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2020

OUTLOOK & INVESTMENT STRATEGY

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Outlook & Investment Strategy 2020

Introduction

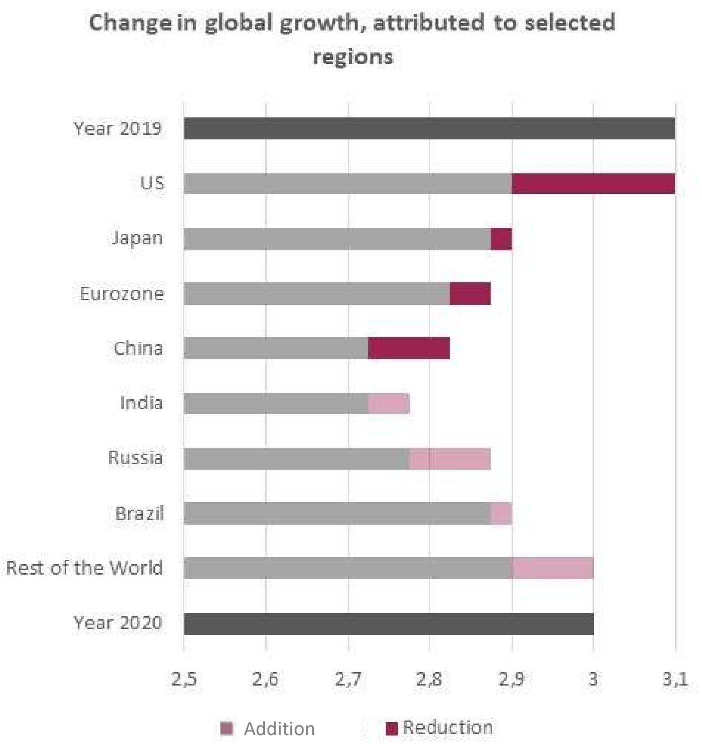
- **Investment management is a continuous process** and not something which should be done exclusively at any given due date of the calendar. Therefore, depending on the ongoing developments in world financial markets, its half-life may sometimes be very short. At the end of 2018 for instance, many market participants expected the FED to hike interest rates during 2019. As a matter of fact, the FEDs itself forecasted two rate hikes for 2019 but instead, the US central bankers changed course as early as January and subsequently cut rates 3 times in 2019!

- Since we at Gigant Swiss Consulting don’t engage in any economic research activities ourselves, **we do not publish our own economic forecast nor price targets** for individual assets/securities. Instead, we compare consensus forecasts vs current market prices out of which one can draw valuable conclusions.

- **Our investment strategy is free from any unwanted or hidden bias**. Because we are independent, we do not need to sell a given set of products, unlike many much larger players in the area of investment management. Instead we can exclusively focus on our clients true needs and always put performance at the forefront of our investment decisions.

- That all said, please find thereafter a summary of our thoughts and expectations for 2020.

Global Macro Economics



After months of contraction, **Purchasing Manager Indices** around the globe finally **point to a resumption of** (rather slow) **growth** rates for early 2020. It should be noted that in developed markets, the service sector, helped by robust consumer demand, has proved quite robust. Going forward, most market participants seem to expect quarterly **GDP-growth rates** to **bottom out in either Q4 2019 or Q1 2020** with a subsequent pick up later in the year. For the full of 2020 however, it should be noted that **the two largest economies, China & the US, are set to experience further decelerating growth dynamics** *year-over-year.* However, the truce in the Sino-US trade war which has been agreed in mid December will most likely have a positive effect , something not many economist might have taken into account as they have composed their outlooks earlier on. Going forward, if there is one lesson to be learned from 2019, it is that **Central Banks** around the globe are ready to **combat any potential macro economic downturn** with a vengeance (for good or bad). Another **wild card for 2020 will be fiscal policy**. After years of austerity, the idea of stimulating a lurching manufacturing sector, is gaining traction among larger parts of political decision makers. And in the US, the Trump-administration is set to whatever it takes in order to propel (if not to say overheat) the economy ahead of the November-election.

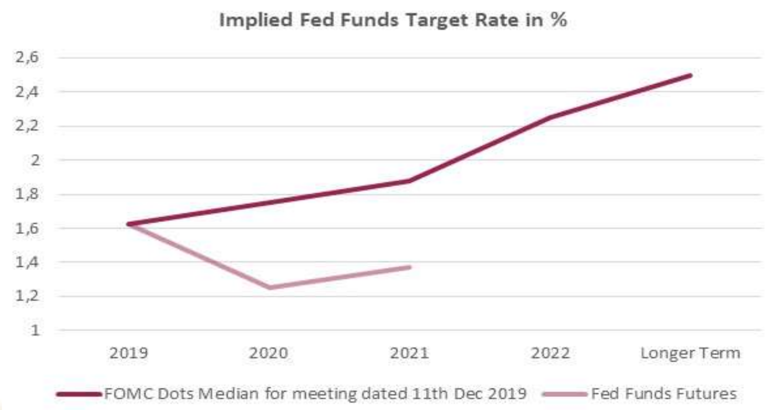
Gigant's view on the global economy in 2020:

After we presented a rather bearish view on macro economic developments for most of 2019, it now seems to us as if the worst has been avoided for now. **Ongoing support from central bank, eventual fiscal stimulus and the recent de-escalation of the Sino-US trade war are factors which could lead to positive growth surprises**. However, ultra-low inflation dynamics, muted potential for commodity prices and unfavorable demographics in developed markets make an overshooting of global growth an equally unlikely scenario. We are further of the opinion that the days of outperformance of the US economy are (finally) numbered.

Source: OECD; UBS; Haver; CEIC *) as per Mid December 2019, numbers in *italic* are estimates

USD Rates

At the end of 2019, **market expectation** as implied by Fed Fund Futures stands for either **no or just 1 rate cute in 2020**. At its last rate setting meeting in mid December 2018, the **FED** itself portrayed an image that is basically **quite happy with where rate currently are** *(see chart on the right).* They further indicated not to expect any changes for 2020 or only in case inflation continues to undershoot their target (!)



The longer end of the yield curve instead is rather impacted by longer term growth and **inflation expectations**. The later has picked up marginally from their Q3 18 lows **but demographics are likely to keep them low for longer**. Most recently, the 10year treasury yield has been hovering around 1.6%-1.9% after its epic drop over the last 12 months during which it nearly halved. Anyhow, the wild card here is a potential renewed “quantitative easing” which the FED might induce in case constraints in the short term USD funding market persist or in case inflation continues to lag.

Gigant’s view on USD-rates in 2020:

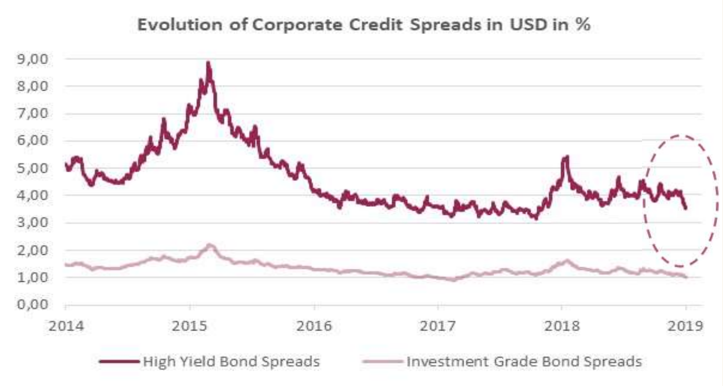
With central banks around the globe competing for the most dovish stance and no reason in sight that inflation expectations was about to pick up, it is indeed **very hard to imagine any scenario under which rates should rise soon again**. Furthermore, the probability of additional easing measures induced by the FED have clearly increased. On the other hand, an improving macro economic environment should result in a moderate steepening of the yield curve. Therefore, **we avoid ultra-long durations.** Generally, we are of the opinion that rates will be more resilient in 2020 compared to 2019. In our eyes, **the impact of rising bond prices will thus be much more muted in 2020** so that investors shall focus on **earning the yield carry instead.**

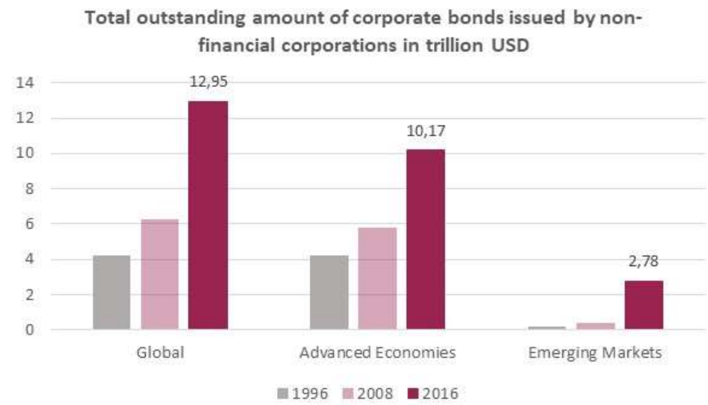
Source: St.Louis FRED; Bloomberg

Credit

As the amount of global debt with negative yield hit approx. 17tn USD during 2019, it does not need not lot of imagination to understand that **avalanches of capital on the hunt for yield flow credit markets thus depressing credit spreads in all segments of fixed income markets**. In historic context, the **extra level one can earn by holding lower quality credit instruments** over risk free government bonds **has reached historically low dimensions**. According to a model compiled by Moody's taking into account fundamental & macro economic data, US High Yield Bond spreads should stay in an area between 4,20-4,80% above treasury yields- in reality they trade as low 3,50%, down -2% since January 2019!

Admittedly, as long as default rates stay low and as long as the time of cheap money supports capital inflows, the high amount of debt is not a problem per se. What is more frightening is the **relative proportion of low quality debt**. Moody's again estimates that during Q4 2019, there were 1,86 credit downgrades for each upgrade- a figure which is well above the average 1,32-ratio going back to 1986. Investors should be aware of the fact that **credit investments implicate a rather skewed risk-reward ratio** these days. Furthermore, it is hard to imagine that a continued spread contraction, a development which over large parts of the last decade has helped produce nice additional returns for bond investors, will occur.





Gigant's view on Credit in 2020:

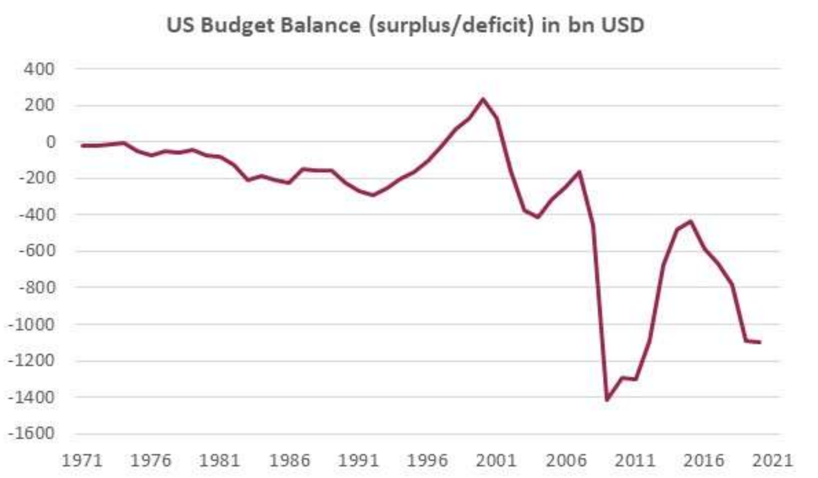
Given the adverse risk-reward ratio described above, **we advice to refrain from any above-average exposure to High Yields markets** (and if, only very selectively). Senior Loans and also less liquid private loan markets, which in our eyes are clearly overheated, are to be avoided. **Emerging Markets** (both corporate- and government bonds in hard currency) **are one of the few places which still offer relatively attractive returns** and which are thus poised to benefit from continued investor demand. Generally speaking, fixed income investors shall prepare themselves for lower returns going forward.

Source: OECD; St.Louis FRED, Financial Times, Moody's

Foreign Exchange: The Majors

Forecast *)	EURUSD
Mid Dec 2019	*1,1100*
UBS	1,19
Deutsche Bank	1,20
JP Morgan	1,14
Goldman Sachs	1,15
Consensus **)	***1,16***
Delta for 2020	***+4,50%***

History suggest that foreign exchange forecasts have rather poor predictive power which is why they should be considered with more than just a grain of salt. That was true again for 2019, a year many forecasters expected the EUR to gain traction vs the USD (instead it lagged, although just marginally). However, **the odds that the USD has indeed seen its peak are clearly higher again**, in particular as the **US budget deficit is increasing at an astonishing pace** *(see chart underneath)* and the **FED being in full dove-mode**. If our scenario of relatively subdued economic growth of the US economy (after a decade of outperformance) should come true *(see page 4 for details),* it is hard to imagine that the USD will be the big winner. Traditionally, the **US currency also tends to decline during periods of broadly positive investor sentiment** as investors feel save to pile into riskier assets. For the US Dollar, there is also a tail-risk of a left-wing democratic presidential candidate. **The EUR** on the other hand **has a couple of potential tailwinds** (ECB's Lagarde to turn even more dovish, Germany to unleash a "fiscal bazooka" and "no hard"-Brexit to get done).



Gigant's view on Foreign Exchange in 2020:

We share the market consensus view and **expect a modest fall for the USD**. However**, investors with USD-denominated accounts have little incentive to switch** as USD-benchmark rates at 1,75% are still very compelling when other major economies are stuck with negative rates. In that sense, the Canadian or Australian Dollar, i.e. currencies with relatively high interest rates, are likely to attract further interest. Likewise, some Emerging Market Currencies may do well on a selective basis. Pound Sterling has the change to climb if (finally) the political outlook becomes clearer. We do not see any major moves for traditional funding currencies such as CHF or JPY.

Source: Bloomberg; FIS Market Map; Financial Times *) as per mid of December 201 **) derived from Bloomberg, taking into account 30 different forecasters

Foreign Exchange: The Turkish Lira

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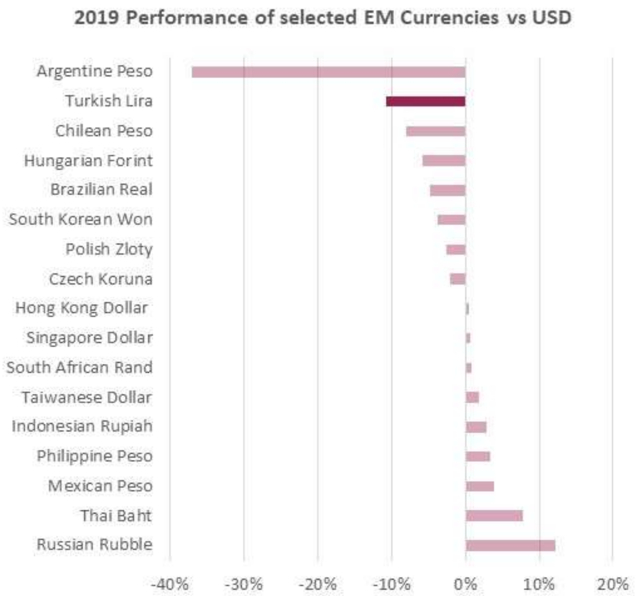
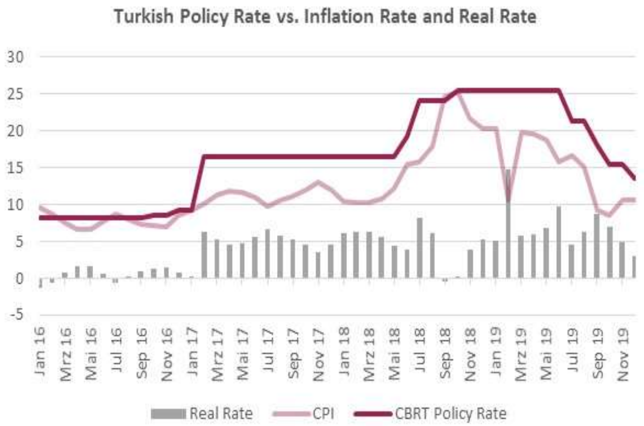




Source: Bloomberg; TCMB

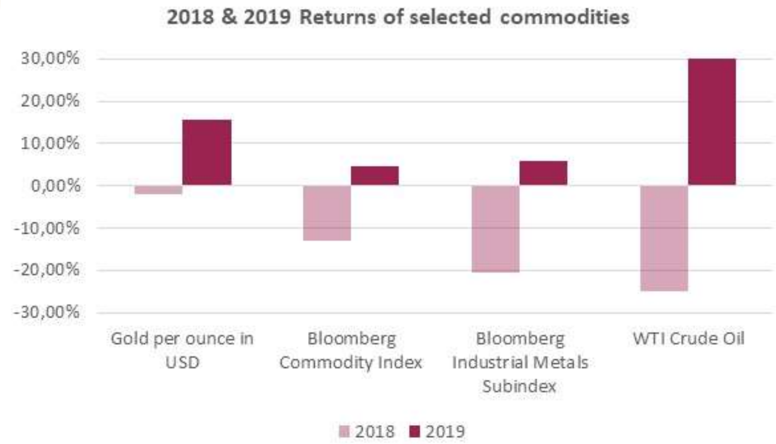
As per mid of December 2019, the **Lira has lost approx. -10% YTD** vs both, the USD and the EUR, making it the second worst performing major Emerging Market currency *(see table on the left)*. That does indeed not speak for the Lira as 2019 was a year of during which accommodative monetary policy and risk sentiment supported risky assets. Various other EM currencies such as the Russian Ruble or the Mexican Peso indeed appreciated handsomely vs the dollar. In Turkey, y/y real GDP-growth returned to positive territory in Q3 (+0.9%) but **the New Economic Program's target of 5% for 2020 looks ambitious**. Additionally, **policy measures to achieve this short term goal may increase imbalances** over the longer term and without structural reforms, the **economy's growth-inflation mix looks challenging** at best. **Inflation picked up again** in November (10,6% y/y; prior: 8,6%) as base effects from the previous year start to fade. It thus does not come at a surprise that the latest aggressive rate cut from mid December sparked a fresh round of lira weakness. While the rebalancing of the current account deficit helped stabilize the Lira for much of H2 2019 , the Turkish economy remains significantly exposed to external funding conditions.

Gigant's view on the Turkish Lira for 2020:

The real yield (i.e. nominal rates minus inflation) is still positive *(see chart on the left)* but its relative size is shrinking fast. Thus, **the latest round of aggressive monetary policy easing has the aftertaste of pleasing politics**, a textbook investors know all to well from the past. As a matter of fact, the **Liras' fate** still heavily **depends on external risk sentiment** and so far, foreign investors have never cheered political involvement. During times, Turkey's relations with Western allies remain somewhat strained, we can thus **not find any reason to be bullish on the Lira**. The 6,50 – 7,00 area of the Lira to the USD seems like a reasonable target to us.

Commodities

Commodity prices tend to be **highly correlated to inflation dynamics** and in the absence of the later, it is **hard to foresee broad based commodity strength** for the year to come. On the contrary, in the absence of a broader recovery in manufacturing- and business investment activity, **cyclically sensitive commodities such as industrial metals and oil are unlikely to see strong increase in demand.** On the other hand, the supply side in industrial metal markets is still facing overcapacities and in the oil market, supply can be positively influenced by capacity reserves of the US oil industry. To make thigs worth, the before mentioned secular trend towards ESG-investments is also **unlikely to result in large investor inflow into commodities**, which Goldman Sachs described as **"over-polluted".** Range-bound trading is our eyes the most probable outcoming for commodities in 2020. In this regards, a potential decline to USD 55/bbl in crude oil could present a buying opportunity later in the year, with OPEC supply being the wild card. **Likewise to 2019, we expect gold also to shine in 2020 but presumably at a slower pace** (gold was up +18% in 2019 (*see chart on the right).* (Again) lower interest rates reduce the opportunity costs for holding gold while muted economic growth is another tailwind. Continued political uncertainty could lead to save-haven flows into gold and **as the yellow metal is priced in USD, a weaker dollar would also support the price of gold**.



Gigant's view on Commodities in 2020:

In our eyes, **gold is the only bright spot in commodity land** which we advice investors to be long- not last thanks to its diversification characteristic. We clearly **avoid industrial metals** and expect the rest of the complex to remain relatively range-bound. Occasional opportunities might arise during the year in oil which traditionally faces headline driven trading patterns. Anyhow, for now, no action is required.

Source: UBS; Bloomberg

Equities

Forecast for end of 2020:	S&P500	Earnings per Share	PE-Ratio
Mid Dec 2019	*3220*	*162,81*	*19,77x*
Credit Suisse	3425		
Goldman Sachs	3400		
Citigroup	3300		
Bank of America	3300		
Deutsche Bank	3200		
UBS	3000		
Average **)	**3315**	**178,57**	**18,56x**
Avg. Delta to 2020	**+3%**	**+9.6%**	**-1.21x**

Wall Street is **predicting** that the record-setting US **stock market rally** will **continue** in 2020, although **at a much more muted pace**. The average price target of 18 deliberately chosen major investment houses for the S&P 500-index stands at 3315, just +3% higher than its current level. **Ultra-loose interest-rate policy,** a **resilient domestic economy** and **improving global business sentiment** are widely cited **arguments for** the **favourable outlook**. In terms **of earnings growth**, the market consensus figures compiled by FactSet, **forecast** earnings per share for the S&P500-benchmark index to grow by **+9.6%** in 2020, in line with the 10-year average (annual) earnings growth rate of +9.1%. To compare: Again according to FactSet, the 2019 Earnings growth will be just +0.2%, making it the lowest annual growth rate since 2015.

Gigant's view on Equities in 2020:

While we very much **share the mildly positive outlook for global economic growth** in 2020 *(see also page 4 details),* **we** somewhat **struggle to translate** this **into higher equity prices** for the year to come. As mentioned, earnings per share growth is poised to gain by +10% which is not unrealistic in historic context and as earnings tend to be notoriously volatile. However, the almost "stagflationary" macro economic framework implies that **pressure on margins** which have already emerged over the last quarters **is likely to stay**. That all said, with **current earnings multiples** at such **elevated levels**, the only **conclusion we** can **draw** is that the **market has already** and by large **priced in the rosy earnings growth expectations** for 2020. **A continued multiple-expansion** is certainly not impossible (markets can be longer irrational than one thinks) but in the longer term context, this **poses a rather fragile investment case**. However, the reverse conclusion is that the **continued central bank liquidity** flooding should **limit any downside risk**, and so should rhetoric from the Trump administration which is set to do anything in their power to keep markets high upon the election in November 2020.

*) Source: Financial Times, FactSet, FIS Market Map as per mid of December　　**) derived from a variety of 18 different forecasters

Equities: Sectors & Styles

For much of the last decade which saw below-average economic growth, investors were bidding up “growth” stocks no matter of their “quality”. However, as we are **in a very late stage** of the current **economic cycle**, we opt to **focus on quality and dividends**. While the short term woes of the Sino-US Trade war have diminished, **global politics** still **face** a variety of **protectionist threats**. Various market participants point to the fact that the age of “deglobalization” might have only just begun *(see chart underneath)*. We thus advice to **choose domestic and consumer-focused companies** that are poised to generate more reliable returns over those exposed to trade and business spending.

If indeed at some point higher fiscal spending should materialize, **(sustainable) energy suppliers should benefit**. On the other hand, the **(US) technology sector**, whose biggest constituents are among the biggest winners of the past decade in terms of stock market return, **are likely to face much tougher regulatory scrutiny**. While not necessarily highly imminent, the success of these stocks is unlikely to repeat going forward. Bear also in mind that thanks to this surge of big tech, the US market has outperformed Europe whose equity market have a much heavier exposure to manufacturing and exports for large parts of the last decade (see chart above).

Gigant’s view on Equity Sectors & Styles in 2020:

The scenario which we just described, clearly speaks for a **focus on company specific selection rather than a random investment in entire industry groups or markets**. While much is still vague from a political point of view, we strongly believe that investors **will do fine with stocks that score high in ESG-criteria**. **Quality and Value are clearly to be favoured** over growth, **domestic over international** exposure and orientation towards **consumer over business spending**. Europe, which was affected much earlier and to a more pronounced extent than the US by the collateral damage of the trade war, may benefit from an improving investor sentiment and a general focus on “value”.

Source: World Bank; FIS Market Map

Our Preferences for 2020 on one slide

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Asset Class	We Like	We Don't Like
Equities	*Area*: **"domestic"** sales exposure *Sectors*: **Consumer staples & defensives, Healthcare, (US) Banks** *Style:* **Quality, Value, Dividends,**	*Area*: **"global" sales exposure** *Sectors:* **Energy, Semiconductors** *Style:* **Value traps, High Growth with no quality**
Bonds	*Duration:* **Short & Medium term duration** up to **7** years *Area:* **Emerging Markets corporate & sovereign debt in hard currency** *Credit:* **high & low grade IG; subordinated debt**	*Duration*: **Floating Rate Notes, duration > 10 years** Area: **EU government bonds** *Credit:* **High Yield, Senior Loans, Convertible Bonds**
FX & Commo-dities	*FX Majors:* **EUR** *FX Minors:* **CAD, NZD, NOK, RUB, BRL** *Commodities:* **Gold**	*FX Majors:* **CHF** *FX Minors:* **TRY** *Commodities:* **Base Metals**
Alternatives	*Alternatives:* ***relative value strategies***	*Alternatives:* ***listed Private Equity***

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