

January 2020

Interest rates & bonds

What political risks?

USA

- The US and China agreed in principle on a phase one trade deal that should de-escalate the tense political situation by removing certain tariffs and halt the implementation of others
- We do not foresee any policy rate adjustments by the Federal Reserve in 2020, but the current FOMC projections (“dot plot”) indicate a hike for 2021, a move we currently do not expect

Eurozone

- Economic data out of Europe have generally disappointed. Manufacturing surveys have stabilised at low levels, not yet indicating a swift rebound of industrial production
- The ECB has a new President, Christine Lagarde, but we do not expect any change in the ECB’s loose monetary policy stance

UK

- The Conservative Party secured a landslide victory in the December general election, which will enable Boris Johnson to take the UK out of the EU by end of January 2020
- Gilts held relatively steady while the GBP performed an up and down after the election results

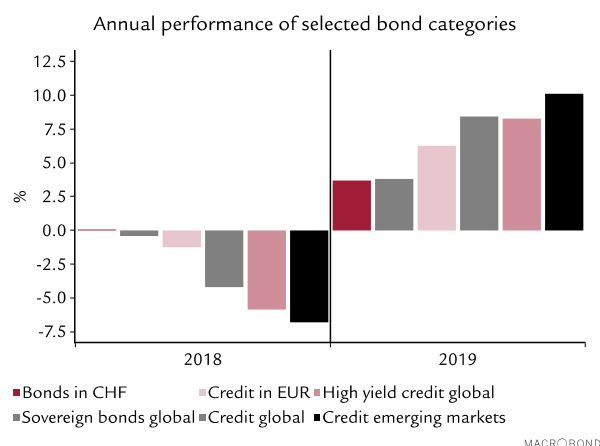
Switzerland

- Third-quarter GDP surprised positively but was boosted by non-cyclical factors. In line with weak business surveys, we expect economic momentum to soften again
- The SNB has kept a dovish stance and is likely to keep the policy rate unchanged in 2020

Japan

- Economic data out of Japan show a relatively strong boom and bust pattern around the October consumption tax hike
- The Bank of Japan could stay on hold for longer after Prime Minister Abe unveiled a fiscal stimulus package to bolster growth

2019 performance as a mirror image of 2018



Christmas arrived early for investors as the US and China laid the ground for a “mini trade deal” and the UK elections brought more clarity on the Brexit front. Besides receding political risks, markets still enjoy the tailwind from “easy money” by central banks, and the global economy seems to be in a better shape than we thought just a few months ago. At the end of 2019, we are therefore seeing quite literally the mirror picture of 2018 and instead of losses, investors can look back at equity-like returns in global bond markets. But what does that mean for 2020? Will we likewise get a mirror performance or have another record year? We think it will be in-between, but the risks are skewed to the downside, given the already low interest rates and very tight credit spreads. That said, we think that the beginning of the year will be supportive of bonds with relatively stable interest rates and tighter credit spreads. But 2020 will not be a one-way street, in our view. On the one hand, the risk for a rebound in global interest rates rises if recession risks get priced out further. On the other hand, there are ample smouldering political hot spots that could derail global growth, while corporate fundamentals in many sectors remain weak. Good sector allocation and security selection will therefore be key to generate excess returns in a likely volatile and difficult market environment.

Equities

Another good year ahead?

USA

- US equities have performed in line with global equities recently, benefitting from the positive developments in the US-China trade conflict
- We keep a positive view on equities in general and US equities in particular. The latter remain supported by the continued outperformance of the US economy, especially compared to Europe

Eurozone

- Despite positive news from the political front (trade dispute, Brexit), EMU equities continued to underperform over the past weeks, with Germany being the main drag
- We remain underweight Eurozone stocks mainly for macroeconomic reasons. In the absence of a strong rebound in external demand, growth is set to remain subdued.
- Additionally, structural overcapacities in Germany weigh on growth and substantial fiscal stimulus, which might be a positive catalyst, is not to be expected anytime soon

UK

- After the Conservative victory in the general election, it is clear there will be a Brexit end of January. UK equities had a relief rally just after the election
- What remains unclear, however, is how long-term trade relations with the EU will look like after the transition period. Hence, we see continued uncertainty going forward and keep a cautious view on UK equities

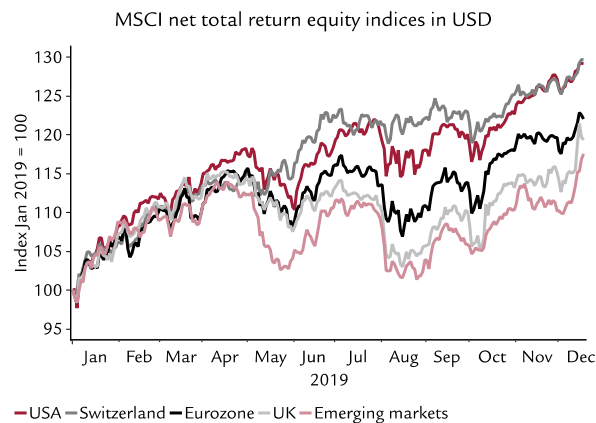
Switzerland

- Swiss stocks have performed strongly in weak market phases in 2019, while still participating well in positive markets. Overall, Switzerland has been among the best-performing equity regions in 2019
- Heading into 2020, we stick to our overweight position in Swiss equities

Japan

- We expect the recent positive effects on the Japanese stock market (mostly easing trade tensions) to fade and the weak economic fundamentals in Japan to come back to the fore. We stay underweight Japanese equities

A strong year, especially for US and Swiss equities



After an extraordinarily good year for equity markets, investors are wondering if and how this positive trend might extend into 2020. We see several reasons for equities to trade moderately higher, most of all the lack of alternatives for a multi-asset investor to generate positive returns. In the global fixed income space for example, a whopping USD 11.7 trn of bonds still yield negatively. Also, many investors have missed out 2019 at least partially and are waiting for any potential correction to enter the equity market. Hence, we think that the “buy-the-dip” mentality will remain in place among investors, which would keep any potential drawdown in check.

On the macroeconomic side, 2020 will likely be a year of moderate, slightly below-potential growth in developed markets with inflation well in the comfort zone of central banks. This is usually a favourable environment for risky assets, as the two main risks – recession or a steep rise in interest rates – are being moved on the back burner. Nevertheless, recession fears might quickly resurface if political risks were to flare up again. Despite the latest détente in the trade dispute, the fundamental issues between the US and China are far from resolved and Brexit worries are set to return if the UK government indeed refuses to extend the transition period. In light of these and other unpredictable risks (e.g. Hong Kong and Middle East tensions, impeachment proceedings in the US etc.), we expect 2020 to be a volatile year on the equity market. Hence, we prefer defensive strategies to implement our positive view on equities.

Currencies

Moving to a neutral view on EUR/CHF

USA

- The USD lost against all major currencies in the first half of December as US-China trade tensions eased. The exception was USD/JPY, which held steady over the same period
- We expect the USD to regain support against EUR and CHF over the next three months. The main reasons are the favourable interest rate differential and the outperformance of the US economy compared to Europe

Eurozone

- The easing of political risks (Brexit, trade tensions) supported cyclical currencies such as the EUR recently
- Nevertheless, the Eurozone economy has remained in the doldrums and business surveys suggest that a swift recovery of manufacturing production is not in the cards yet. We keep a negative view on EUR/USD

UK

- The Conservatives' victory in the general election provided a short-lived boost to sterling, but fears of a potential hard trade rupture with the EU at the end of the transition period in December 2020 erased these gains
- We expect the political noise to increase as we move towards UK-EU trade negotiations and prefer a neutral view on GBP/USD over a three-month horizon

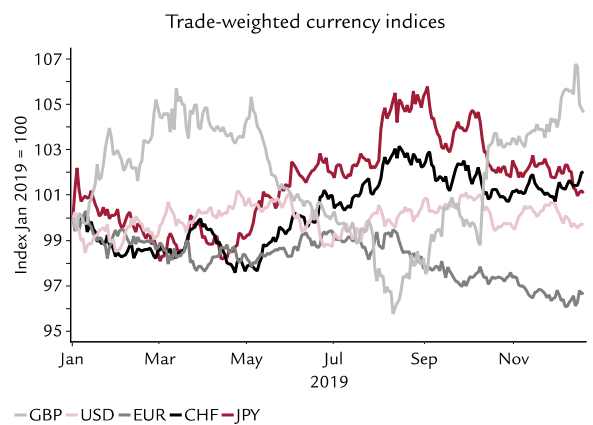
Switzerland

- Even though political risks receded, CHF remained surprisingly well supported in the first half of December, appreciating against EUR and USD
- At these levels, we see further upside against EUR as limited and have thus moved to a neutral view on EUR/CHF

Japan

- The upward trend of USD/JPY since August has almost come to a halt in November and December despite a risk-friendly investor sentiment
- As political risks have receded somewhat and the Japanese economy is expected to perform poorly due to the recent consumption tax hike, we expect a higher USD/JPY exchange rate over the next three months

Sterling moving from worst to best-performing currency




MACROBOND

2019 has been a remarkable year on currency markets. Sterling performed a roller coaster ride in line with perceived no-deal Brexit risks, moving from best (first half of 2019) to worst (August) and back to best-performing currency among the majors. Nevertheless, the significant post-election rally of sterling was erased in just three days. The reason was Boris Johnson's assertion, intended to be written in law, not to extend the transition period beyond 2020. This keeps the threat of a hard Brexit after the transition period alive. Our cautious view on sterling already expressed in the last edition of this publication thus proved to be correct, and we continue to hold a neutral view on GBP/USD over a three-month horizon. The other remarkable feature in 2019 was the consistent underperformance of the EUR, reflecting underwhelming economic growth, monetary policy frozen at sub-zero rates and widespread political standstill in terms of fiscal policy and reforms. We think that the structural issues haunting the Eurozone as well as the cyclical headwinds will remain in place in 2020 and keep a negative view on EUR against USD. The latter also remains supported by a favourable interest rate differential. Even though we remain cautious on global growth, we acknowledge that political risks have eased somewhat, especially regarding the US-China trade dispute. Hence, we changed our view on safe-haven currencies. First, we expect that the positive trend of USD/JPY will extend over the next three months. Second, we no longer expect the CHF to appreciate against EUR, but have instead adopted a neutral view on the currency pair.

Swiss Life Asset Managers



Marc Brütsch
Chief Economist
marc.bruetsch@swisslife.ch
 @MarcBruetsch



Michael Klose
CEO Third-Party Asset Management
michael.klose@swisslife.ch

Do you have any questions or would you like to subscribe to this publication?

Please send an email to: info@swisslife-am.com.

For more information visit our website at: www.swisslife-am.com/research



Released and approved by the Economics Department, Swiss Life Asset Management Ltd, Zurich

Swiss Life Asset Managers may have acted upon or used research recommendations before they were published. The contents of this document are based upon sources of information believed to be reliable but no guarantee is given as to their accuracy or completeness. This document includes forward-looking statements, which are based on our current opinions, expectations and projections. We undertake no obligation to update or revise any forward-looking statements. Actual results could differ materially from those anticipated in the forward-looking statements.

France: This publication is distributed in France by Swiss Life Asset Managers France, 153 rue Saint-Honoré, 75001 Paris to its clients and prospects. **Germany:** This publication is distributed in Germany by Corpus Sireo Real Estate GmbH, Aachenerstrasse 186, D-50931 Köln and Swiss Life Invest GmbH, Zeppelinstrasse 1, D-85748 Garching b. München and BEOS AG, Kurfürstendamm 188, D-10707 Berlin. **UK:** This publication is distributed by Mayfair Capital Investment Management Ltd., 55 Wells St, London W1T 3PT. **Switzerland:** This publication is distributed by Swiss Life Asset Management Ltd., General Guisan Quai 40, CH-8022 Zurich.