failure and of a potential recession in 2020. US 10-year bond yields of 1.5% are back to their 2016 lows where we think they will find support for now. Considering the amount of negative yielding assets globally, we find value in some emerging markets sovereign bonds in Brazil and Argentina.

- The global economy has reached a critical juncture. Growth has been slowing the last year (**Chart 1**), reaching what many would regard as “stall speed.” This is the point where economic weakness begins to feed on itself, potentially triggering a recession. That said, we don’t think growth will worsen. Global financial conditions have eased significantly over the past four months, thanks in part to the dovish pivot by most central banks. Looser financial conditions usually bode well for global growth (**Chart 4**). The risk remains that weakness in the manufacturing sector will spread to the much larger services sector. There is some evidence of this, with last week’s weaker-than expected ISM non-manufacturing release (**Chart 2**). However, the deceleration in service sector activity has been limited so far. Even in Germany, with its large manufacturing base, the service sector PMI remains in expansionary territory.
- The market is pricing a 70% probability of a 25bps rate cut at the next Fed meeting on 30th of October. Chairman Powell should use this occasion to assert his willingness to pro-actively tackle the current economic slowdown. Should the Fed succeed to look “ahead of the curve” we believe US 10-year bond yields will stabilize around current levels (**Chart 3**) and the yield curve will bull steepen.
- Considering the poor return prospects offered by government bonds in most developed markets, we are looking towards Emerging Markets for opportunities. Argentinian bonds have been great instruments to trade post-restructuring. This time is not different. We will focus on this opportunity after local elections on October 27<sup>th</sup> 2019. We also like Brazil local currency bonds. The currency is cheap. Brazil’s current account deficit is currently 1.1% of GDP, compared with over 4% four years ago. The country’s official reserves are more than 5 times of its short-term foreign. The risk of a balance-of-payment crisis is low (**Chart 4**).

Chart 1: Global Manufacturing, Services, and Composite PMIs

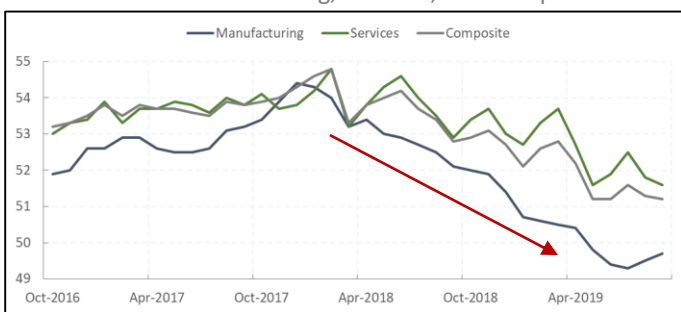


Chart 2: US Consumer Sentiment Index

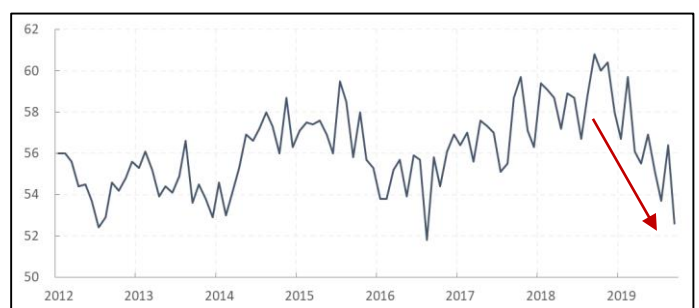
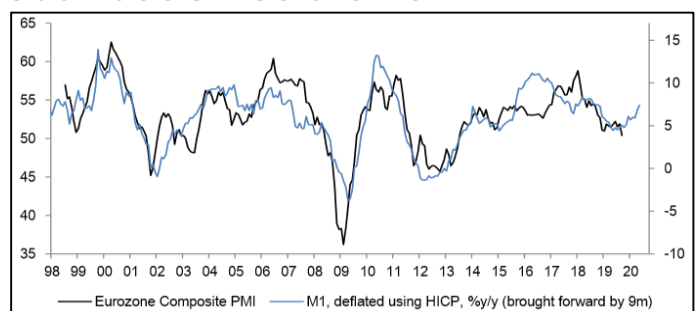


Chart 3: US 10 Year Bond Yields (Weekly)



Chart 4: Eurozone M1 Growth vs PMIs





# CREDIT

**Conclusion: Underweight.** We have been negative on corporate credit for some time and it paid off in 2018 as credit lost value across the board. Admittedly, we missed the stealth relief rally in bonds in H1 2019. The Global aggregate bond index is +7.1% YTD. However, we see no reason to dramatically change our overall cautious stance. Rising leverage and poor value remain the key themes across US and European credit. Current levels of global economic deterioration call for much wider credit spreads (**Chart 1**) and a potential triple-B cliff on the horizon. Within credit, we continue to prefer Emerging Market local currency debt and alternative funds.

For corporate bonds, investors should stick to higher quality investment grade tranches over high-yield, given our concerns about the U.S. debt build-up.

Credit quality in many indices is at a record low, while the size of the BBB rated corporate market has ballooned to \$3.8trn compared to \$936bn in 2007, or 4x larger than the BB rated market (**Chart 2**). High debt levels mean that declines in revenues or asset values would have a larger effect on corporate hiring and capital expenditures than they otherwise would. Rising spreads may trigger downgrades and force many funds to liquidate holdings. We have long warned about the lack of liquidity in the bond market. In the event of forced fire sales, credit markets are likely to display outsized negative performances.

Our central thesis, however, is that BBB companies will do everything they can to avoid a downgrade to High Yield by cutting dividends and share buybacks. Companies increased their leverage in order to buy back shares and engage in large M&A over the past few years. In the next recession, we believe this dynamic will reverse and equity investors will “pay” for deleveraging and the unwinding of some of this debt buildup through lower shareholder payouts. This is supporting our long-term cautious view on Equities.

We turned more bullish on EM local currency debt in Q1 2019. Trade uncertainty remains an overhang on spreads, but lower global interest rates should support returns in EM Corporate Credit. EM Currencies are cheap on a Real Effective Exchange rate basis. The WisdomTree EM local debt fund (**Chart 3**) looks set for a continued period of outperformance.

In credit, we continue to like alternative sources of return such as funds investing in short-term trade receivables with US or European exposure.

Chart 1: US High Yield Spread vs. ISM Manufacturing (Red)

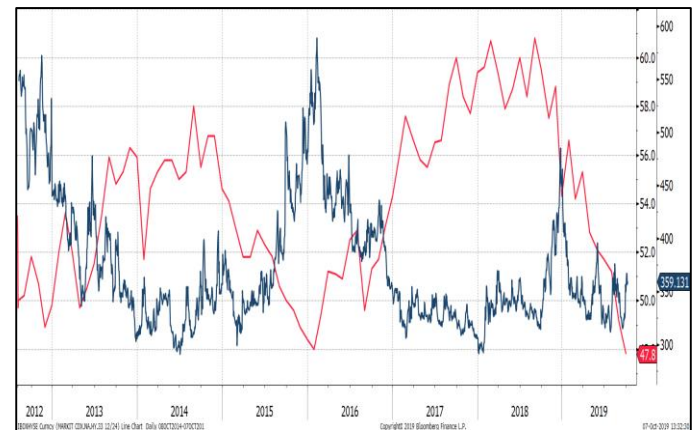


Chart 2: Rise in Corporate Leverage Since 2011

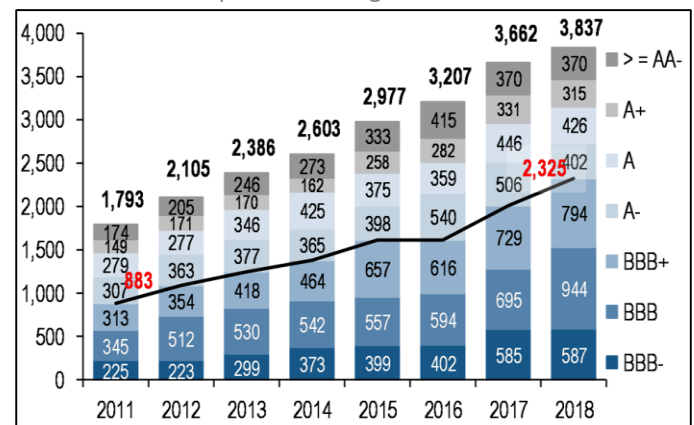


Chart 3: WisdomTree EM Local Debt Fund





# CURRENCIES

**Conclusion: Bearish USD.** We remain fundamentally bearish the USD. The USD Index is +2.8% YTD. Despite that, our fundamental view remains unchanged, based on 1) increased US deficit at the peak of the US economic cycle 2) a potential pick-up in global growth 3) over-extended Long USD positioning from investors. We shouldn't minimize the probability of a brewing currency war as Trump accuses the ECB and PBOC of currency manipulation. We will use technicals to guide our short-term EUR/USD outlook. For now, the trend is for a lower FX pair. Medium-term, commodity FX look attractive fundamentally. We particularly like the BRL.

- Investors are already long USD. Speculative positions on the dollar are close to 5-year highs (**Chart 1**). Historically, this level of positioning has given way to an unwind leading to a period of USD weakness. The USD is a countercyclical currency. The widening in the growth differential between the US and the "Rest of the World" is what has driven the dollar higher since January 2018. From here, considering our thesis of a pick-up in global growth in Q1 2020, convergence is more likely. The Eurozone current account surplus has increased materially over the last few years, driven by Germany. On the other side, US funding needs remain material - weighing on the USD. Finally, President Trump's recent comments on the ECB and PBOC indicates that he favors a weak dollar policy. We cannot rule out a 2011-type intervention to weaken the USD as global "currency wars" intensify.
- Technically, the EUR remains in a 3-year wedge formation. An overshoot to the downside to 1.06 is plausible. We will monitor this chart pattern and use any meaningful breakout as a confirmation of our weak USD thesis (**Chart 3**).
- We recommend going long commodity currencies. The NOK, the BRL, and the AUD currencies are interesting plays. The BRL (**Chart 2**) could benefit from 1) higher oil prices 2) a boost in the local economy from lower rates.

Chart 1: Net Speculative USD Positions

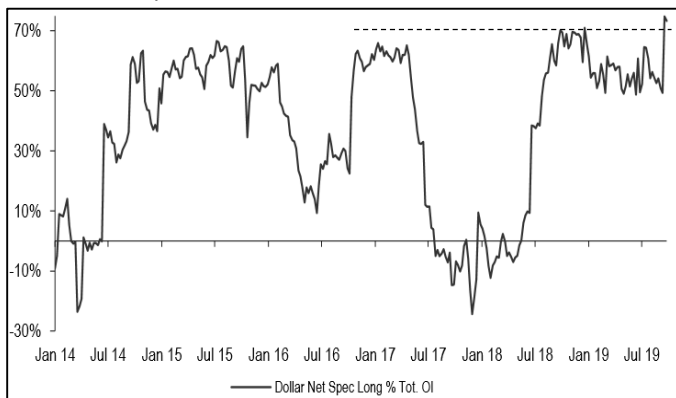


Chart 2: BRL/USD Exchange Rate (Monthly)

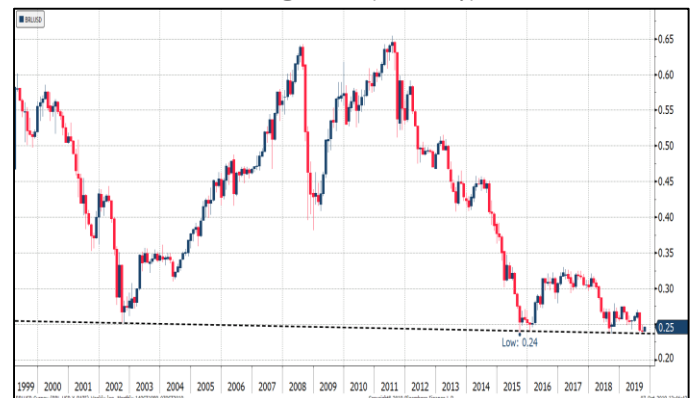


Chart 3: EUR/USD Exchange Rate (Weekly)

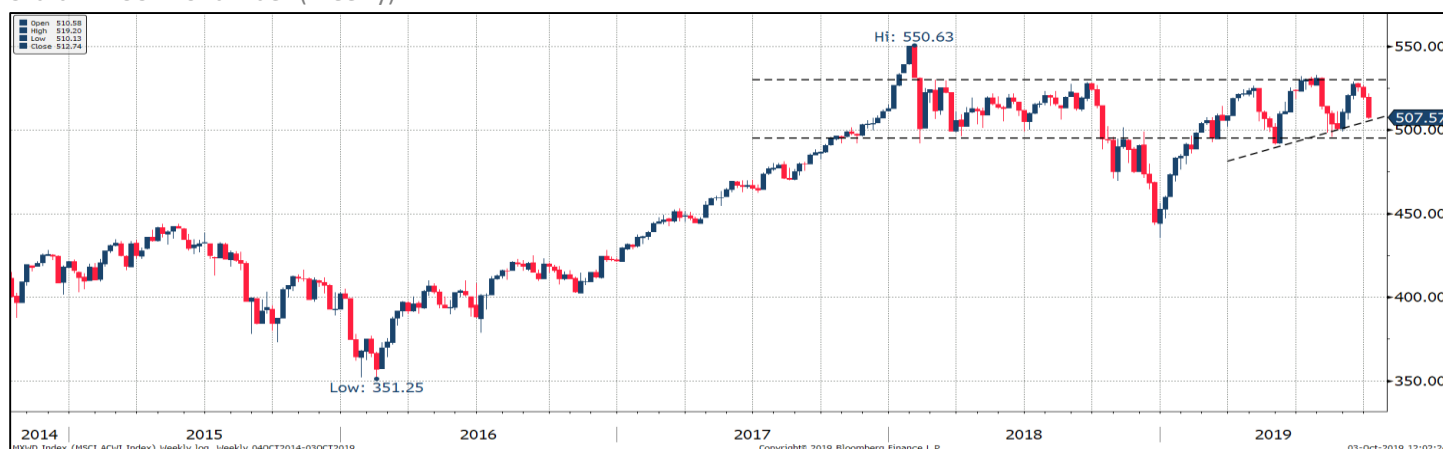


# EQUITIES

**Conclusion: Tactical Long.** The MSCI World Equity Index finished -0.51% in Q3 2019 as equities began pricing the global economic slowdown. While valuations are close to historical peaks, some measures still point to a potential 15% rally as monetary policy remains very supportive globally. Investor positioning remains low and one of the elements leading to our tactical long view. We will continue to buy market dips as long as the MSCI World remains within range (**Chart 1**). We maintain a flexible mindset as this is clearly a very late-cycle environment. Longer-term, we continue to believe EM equities will provide attractive investment opportunities.

Lower interest rates globally and over-valued fixed income markets make equities look appealing to investors. Although MSCI World Index valuations are neither cheap nor expensive on a straight P/E basis with a 15.7x multiple, other valuation methods such as CAPE and Tobin Q argue that equity markets are getting very expensive. This is symptomatic of a late-cycle environment. In the short-term, low investor positioning, central bank easing, and peak economic pessimism make us tactically bullish equities. We see 15% upside potential. We remain flexible in our thought process at this part of the cycle and ready to change our mind.

Chart 1: MSCI World Index (Weekly)



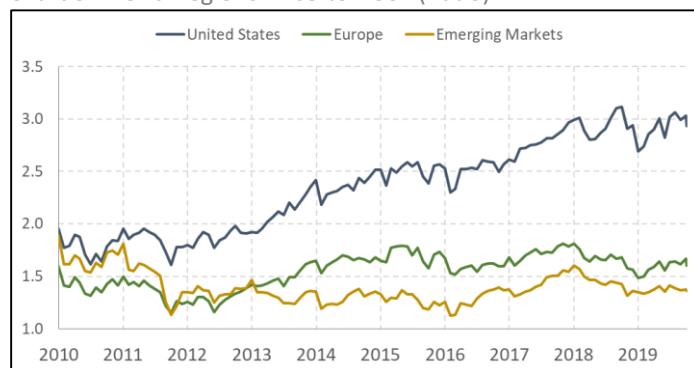
As the Russell 2000 Index relative to the S&P 500 Index is now back to levels not seen since 2008 (**Chart 2**), we believe the market to be fully pricing some of the current economic slowdown. We maintain our interest for US equities with a long bias for small cap stocks, beneficiaries of potential economic rebound over the next two quarters.

Outside the US, we like the value offered by Emerging Markets equities (**Chart 3**). We remain attentive to trade war escalations and disruptions in the global supply chain. We remain optimistic with regards to the success of Chinese stimulus. We see some of the greatest opportunities in Latin America (i.e. Mexico) and Asia where valuations are attractive and the macro backdrop is fairly stable. An accommodative Fed offers support across the board, particularly for EM countries with external debt loads such as Brazil.

Chart 2: Russell 2000 Index / S&P 500 Index (Ratio)



Chart 3: World Regions Price-to-Book (Ratio)



# COMMODITIES

**Conclusion: Bullish.** Commodities remain one of our preferred asset classes in a late cycle environment. Valuations are close to record lows, despite some recent spikes in volatility and prices. Our outlook of a weaker USD and the dovish central banks policies coming into play are supportive. We remain long gold with a price target at US\$1,600/oz (+6.8% upside potential). Geopolitical conflicts and a potential weakening of the USD support our bullish view on oil with a target still at US\$65/bbl (+23.7%). Natural gas could be a compelling seasonality play with a price target at US\$2.70/MMBtu (+17.2%) due to demand increasing and inventories dropping ahead of winter. With prices at decade lows, we believe in tactical long trades on some agricultural commodities (i.e. Soybean, Wheat, Cocoa, and Corn) and livestock (i.e. Lean hog).

- The Bloomberg Commodity Index fell -1.6% in Q3 2019 (**Chart 1**) driven by a stronger USD. Part of the decline was driven by the pullback on precious metals observed throughout September which weighted substantially on the Index performance. However, the rate cuts observed, an expected weakening of the USD, and attractive valuations reinforce the appeal of the asset class in the current market environment and continues to incite us to be strategically long on commodities.
- WTI oil prices (**Chart 2**) fell -8.9% in Q3 2019 amid weaker demand and a stronger USD. However, volatility and prices spike observed early September after the Saudi Aramco's oil attack underline the impact of conflicts on prices, should they come to materialize. The lack of tensions resolution in perspective, OPEC continued uncertainty, and a potential economic recovery are positive catalysts. We still believe in a potential upside to US\$65/bbl (+23.7%) in the mid-term.
- We have been bullish on Gold prices (**Chart 3**) since Q4 2018 and remain so to date. The recent pullbacks are a buy on weakness opportunity. In its ascension above US\$1,900/oz in 2011, gold prices experienced a series of small pullbacks which is why we are not yet alarmed by the recent decline. The unresolved trade war, Iranian conflict, and gold's attractive value proposition against negative yielding assets contribute to our price target of US\$1,600/oz.
- Agricultural and Livestock commodities (**Chart 4**) have been on the rise over September. We believe in strategically tactical long-trades on some agricultural commodities (i.e. Soybean, wheat, cocoa, and corn) and livestock (i.e. Lean hog) amid supply concerns due to countries instability for some, diseases impact for others, and overall prices at decade lows.

Chart 1: Bloomberg Commodity Index (Monthly)



Chart 2: WTI Oil Prices (Monthly)



Chart 3: Gold Prices (Monthly)



Chart 4: BCOM Index Agriculture & Livestock (Monthly)



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