MERRION INVESTMENT MANAGERS

CANTOR Fitzgerald

Strategy & Outlook MARKET UPDATE

December 2019

Outlook

Over the last 6 weeks there has been an aggressive change in sentiment and market positioning coupled with a large increase in global equity flows. These have historically been associated with short term market tops. A widely followed Fund Manager Survey sums up just how quickly sentiment has changed, with measures of cash levels showing the biggest drop since President Trump's election and now sitting at their lowest levels since June 2013, optimism about global growth surging to an 18-month high (implying a significant rebound in global PMI indices) and for the first time in a year, investors want more companies to increase capex rather than reduce debt / improve balance sheets.

Market commentators have ex-post rationalised these moves as driven by increasing global growth expectations / improving trade talks but it appears to have been also driven to a large extent by the Federal Reserve, in particular their decision to solve the crisis in the repo market by expanding their balance sheet through buying 60bn Treasury bills a month from early October. Federal Reserve officials have denied that this is Quantitative Easing and there is a two-way split in the market on this point. Even if one believes this is quantitative easing however, the rally we have seen has overshot all other periods when there was unequivocally quantitative easing taking place. The increase in risk assets has over-shot the current fundamental performance of both corporate profitability and the global economy, overshooting what one would expect to occur when growth has definitively bottomed. Commentators have pointed to the "global PMI bottoming" as justification for the recent price action but excluding some front running of tariffs for technology goods in China, we see little sign of a pick-up in global growth.

As noted above, the global bond market has failed to confirm this risk-on rally in equities. Bond yields in the US and Europe, having attempted to move higher in the early part of the month, have retraced to end the month almost unchanged. Inflation expectations are also unchanged, yield curves have begun flattening again, and the weakest credits in the investment universe have seen spreads widen significantly. This is very much at odds with the narrative of a strengthening global economy.

On the trade deal, there is still no news, except the ongoing headlines that that both sides are "close to a deal". Adding a further complication to the picture is the bi-partisan bill passed by congress and signed by President Trump supporting the Hong Kong protestors in their efforts.

Aside from trade and global growth, it should be noted that if central banks are willing to continue with ultra-low interest rates combined with an extraordinary provision of liquidity the valuation of high quality companies can remain elevated relative to what might otherwise be considered fair value.

We remain close to the lower end of our asset allocation ranges, with a defensive bias. It is worth noting that since July, the Federal Reserve has cut rates 3 times, expanded its balance sheet by more than $200bln, is regularly supplying approximately $80bln of funding in overnight markets, the ECB has cut rates deeper into negative territory and announced indefinite quantitative easing, yet global equities are higher by just 4%.

Within our equity exposure, we added to our global technology holdings, focusing on payment providers and we reduced our underweight in healthcare by adding to US med tech and health care service companies and European pharmaceuticals. Some of the political headwind towards this sector may have peaked. We funded this through reducing our overweight in consumer discretionary names especially in US internet retail and by going further underweight the underperforming global energy space. We remain overweight high quality stocks within our equity portfolios.

We for now feel, despite not participating in the rally of the last 6 weeks as much as we would have liked, that it is best to maintain a defensive positioning and have actually trimmed those cyclicals we bought in early September and in the alternative funds have added some defensive trades.

MERRION INVESTMENT MANAGERS

CANTOR Fitzgerald

75 St Stephen's Green, Dublin 2. Tel: +353 1 670 2500.

email : info@merrion-investments.ie **web :** www.merrion-investments.ie / www.cantorfitzgerald.ie