MARKET COMMENTARY – Q2 2019: Are we flying too close to the sun?

We are living with an abundance of liquidity without precedent and we are getting so used to it that most investors have started seeing it as the new normal. Nevertheless we reached a new record of $12.5 trillion of negative-yielding bonds, a level which defies any sound capital market reasoning. This, of course, reflects central banks' dovish stances, to much acclaim from investors. A safety net that overall decreases investment risks. But in the meantime, international tensions continue to grow. The US made it clear that its fight to preserve its worldwide hegemony is their first priority. The trade war, although focused on China, will indeed not spare others. Europe's fragile Union is struggling with the departure of the United Kingdom, its weaker governments and the US challenging their imports and monetary policy. The Iranian crisis focused attention back on the Middle east. The impact of next year's US elections already became apparent when a peak of volatility hit the US healthcare sector during the month of April. This raises the question of large US tech firms which historically have been very low taxpayers and have had questionable practices when it comes to their user information, becoming a prime target for politicians. Why shall market participants worry when the strong pressure on the US yield curve resulted in a de facto supportive environment where corporates can refinance themselves at significantly lower terms? As Icarus's once were, Market wings seem to be well supported; however the question remains; how sustainable this is? To which we reply, let's be careful not to fly too close to the sun.

In **April**, the IMF highlighted a slowdown in their global economic outlook. Monetary policies were under substantial scrutiny, the fed in particular which despite a more dovish tone remains under pressure from the Trump administration. The PBoC paused its reserve requirement ratio cut as the Chinese economy showed signs of stabilization. On the European side, a new Brexit deadline was set for the end of October and the US threatened the EU with tariffs on $11bn of European Imports on the back of Airbus subsidies. But markets remain in the positive while hopes of a trade deal between China and the US and Equity continued to rally.

The situation reversed its course in **May** when the US signaled additional tariffs on goods partially made in China and accused Beijing of backtracking on the trade deal. After Chinese retaliation, the US then blacklisted Huawei, the largest smartphone provider. Donald Trump also threated Mexico with 25% tariffs over the migrant surge. In Europe, Theresa May formally announced her resignation due to her failure to deliver on Brexit, the European election resulted in a fragmented parliament and the Italian deficit and its government were back in spotlight. The US Yield curve dropped significantly putting further pressure on the US central bank to consider cutting their key rate.

In **June**, the tension with Iran increased significantly. Initiated by an attack on an oil tanker, the pentagon planned to send more US military troops to the region and further economic sanctions were set. Donald Trump continued to increase pressure on other countries ahead of the G20 for currency manipulation pointing his finger at Europe, or even stating considering ensuring 5G use in the US tp be made entirely outside of China. Nevertheless, markets once again focused on monetary policies. They weren't disappointed when Mario Draghi clearly communicated that the ECB was ready to act if the inflation target wasn't reached and if trade tensions remained. At the fed, Jerome Powel also communicated a more dovish stance and dropped the word "patient" from his statement, leading market participants to believe that the likelihood of a rate cut in July was very important.

The markets in general performed well on both the risky and safer sides of assets. Equity and fixed income continued to surf on the anticipation of further liquidity injections by central banks. Although keeping an overall neutral stance toward equity, we underweight European equity as we believe, despite low valuations, that the weaker political setup and the unresolved issues such as the Italian debt and most importantly the lack of a clear Brexit strategy are creating an unfavorable backdrop for investment. We are slightly underweighting the US tech sector as per the potential pressure coming from both high valuations and domestic political development. On the fixed income side, from an absolute return standpoint, such low yield environments support our negative view on the asset. In particular we reposition ourselves underweight US treasuries. The extreme yield drop we saw can't be sustainable and despite increased probabilities for the fed to cut rate in July, we believe it doesn't warrant such inversion of the curve. Finally, we are keeping our long gold position as a reflection of the uncertainty we perceived.

Kenji Yamada, CIIA
Managing Director & CIO

Markets	**Indices**	**Q2-2019**	**YTD**
Equity World	*MSCI All Countries World Daily Total Return Net USD Index*	**3.6%**	**16.2%**
Equity Emerging Market	*MSCI Emerging Net Total Return USD Index*	**0.6%**	**10.6%**
Global Fixed Income	*Barclays Global-Aggregate Total Return Index USD*	**3.3%**	**5.6%**
Global Commodity	*S&P GSCGI Index Spot Index*	**-2.0%**	**13.6%**
Hedge Funds	*Hedge Fund Research HFRX Global Hedge Fund Index*	**1.6%**	**4.2%**
EUR/USD	*Euro Dollar*	**1.4%**	**-0.8%**