

December 2019

## Interest rates & bonds

Crisis averted or crisis postponed?

### USA

- A more positive tone from the trade war negotiations, stabilising macroeconomic data and a better-than-expected earnings season have led to an improvement in sentiment, supporting risky assets
- Remarks from the Fed were rather hawkish, indicating unwillingness to cut rates further

### Eurozone

- In Europe, macroeconomic data also started to stabilise, although at lower levels with ongoing weakness in the manufacturing sector
- Despite the ECB's re-started corporate bond buying program, credit spreads widened as the market had to digest a glut of issuance

### UK

- UK elections are taking place this month, with Conservatives aiming for Brexit at the end of January, while the Labour party is open for a second referendum
- UK Gilts will likely remain range-bound as investors await the outcome of the election and a possible reaction from the Bank of England

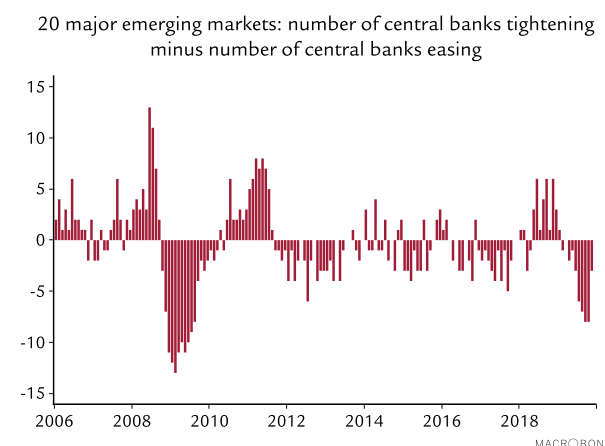
### Switzerland

- The Swiss economy stopped slowing as the manufacturing PMI almost jumped back to the 50 points mark and GDP grew by a surprisingly strong 0.4% in the third quarter
- While the SNB stands ready to intervene in the foreign exchange market, we do not expect a rate cut going forward

### Japan

- Japan's economy continues to struggle with the fallout from the trade war and the additional headwind from the consumption tax hike
- The Bank of Japan indicated that it might lower the target rate further if inflation does not move towards its 2% target

### Emerging market central banks on an easing spree



As investors put political risks somewhat on the back burner in November, corporate bond markets experienced lower volatility than in previous months. Spreads for EUR bonds drifted a tad wider, mainly driven by strong new issuance, especially from US companies. USD bonds, however, tightened by 4 basis points, as falling currency hedging costs attracted foreign buyers. Absent any escalation of the trade dispute, we expect this year to end on a positive note as spreads will likely move sideways. The macroeconomic environment has started to show signs of stabilisation amid a synchronised easing of central banks globally. And it wasn't just the ECB and the US Fed that were ready to loosen monetary policy again. Emerging market central banks opened the monetary floodgates at the highest rate since the financial crisis (see chart above). That said, we expect the positive effects from these easing measures to diminish in 2020 and would not yet call for a strong economic recovery. We therefore remain neutrally positioned with a preference for European corporate bonds over US credit. The strong technical support from the ECB's bond buying program should provide a backstop to any potential spread widening. For the end of the year we expect government bond yields to fall slightly, driven by demand and supply dynamics.

## Equities

Recession fears fading – will animal spirits persist?

### USA

- The trade war discussions have moved into a positive direction and macroeconomic data have generally surprised to the upside, which has pushed US stocks to new record levels with the S&P 500 having gained 26% year-to-date
- We still see some upside potential for equities until year end, but any escalation on the political front remains a non-negligible risk

### Eurozone

- Germany narrowly avoided a technical recession in the third quarter. While the Dax, despite the weakening macroeconomic conditions, performed in line with the MSCI EMU year-to-date, the mid and long-term effect of the slowdown of the biggest economy in Europe might weigh significantly on Eurozone stocks going forward
- US stocks, especially after considering the currency effect, have been the better choice for European investors year-to-date, and we do not currently see a trigger to change our overweight of US vs. Eurozone equities

### UK

- Investors were cautious on UK equities ahead of the general elections and UK stocks missed out the latest rally in global equities
- We keep our underweight position in UK equities given ongoing political risks

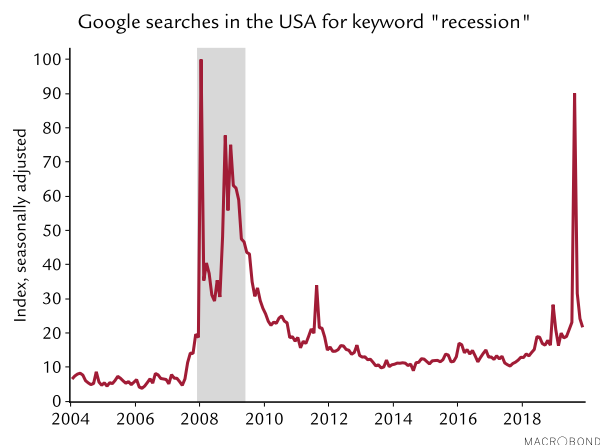
### Switzerland

- Although US stocks advanced more than Swiss equities in November, the latter held up very well on a year-to-date basis and remain a good choice for investors in our view, especially as a defensive “hedge” in an equity portfolio

### Japan

- In the last two months, the Japanese stock market has benefited from a weaker yen, easing trade tensions and signs that the consumption tax hike might have a weaker-than-expected impact on the economy
- However, we do not see much reason for further out-performance here and keep our cautious view on the market

### Recession fears taking a back seat



Company earnings as well as macroeconomic data have generally surprised positively as of late. Hence, equity markets maintained their positive momentum and might drift even higher until year-end. Unless a “political accident” were to happen, a major sell-off as we saw end of last year is unlikely to occur. While such political accidents are nearly impossible to predict, macroeconomic developments can at least be monitored to provide guidance for investors. What keeps us optimistic in the short run is that the latest set of macroeconomic data was solid enough to literally move the recession topic out of people’s mind, as can be seen in the chart above. Since the peak in August, Google Trends data show that internet user’s interest in the keyword “recession” has receded significantly. Nevertheless, a renewed deterioration in macroeconomic data or flare-up of political issues might bring such fears back on the table, especially as investors are aware that the current upswing in the US is already the longest in US history. Hence, many investors have chosen to be cautious and to stand at the side-lines, which is a bad strategy, in our view. We believe that defensive strategies such as minimum volatility or protected equities provide a better solution as they enable participation to the upside but still buffer market drops.

## Currencies

### US economic outperformance supports USD

#### USA

- In November, solid macroeconomic data and less easing expectations for US monetary policy led to a stronger USD against all major currencies, with GBP being the exception
- We maintain a positive view on the USD over the next few weeks. Apart from solid data, the USD should continue to benefit from a favourable interest rate differential compared to other currencies

#### Eurozone

- Business surveys suggest that the worst is over in the European manufacturing sector and that momentum might stabilise. However, signs of a more pronounced recovery are still elusive
- We still expect the Eurozone economy to underperform until year-end and thus stick to our negative views on EUR/USD and EUR/CHF – views which have played out well so far this year

#### UK

- Even though the Tories extended their lead over Labour in polls for the general election, GBP only appreciated modestly against USD in November
- We continue to prefer a neutral view on GBP ahead of the general elections

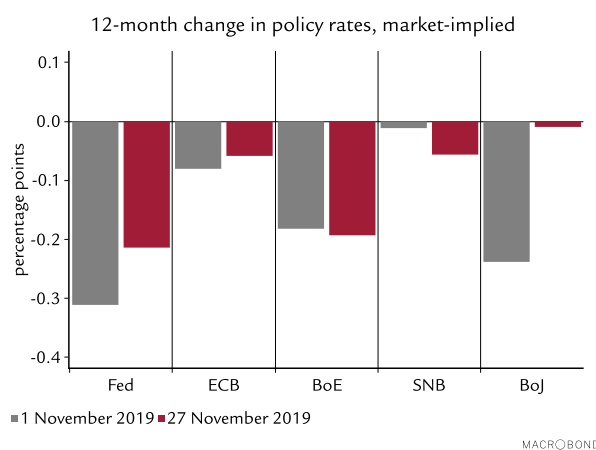
#### Switzerland

- Despite a generally risk-friendly investor sentiment in November, CHF remained unchanged on a trade-weighted basis. Apparently, many investors remain sceptical that the recent easing of political risks will prove long-lived
- We would agree with such a view and thus reiterate our positive view on CHF against the cyclical EUR

#### Japan

- Even though markets started to price out rate cuts by the Bank of Japan, the yen lost somewhat against the USD in November
- Nevertheless, we reiterate our positive view on JPY for the same reasons mentioned above for the CHF

#### Change in US monetary policy expectations



The month of November showed a pattern all-too-familiar to FX traders this year: The USD remained well supported against most major currencies, gaining 1% on a trade-weighted basis. Meanwhile, the EUR extended its dismal year-to-date performance and lost 1% against the USD as well as on a trade-weighted basis. One of the most important drivers for USD strength – not only in November, but throughout 2019 – has been the persistent outperformance of the US economy, especially compared to Europe. This has also led to some re-pricing of US monetary policy expectations (see chart). At the beginning of November money markets priced in a 30 basis points decline in US policy rates for a 12-month horizon, while not even a full 25 basis points cut remained priced in at the end of the month. Meanwhile, market expectations for other major central banks barely changed (Japan being the exception), which also lent support to the USD. We expect the USD to keep its positive momentum against EUR over the next few weeks.

Another interesting feature in November was the stability of GBP, even though odds of a Conservative majority in the general elections were rising steadily. This is not entirely surprising to us. A Johnson government would certainly bring the ratification of the current Brexit deal, but also renewed uncertainty in the first half of 2020 whether trade negotiations with the EU proceed enough rapidly to prevent a hard Brexit at the end of 2020, when the transition period ends. An extension of the transition period is of course possible but has been ruled out in the Conservatives' manifesto. We keep a neutral view on GBP/USD.

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