Investment Policy | 2.2018

English Version

Axion SWISS Bank

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Investment Policy

2018 started on a euphoric note. Investors chased equites and drove indices around the globe into an hyperbolic ascent within weeks, almost defying gravity. As we know now with hindsight, the laws of physics do apply to stock markets too. The parallel comes from recent research, which proclaimed that markets succumbed to themselves, so to speak, to their own weight. Without dwelling into technical details of what caused the volatility event on Monday, February 5, which catapulted the VIX to 38.8% form levels below 15% recorded on the previous week close, volatility has returned to financial markets in Q1.

Equity markets, as measured by the S&P 500 index, rose 7.24% before tumbling 11.7% by February 9. US bond yield marched closer to but not beyond the 3% level. The release of January's average hourly earnings at 2.9% YoY vs. 2.6% expected (and since revised back to 2.7%) intensified fears over inflation. The latter had been wished-for for the last 5 years, but it never materialised. HY (High Yield) and BBBs bonds suffered as credit spreads widened, and the SWISS Franc and the Yen strengthened as expected here in our note in Q1.

Our outlook was right, but our timing not. Nonetheless, our mandates did weather the storm quite well. After the initial sell-off, the allocation to equities was cut, first and foremost, in order to protect the good performances achieved in the years 2016 and 2017. Our assessment for 2018 has not changed - we remain constructive and see the fair chance of a final equity market rally in this bull market before a much more prudent stance will be warranted.

Graph 1: Volatility is coming back

Macro

The global economic outlook looks bright for 2018, with expectations of sustained synchronised and above trend growth. We are however a bit more cautious and expect negative surprises driven by policy uncertainty, especially from the Trump administration. Inflation is the key data point to follow.

Fixed Income

There is little value left, except if central banks (CB) are cornered and nominal rate fixing, as in post WW II, becomes the norm. Only dollar denominated assets offer diversification and now attractive risk premia. For Euro and SWISS Franc based investors there is little to cheer. But, it may well be that CBs are cornered, indeed.

Equities

After a decade of stellar equity returns, courtesy of shrinking risk free rates and QEs (Quantitative Easing), we are more cautious. Valuations are high, pricing power generally weak, and besides tax stimuli in the US, corporate profits should be negatively impacted by wage pressure and global competition/disruption by the new trust of technological innovation. Selectivity will be the key to superior returns.

Alternative Investments

Alternative Investments have lagged as volatility and valuation dispersion has collapsed — until recently. We think that long equity positions should be complemented by L/S equity funds, volatility based, and truly uncorrelated strategies. Insurance linked products are now also interesting. Gold remains a controversy that looks like it is loosing its shine vs. cryptocurrencies, but we remain convinced that it should be core to any portfolio as it is truly in limited supply and, ultimately a key beneficiary of negative real interest rates that are required to redistribute wealth form creditors to debtors in coming decades.

Forex

Currencies are the most liquid asset overall and are the fastest to reflect changes in investors' expectations. The European currency is regaining strength after years of lingering doubts about the sustainability of the EU. We believe it to continue to do well also in 2018, more so because of a negative reassessment of the strength in the US economy in H1. The SWISS Franc and the Japanese Yen could regain a bid as "save heaven currencies" over the year.

The global economy remains strong, and growth is likely to remain above trend in 2018. Inflation expectations remain anchored at 2.2% five years forward, a level still below the average from 2008. And, actual reported data still paints a picture of modest price pressure. The ingredients for a "classic" overshoot are here: a) a tax-cut led acceleration of earning growth to 20-30% over the coming 18 months is possible, and b) the belief of a "new era" is infatuating investors' minds – Artificial Intelligence, Robotics, EV (Electric Vehicles) revolution and cryptocurrencies to name a few. The combination of the two, alas, could well mean that stock markets reach new highs and become even more overvalued. Hence, equity markets can stage a further rally – in theory. Much of this potential hinges on Mr. Trump's trade policy, we think. An out blown trade war is never positive for markets (see the 1930s) and this issue has to be followed carefully as the global economy is much more intertwined than earlier in the last century.

Outlook

We expect equity markets to remain fragile as long as the sable rattling between the US and China goes on. A re-test, and a break of the 200 days moving average in the SP500, which is the leading market globally, is a distinct possibility. We would see this an opportunity to re-engage in stocks, and lift weights from current neutral levels. We continue to like the themes that we outlined in Q1 (Technology, Telecom, Demographic among others) and would add, at this stage, China and India as focus areas. Both countries are transitioning to become global leaders and specifically benefit from China's Belt and Road initiative.

Alternative investments, in particular Long/Short equities strategies, are becoming a more interesting complements to long only equity exposure. In fixed income, our preference remains for better-rated and liquid bonds and still, emerging market bonds. Insurance linked bonds, such as Cat Bonds, after the hits taken in autumn 2017, offer attractive yields on a floating rate basis.

Asset Allocation Q2 2018

Private & Confidential

Classic Mandate

Axion SWISS Bank's classic mandate allocates at least 65% of assets to the reference currency of the mandate. The investment objectives are Income, Yield, Balanced or Growth. Mandates are available in CHF, EUR & USD.

Multi Currency Mandate

Axion SWISS Bank's multi currency mandate allocates at least 20% of assets to the reference currency of the mandate. A balanced currency diversification is achieved for clients who wish to do so. The investment objectives are Income, Yield, Balanced or Growth. Mandates are available in CHF, EUR & USD.

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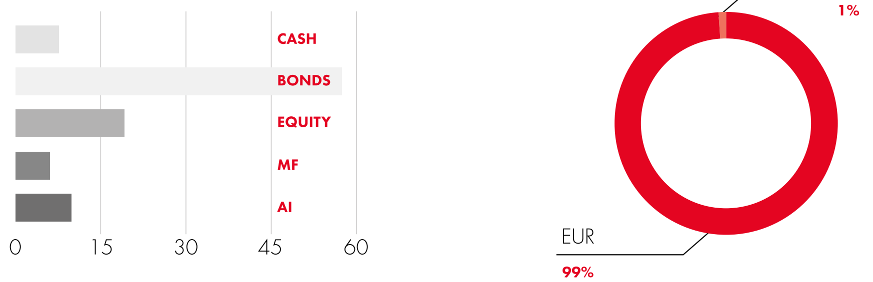
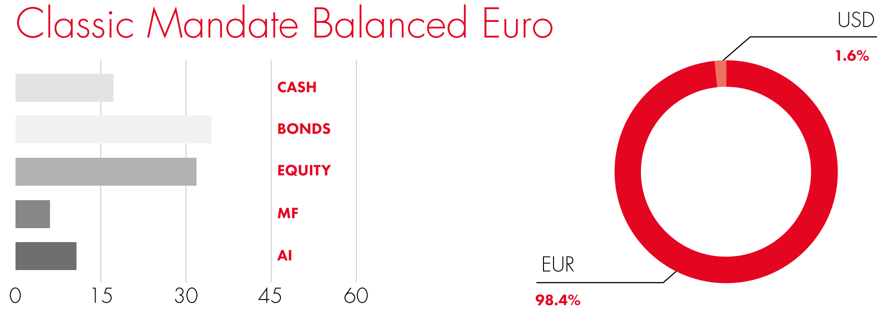
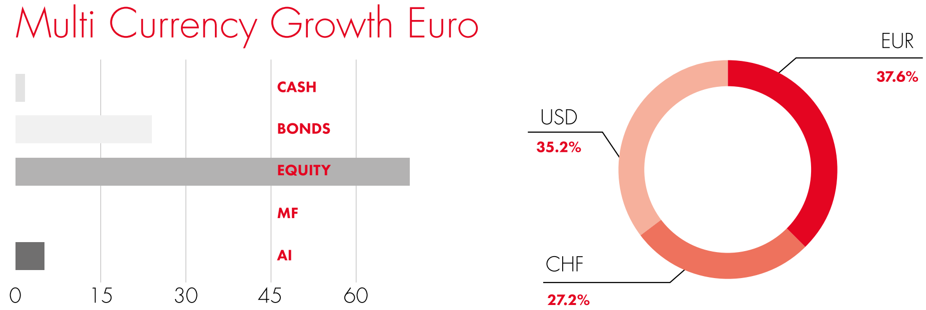
Classic Mandate Yield Euro



Classic Mandate Balanced Euro



Multi Currency Growth Euro



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