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Market Overview

November 2019

Market overview: loose monetary policy and a booming Wall Street

Three in four central banks worldwide are easing their monetary policy or have announced plans for easing. What is crucial here is whether or not enough liquidity reaches the markets in time and interest rates are lowered sufficiently; after all, the central banks acted too late during the two big slumps of 2002 and 2008. The USD 60 billion newly arriving in the US each month via open market transactions are having a particularly positive impact at the moment. The Federal Reserve (Fed) has now, as expected, reduced its key interest rate for the third time in a row. After cutting the rate by 0.25 percentage points the Chair of the Fed, Jerome Powell, has signalled stability for the time being.

More action needed

If monetary easing were to result in a new economic upturn in 2020, this would more likely benefit cyclical stock markets like Germany. The global economy on the other hand would require far more support than these fiscal policy stimuli – such as tax cuts for instance.
The UK should actually have left the EU on 31 October 2019. But that did not happen: the Brexit deadline has been extended again by up to three months. This is the third postponement already. The British parliament has called for new elections on 12 December 2019; 438 members of parliament voted in favour of Prime Minister Boris Johnson’s motion.
There is some movement in the trade conflict between the US and China: talks regarding an interim trade deal are progressing, raising hopes of a deal being signed by the heads of state and government of the two superpowers.

Wall Street continues upward trend

From a technical market perspective, Wall Street is making a good impression by international standards. New historic share index highs could still be within reach in the US before the end of the year. As with the US bond market where, by international standards, relatively high interest rates are attracting capital, a new increase could trigger higher overseas purchases of American equities (= dollar supply), which could curb an overdue correction on the dollar.
The favourable reporting season in the US has been a particular source of momentum. Company results have been positively surprising thus far, although expectations had been adjusted downwards. In one of the most significant findings, 82% of companies earned more money than expected by Wall Street. For that reason the success rate is higher than usual. The current quarterly results have dispelled fears that the American economy could be drifting towards recession, but a flattening of the yield curve is unavoidable.

DAX benchmark falls

DAX companies are faced with a number of worries. These include in particular cyclicals and companies with a high export ratio. In the second quarter, the operating profit of index members fell by approximately 30%. Now a stabilisation is expected at the very least. Claims were

substantially reduced; as a result, the benchmark is low too.
Gold held up well despite its overbought position (sell signals reflecting the highs of 2016) and remained surprisingly stable given the almost non-existent purchases by India and China. The expansionary policies of central banks worldwide and an absence of real interest rates should lead to higher gold prices in the medium term. There is unlikely to be any shortage of geopolitical crises in the future.

Fixed income: Mario Draghi leaves – low interest rates remain

Bond interest rates have risen sharply over the course of the month. Some investors are likely to have used the now increased return level to secure higher returns in the run-up to the ECB's upcoming new quantitative easing (QE) programme. Furthermore, the spreads of Italian government bonds have continued to narrow compared with their peers. Nearing its conclusion, the great Brexit soap opera is still a source of major interest – although investors are sceptical and doubtful of whether or not this drama has reached its final act. The European Central Bank (ECB) adopted an unchanged interest rate policy. It has rightly identified further downside risks to the economic outlook and remains ready to take further action if need be. As expected, Mario Draghi is not pushing new developments anymore. And he has no advice for his successor Christine Lagarde. According to Draghi, she will now have ample time to form her own policies. He stressed that interest rates were likely to remain low in the long term, something which is reflected in the "open-ended" interest rate guidance of the ECB. Draghi also underlined that monetary policy makers will continue to do their work, but faster and with less side effects if fiscal policy plays a more active role.

When will the recession reach the service sector?

Mood indicators have taken away any hopes of a trend reversal: the industry recession continues. The big question is whether or not the service sector can remain resistant to this given that the prospect of a genuine recession is becoming more and more likely. Even if the latest weak economic data was not enough to diminish returns considerably, it is reinforcing the low-interest-rate environment.
Countless transactions were pending on the new issue market. In the euro segment, the emphasis was on the long end of the interest curve. In light of the negative returns on 10-year securities from core Europe, bond investors switched their focus to return stocks with very long terms. Last month, the demand for bonds on the primary market was so great that the issue premiums narrowed considerably. Furthermore, states and companies with disproportionately high levels of debt refinanced themselves on the bond market in order to benefit from the low-interest-rate environment. In light of ongoing speculation about further reductions of the key interest rate by the Fed, many shares were also issued in USD, particularly in the case of companies with lower ratings.

Alternative investments: How do I go about choosing my ILS manager?

The ILS asset class (insurance-linked securities) has been dealt with here on more than one occasion. An ILS manager or ILS fund invests in insurance-linked assets like catastrophe bonds and private reinsurance with primary insurers and reinsurers. In return for coverage of event risks – primarily natural disasters – the fund is compensated with premiums. Over an extended period, these premiums should exceed the payouts by insurance policies for any events occurring, leaving us as investors with an attractive net return.

Tough years for ILS investors

2017 and 2018 were real endurance tests for ILS investors; the costs of insured damages exceeded the premiums received and brought losses. 2019 has seen a positive performance thus far by the standards of the ILS indices, but one which has remained below expectations. A negative performance is expected for October, too, following the typhoons in Japan.

Major differences between ILS managers

Discrepancies between the performances of different managers have been surprisingly high over the past few years. These years of damage have had the positive effect of helping allocating investors to evaluate and select managers by providing them with a huge number of data points. It was for example revealing to see how positions were valued, whether or not difficult-to-value positions were moved to a side pocket on time, how loss estimates (loss creep) developed and, above all, how trapped collateral was dealt with. Trapped collateral can be understood as follows: Where a private contract has been entered into directly with the counterparty, the capital of the counterparty can be retained until it is 100% clear whether or not the contract is affected. During this time, the capital will not be available to the fund and the level of investment will drop, impacting the anticipated return negatively.

50 providers in the universe

The investment universe comprises roughly 50 designated ILS managers, frequently offering more than just one fund. It is customary to offer different funds with varying risk profiles (measured by the degree of annual anticipated loss). Most managers invest in both catastrophe bonds and private transactions. There are, however, specialists like Fermat which focuses on cat bonds, or various Bermuda-based managers that specialise exclusively in private transactions (Hiscox, AlphaCat, Aeolus), or even just retrocessions (reinsurance for reinsurers). There are even a handful of ILS funds-of-funds on offer.
The majority of the funds are offered in an open-end format. In this case, a certain ratio of cat bonds for liquidity management is usually unavoidable so as to facilitate any redemptions if need be. Somewhat more unusual is the issue of a closed-end structure, built up by means of one or two capital calls. The risk period will then last no longer than one or two years, since private contracts generally run with a risk period of twelve months.

Revealing ownership structures

The last few years have seen a wave of M&A transactions; the number of independent companies has fallen. Ownership structures should therefore be given adequate consideration when selecting an ILS manager. There are three models here: The majority of the shareholders belong to the management board (Twelve Capital), an asset manager (Credit Suisse) or a reinsurer (SCOR). The ownership structure influences the sourcing of transactions, the counterparties, the incentive structure for managers or even the approach to trapped collateral. It is therefore advisable not just to consider the ILS quota in a portfolio, but to prioritise effective implementation and the manager selection process too.

Equity markets	Oct 31th	% October	% YTD
MSCI AC World	266.21	2.74	19.38
SMI	10’219.82	1.40	21.24
SPI	12’337.05	0.85	25.50
DAX	12’866.79	3.53	21.86
EuroStoxx 50	3’604.41	0.98	20.09
EuroStoxx 600 Price Index	396.75	0.92	17.50
FTSE 100	7’248.38	-2.16	7.73
DOW Transportation	10’498.86	1.31	14.49
S&P 500	3’037.56	2.04	21.17
NASDAQ 100	8’083.83	4.31	27.71
Shenzen-Shanghai CSI300	3’886.75	1.89	29.10
Emerging Market	1’041.98	4.09	7.89
Nikkei	22’927.04	5.38	14.55
Volatilität	13.22	-18.60	-47.99

Commodities	Oct 31th	% October	% YTD
WTI-CrudeOil	54.18	0.20	19.31
Brent Oil	60.23	-0.90	11.95
ThomReuters /JefferiesCRB	176.89	1.70	4.18
Gold	1’512.99	2.75	17.97

LIBOR	Oct 31th	% October	% YTD
Libor 6M CHF	-0.69	3.26	-9.78
Euribor 6M	-0.40	2.75	-33.44
Libor 6M USD	1.92	-6.78	-33.36

Alternative Investments	Oct 31th	% October	% YTD
S&P Leveraged Loan TR Index	2’990.53	-0.45	6.31
Swiss RE Cat Bond TR Index	337.66	0.44	3.84
HFRX Global Hedge Fund Index	1’263.90	0.31	6.22

Currencies	Oct 31th	% October	% YTD
EUR/USD	1.1152	2.32	-2.75
USD/CHF	0.9864	-1.13	0.44
USD/JPY	108.0300	-0.05	-1.51
EUR/CHF	1.1001	1.15	-2.26
GBP/CHF	1.2766	4.06	1.94
CAD/CHF	0.7493	-0.56	4.01
AUD/CHF	0.6800	0.98	-2.05
JPY/CHF	0.9132	-1.09	1.92
BRL/CHF	0.2450	2.08	-3.16
CNY/CHF	0.1402	0.43	-1.75
INR/CHF	0.0139	-1.42	-1.42
RUB/CHF	0.0154	0.13	8.60
TRY/CHF	0.1727	-2.28	-6.95
ZAR/CHF	0.0653	-0.91	-4.39

Countries / GDP	%Q3 18	% Q4 18	% Q1 19	% Q2 19	% Q3 19	% Q4 19	% 2018	% 2019	% 2020
USA	3.50	2.20	3.10	2.00	1.80	1.70	2.90	2.30	1.70
Euro Area	1.70	1.15	1.20	1.20	1.10	1.00	1.80	1.10	1.00
Japan	-1.20	1.40	2.20	1.30	0.60	-2.70	0.70	0.90	0.30
China	6.50	6.40	6.40	6.20	6.00	6.00	6.60	6.10	5.90
Schweiz	2.90	1.90	0.95	0.90	0.80	1.10	2.60	0.80	1.20

Countries / CPI	%Q3 18	% Q4 18	% Q1 19	% Q2 19	% Q3 19	% Q4 19	% 2018	% 2019	% 2020
USA	2.60	2.20	1.60	1.80	1.80	2.00	2.40	1.80	2.10
Euro Zone	2.10	1.90	1.40	1.40	1.00	1.20	1.70	1.20	1.20
Japan	1.10	1.00	0.30	0.80	0.30	1.00	1.00	0.60	1.00
China	2.20	2.40	1.80	2.60	2.72	3.10	2.10	2.50	2.40
Schweiz	1.10	1.00	0.60	0.60	0.45	0.30	0.90	0.50	0.70

Rates	Oct 31th	in bps Oct	in bps YTD
10j. USD (Swap)	1.60	3.82	-110.65
10j. EUR (Swap)	0.02	17.52	-78.84
10j. UK (Swap)	0.82	17.32	-61.40
10j. CHF (Swap)	-0.23	16.55	-52.95

Bonds	Oct 31th	in bps Oct	in bps YTD
US Govt 10Y	1.69	2.56	-99.32
GER Govt 10Y	-0.41	16.46	-64.73
Swiss Govt 10Y	-0.59	19.98	-30.93
UK Govt 10Y	0.63	14.42	-64.74
IT Govt 10Y	0.92	10.10	-181.80
ESP Govt 10Y	0.23	9.21	-117.82

Generic iTRAXX	Oct 31th	in bps Oct	in bps YTD
Europe Main	51.93	-3.20	-35.44
Finl Sen	60.49	-3.75	-48.03
Finl Sub	124.88	-14.51	-103.51
X-Over	239.40	7.74	-113.30

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