

November 2019

## Interest rates & bonds

Central banks – the only game in town

### USA

- Business confidence surveys in the US continue to weaken, while consumer confidence and GDP growth have remained relatively robust
- The US Fed reduced the policy rate by another 25 basis points in October, which we expect to have been the last rate cut for this year

### Eurozone

- Eurozone economic activity remains sluggish, with Germany and Italy being the weak spots, while France and Spain fare relatively better
- In November, the ECB will restart its asset purchase program, which should provide technical support for bond prices and keep interest rates anchored in negative territory

### UK

- The Brexit saga took an unexpected turn for the better with a no-deal divorce now being a highly unlikely outcome. Nevertheless, the uncertainty regarding future relations between the UK and EU is staying with us for the foreseeable future
- Despite the appreciation of Sterling and the soft patch in inflation, we do not expect the Bank of England to cut policy rates

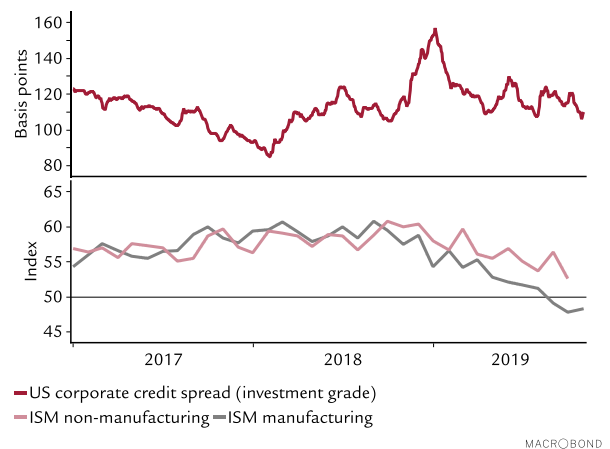
### Switzerland

- Like other export-oriented economies, Switzerland is currently feeling the negative impact of the global growth slowdown
- We currently do not foresee further monetary stimulus from the SNB but expect ongoing interventions in the foreign exchange market if needed

### Japan

- Japan's growth prospects are clouded by the increase of the consumption tax in October 2019
- The Bank of Japan kept its policy rate unchanged in October, but introduced an easing bias as underlying inflation remains weak

### Tighter credit spreads despite weaker business sentiment



Markets have been dominated by politics and central bank actions this year, while deteriorating fundamentals seem to be only a peripheral issue on investors' minds. US credit spreads tightened by 6 basis points in October while total returns were slightly negative due to rising interest rates. In the meantime, the S&P 500 hit a new all-time high, fuelled by the hope of a mini trade deal between the US and China. Yet at the same time the ISM manufacturing index in the US just hit a 10-year low. Similarly, we are starting to see weakness in services. US corporate earnings growth is slowing, and the deterioration of credit fundamentals continues. Europe does not look any better, with most sentiment indicators flashing bright red. So, the question is: How long can valuations remain decoupled from fundamentals? We think they still can for a while given the strong technical support. Especially in Europe, the restart of ECB net asset purchases will likely suppress volatility, keep credit spreads from moving materially wider and anchor interest rates in negative territory. In the US, the picture is less certain, but we also expect the Fed to stand ready to act should it become necessary. We are therefore constructive but selective with respect to credit risk and maintain a neutral to slightly long duration position in both key markets.

## Equities

Up and down and up again?

### USA

- After a positive September, US markets started into October with an initial drop followed by a rebound. Yet again, the trade war that contributed significantly to zig-zagging markets. Upside surprises in company earnings and sales had a somewhat re-assuring impact that supported the swift re-stabilization of markets
- The US equity market remains highly concentrated, which we watch with growing concern since some of the big elephants in the IT sector are increasingly exposed to legal and regulatory challenges

### Eurozone

- The Eurozone equity market clearly benefited from the positive developments around Brexit, which led to an outperformance against the US market in the second half of October
- However, we think it is unlikely that Eurozone equities will continue to outperform as many political issues remain unresolved

### UK

- Even if a Brexit deal is ultimately delivered by the end of January 2020, uncertainties regarding the long-term regulatory arrangements with the EU remain elevated
- We keep an underweight position in UK equities since volatility is likely to stay higher than in other markets

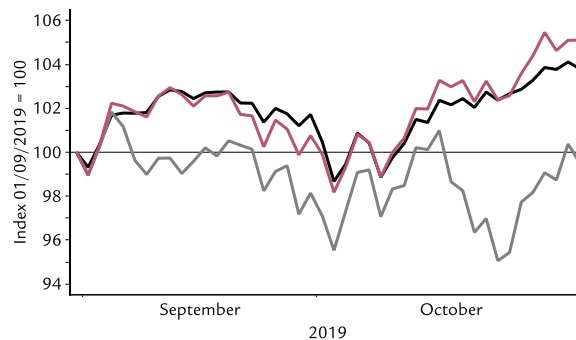
### Switzerland

- Swiss stocks have outperformed global equities year-to-date
- We stick to our preference for large caps, as they are less affected by a strong Swiss Franc and likely to be more robust in case of market disruptions

### Japan

- In the past two months, Japanese stocks have reduced some of the significant underperformance year-to-date. Nevertheless, we expect the rally to be temporary and keep a cautious view on the market
- Over the last weeks roughly 10% of the companies reported their earnings, painting a mixed picture. Companies in Health Care and Utilities largely surprised on the upside, while Technology and Industrials have rather disappointed so far

### Software stocks have lagged recently



— NASDAQ 100 Index  
— S&P North American Expanded Technology Software Index  
— S&P 500 Index

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We have already commented in earlier issues about the high equity market concentration that has been largely driven by tech companies, mainly in the US but also in Europe. We are concerned that this development is not a new steady state. It rather represents a risk that a correction could occur at some point. Such a correction could be triggered by changes in regulation or disappointments regarding elevated growth expectation. However, we think that any potential unwinding of the crowded tech trade would mainly be focused on a few but highly capitalised software stocks. The chart above highlights the recent evolution of the US large cap index S&P 500, the broad US technology index Nasdaq 100 and the S&P index for North American software companies. While the Nasdaq managed to outperform the S&P 500 over a two-month horizon, software companies performed poorly during that time. The regulatory and political environment becomes increasingly tough for these companies, as the recent Facebook Congressional interrogation vividly illustrates. It remains to be seen in which direction the situation evolves and whether the issues that large software firms are facing today will spill over to other major parts of the tech sector.

## Currencies

A more challenging environment for USD in 2020

### USA

- In October, a “risk-on” sentiment prevailed in financial markets as political risks receded. As a result, the USD weakened against all major currencies except the JPY
- The US Federal Reserve cut the policy again at the October FOMC meeting, but signalled, in Jerome Powell’s words, an end to the “midcycle adjustment”. Nevertheless, the interest rate differential remains favourable for the USD, which we expect to recover over the coming month

### Eurozone

- The most recent business surveys brought some stabilisation in Germany and an improvement in France. The somewhat more benign macroeconomic backdrop also contributed to the rebound of EUR exchange rates in October
- Nevertheless, growth dynamics remain weak and we expect political risks to flare up again after the recent lull. Hence, we continue to prefer a negative view on EUR both against USD and CHF

### UK

- The GBP/USD exchange rate showed the biggest monthly gain since May 2009 as no-deal Brexit risks were priced out in financial markets
- As an acceptable deal is now available, we expect a favourable Brexit outcome to prevail. Nevertheless, political uncertainties will remain elevated until the December general election, and we prefer a neutral view on GBP against USD over the coming month

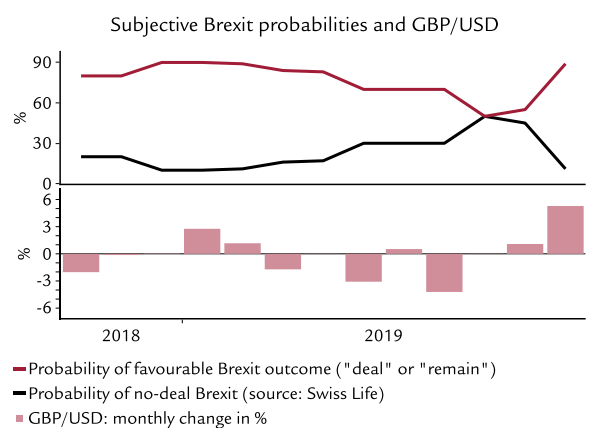
### Switzerland

- CHF lost against the cyclical EUR in October, but strengthened vis-à-vis the USD
- The recent easing of political risks will likely prove to be a temporary phenomenon, and we also expect global recession fears to flare up again periodically. Hence, we retain a positive view on CHF against EUR

### Japan

- As markets were in full-blown “risk-on” mood in October, JPY lost against all major currencies
- Nevertheless, we reiterate our positive view on JPY for the same reasons mentioned above for the CHF

### No-deal risks evaporate, Sterling spikes




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The most spectacular currency move in October pertained to Sterling, which rallied more than 5% against the USD. No-deal Brexit risks were rapidly priced out due to the surprising emergence of a palatable deal between the UK and the EU. Even though uncertainties will remain elevated in the UK as we head towards the general elections in December, we think it is unlikely that no-deal worries will return among investors. Hence, we have shifted to a neutral view on GBP against USD. Echoing the positive Brexit developments, risks regarding an escalation of US-China trade tensions also receded significantly, which led to a drop in defensive currencies in October. While we indeed expect a “mini trade deal” to be signed this year between the US and China, we remain sceptical that a more comprehensive second trade deal will follow next year. Hence, we think that political risks will return after the recent improvements and thus prefer a positive view on safe haven currencies such as JPY and CHF. Regarding USD strength, the situation will become more challenging as we head into the next year. Most notably, we expect the US economy to slow in 2020. This might prompt the Fed to deliver more easing in 2020 after the pause in the “midcycle adjustment” that was announced at the recent October FOMC meeting. Despite these risks, we expect the USD to remain supported in the near term, also due to the still very favourable interest rate differential compared to other major economies.

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