vescore
by Vontobel Asset Management

Global Market Outlook

December 2019

- **Stable risk appetite despite interference on the political front**
- **Decline in equity overweight**
- **Increasingly negative position in global bonds**
- **Natural gas and nickel weakest commodities**
- **Swiss equities: Attraction of value stocks stabilizing**

Stable risk appetite despite interference on the political front
The fundamental economic market environment at the beginning of December was marked by stable appetite for risk among investors. This is underpinned particularly by the hope of market participants of agreement in the US trade dispute.

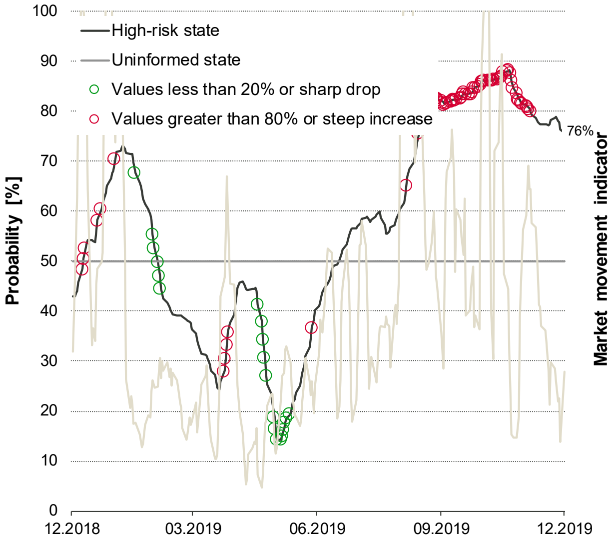
Market activity in November was again driven by developments in the conflict between the US and China. Despite some uncertainties triggered by the US bill to support human rights and democracy in Hong Kong and contradictory statements from both parties, positive sentiment preponderated. The majority of investors is expecting agreement before the end of the year. Share price performance is still underpinned by the ongoing expansive interest rate policy. Thus the European Central Bank has started to buy something to the order of 20 billion euros in sovereign bonds and other securities each month to promote the European economy and support the inflation target of close to 2%. In addition, the additional liquidity ought to provide incentives for corporate acquisitions. In November, an increased M&A volume had already been announced by European companies.

In December, the situation on global capital markets is likely to remain driven by the US trade dispute with China. Furthermore, with the elections in Great Britain, the Brexit is again moving into the sights of market participants. Also important is the US Fed December meeting. However, no interest rate moves are anticipated here.

Risk environment

Risk indicator remains high
The aggregate probability of a future high-risk state again fell slightly in November (down 5%), but remains at a an elevated level of 76%. The decrease is attributable to the considerably lower risk assessment (-25%) of currency markets with a current assessment of only 50%. On the other hand, the risk probability in stock markets increased two percentage points to 99% and on bond markets by 7 percentage points to 80%.

The risk assessment for emerging markets dipped to 62% in comparison to the previous month. While at 84% the assessment of equity markets is considerably lower (-9%), the risk probabilities on bond markets at 95% (+4%) and on currency markets at 7% (-1%) is more stable than in the previous month.



The chart shows the development of the probability of a high-risk market environment in the industrialized countries in the near future (black line). The aggregated probability is calculated in three market segments: equities, bonds, and currencies in industrialized countries. Specific characteristics are indicated by green or red circles. Green indicates a calm and red an unsettled market environment. The uninformed assessment of the future market environment is shown at 50% (thick gray line). An aggregated indicator of the historical market movements in the three segments is shown in the background (beige line). Information as of December 2, 2019

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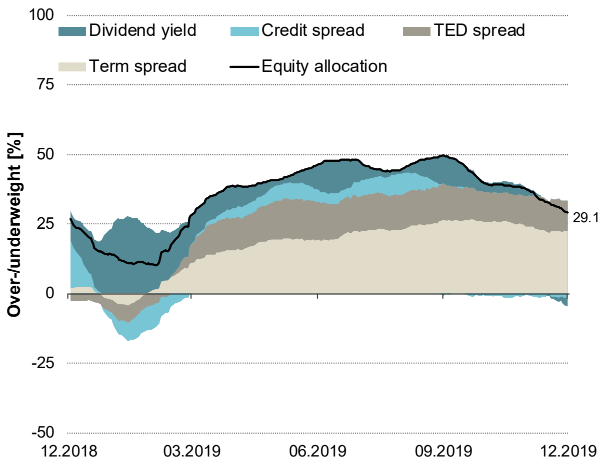
Equities

Ongoing decline in equity overweighting

At the beginning of December, the equity overweighting in the global GLOCAP sample portfolio (50% equities, 50% cash) was 29.1%. Consequently, the equity allocation has been decreased by 8.6 percentage points since the start of November.

The equity overweighting is still based on the two macroeconomic variables, the term spread and the TED spread, while the two microeconomic variables, dividend yield and credit risk spread, are now impacting the equity allocation negatively. Month-on-month most of the contributions declined. Overall as a result of the positive performance on equity markets, the impact of the dividend yield moved back by 6.4 percentage points, thus curbing the equity allocation to the end of the month by 3.1%.

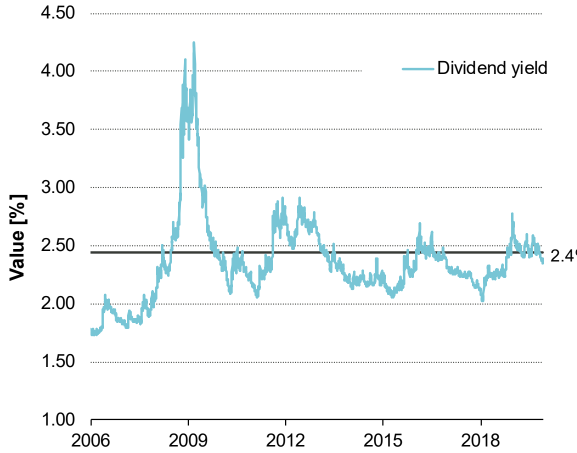


The chart shows the active equity weight (black line) of a global portfolio in euros with a neutral allocation of 50% equities and 50% cash. Foreign currencies are hedged. It also shows the contributions of the individual driving forces (term spread, TED spread, credit spread and dividend yield), which come together to give the active equity allocation. Information as of December 2, 2019

Dividend yield indicates slight overvaluation

A largely positive reporting season and hopes for agreement in the trade conflict were contributing factors in US stock market indices posting new highs in November. What is more liquidity supply from the most important central banks remains high, partly due to the resumption of the EBC bond buying program and various repo transactions for banks by the US Fed. The American bill for supporting human rights and democracy in Hong Kong did nothing to disrupt positive general sentiment on equity markets.

The model factors in dividend yields on G7 equity markets, weighting them in line with their GDP. The dividend yields serve as an indicator for the fundamental valuation of equity markets, which is currently 2.4%. The figure has dropped considerably in the wake of the positive performance on equity markets.



The chart shows the indicator for fundamental valuation, which measures the aggregated ratio of dividend to price and reflects the expected equity market yield as the central valuation parameter. The chart shows a weighted average of the indicators for fundamental valuation (blue line) of the major industrialized countries, the median of this instrumental variable and the 25% and 75% quantile of its distribution (thin gray lines). Information as of December 2, 2019

	December 2	November 1
Equity overweighting	**29.1%**	**37.7%**
Contribution of the term spread	22.4%	24.2%
Contribution of the TED spread	11.1%	10.7%
Contribution of the credit spread	-1.3%	-0.5%
Contribution of dividend yield	-3.1%	3.3%

The table shows the contributions of the instrumental variables to the equity overweighting at the beginning of the month.

Management of equity allocation with GLOCAP: Active divergences from the neutral position (50% cash, 50% equities) are entered into on the basis of an assessment of the economic environment. The long-term economic expectations (term spread), the stability of the financial system and the liquidity preferences (TED spread), market participants' trust in corporations (credit spread) and the fundamental stock valuation (dividend yield) are evaluated and quantified. The sum of the contributions of these indicators reflects the active equity over- or underweighting. The indicator for long-term business expectations is the difference between long-term and short-term interest rates of the major industrialized countries. The TED spread is the difference between interest rates for USD, JPY, and EUR investments on the euro money market and the associated government bond of the same maturity. The indicator for confidence in corporates is the spread of corporate bonds with low ratings versus top-rated securities. The global dividend yield measures the aggregated ratio of dividend to price on the equity markets and reveals the fundamental valuation on the equity market.

Government bonds

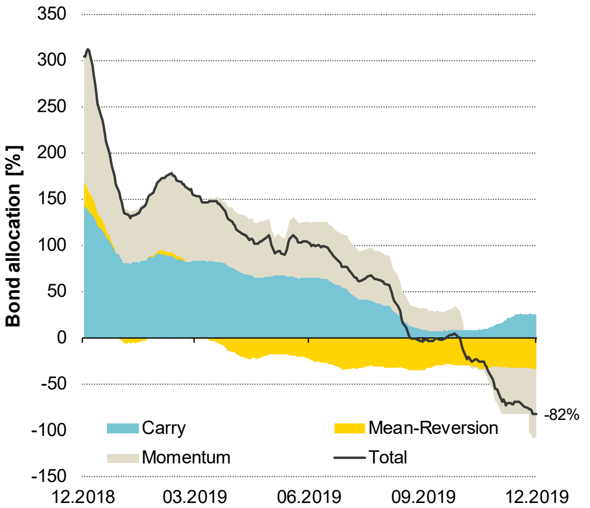
Increasingly negative position in global bonds

The allocation of a global bond portfolio declined considerably over the course of the month and amounted to a negative 82% at the start of December. The position in global government bonds held in the portfolio comprises the contributions of the individual carry, mean reversion, and momentum models.

Over the month, there was a reversal in the prevailing trend of declining carry amounts. The contribution to the bond allocation resulting from the carry model rose by 26% in the course of the month, taking account of the global yield curve which had again steepened somewhat. However, the biggest allocation driver in November was the momentum component. Due to prevailing negative sentiment, its allocation contribution backpedaled a further 31 percentage points, depressing the overall allocation of the bond model to -82%, thus clearly in short territory. Over the month there was virtually no movement in the mean reversion models which continue to indicate rising interest rates.

Negative weighting in Europe

For the three European bond markets in the portfolio (Germany, France and Italy), a short position is indicated at the beginning of December. While slightly positive carry signals are almost in equilibrium with negative mean reversion weights, current interest rate momentum drives this allocation.



The chart shows the bond allocation of a global portfolio in euros. The model allocation is calculated on the basis of the short-term forecast models carry, mean reversion and momentum. Information as of December 2, 2019

Optimism in trade dispute negatively impacting bonds

Optimism in the trade conflict was a negative factor for bond prices, particularly at the beginning of the month. With valuations on the bond market currently being high, even vague signals of détente between China and the USA were enough to generate considerable daily losses. The German 10-year yield has since moved considerably away from its September lows of -70 basis points. Even if the de-escalation signals prove to be less than sustained, optimism in November was enough to push the benchmark yield to a high of -23 basis points.

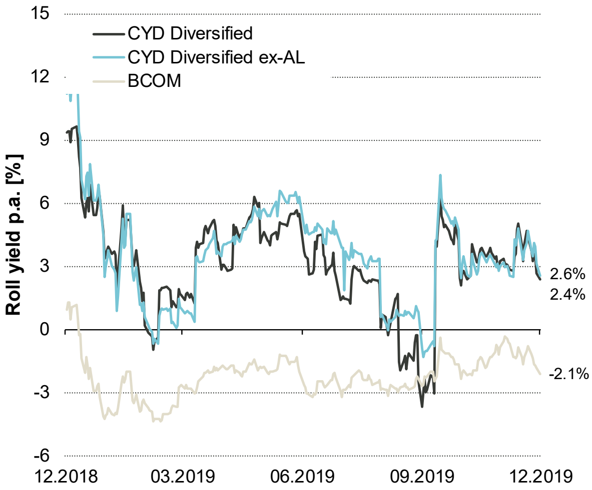
	TOTAL	CARRY	MEAN REVERSION	MOMENTUM
Global	-82%	26%	-33%	-75%
Germany	-13%	7%	-7%	-13%
France	-13%	9%	-10%	-12%
Italy	-3%	4%	-3%	-4%
Great Britain	-7%	0%	-3%	-4%
Switzerland	-15%	4%	-6%	-12%
US	-3%	0%	-2%	-1%
Canada	-1%	0%	-1%	-1%
Japan	-28%	2%	-1%	-28%

The table shows the bond allocation of a global portfolio in euros (total) broken down into individual countries. It also lists the contribution of the short-term forecast models carry, mean reversion and momentum to the total bond allocation. Information as of December 2, 2019

Active duration management with FINCA: The bond allocation is based on the FINCA multi-model approach, which is used as a tool for forecasting changes in the world's most important yield curves of government bonds and swaps. Short-term forecast models (carry, mean reversion, and momentum) are analyzed for each currency. The resulting allocation is then adjusted to economic conditions. Carry models optimally gear the portfolio dynamically to the expected carry in the respective currency. The carry results from the daily shortening of the term of a bond in combination with an interest rate change, assuming a constant or only slightly changing yield curve. Mean reversion models are aligned to the convergence of interest rates toward a long-term equilibrium. This convergence can be rationalized on the basis of the economic cycle or central banks' countercyclical setting of interest rates. Momentum models follow trends and in particular exploit quick changes in interest rates after political decisions or central bank announcements.

Select topics

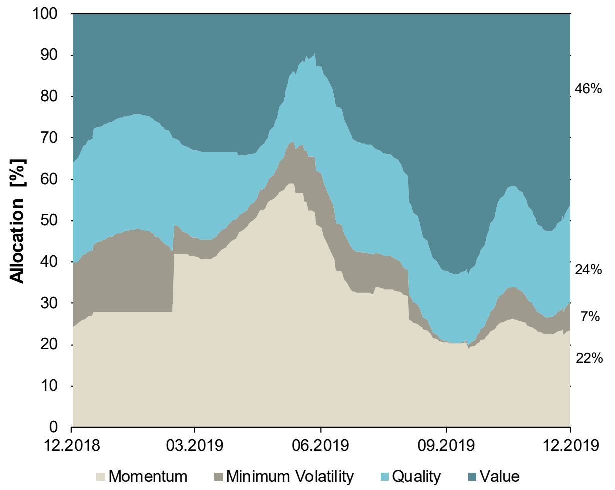
Natural gas and nickel weakest commodities in November
The aggregate roll yields of the BCOM Index (currently -2.1% p.a.) and the CYD Diversified Commodities Index (currently 2.4%) declined slightly in November. The CYD strategy continues to offer value added against the BCOM Index. There was a considerable correction after the roll yields and natural gas prices had increased to the end of October as a result of the cold temperatures in the USA. The fundamental situation (high inventory levels and production) combined with the prospect of warmer US weather resulted in prices slumping almost 20% within three weeks. Nickel prices also suffered in November (-18%) driven by the weak steel sector and allayed concerns on the supply side, despite exports of unprocessed ore from Indonesia being forbidden.



The chart shows the aggregate roll yields of the CYD Diversified Index, CYD Diversified ex-AL Index and the Bloomberg Commodity Index. Roll yields can be derived from the maturity structure of commodity futures. Information as of December 2, 2019.

Swiss equities: Attraction of value stocks stabilizing
At the beginning of December, the factor weights were almost unchanged month-on-month. The allocation continued to be shaped by an overweighting of the value factor (46%). The assessment of the short-term model impacts most in the overweighting. On the other hand, the long-term model contributes to weighting the momentum and quality factors.

The dynamic factor allocation is based on three sub-models that evaluate the economic environment, the price trend and the mean reversion potential.



The chart shows the factor allocation for the Swiss equities market. Based on an equally-weighted portfolio with 25% each in momentum, minimum volatility, quality and value, the factors are over- or underweighted according to market environment and attractiveness. Information as of December 2, 2019

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