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CIO Viewpoint

Ten investment convictions for 2020

Investment Solutions

25 November 2019

This year offered investors sound returns. For 2020, economic data increasingly suggests that the worst of the economic slowdown may be behind us. Still, we remain in a low-yield, low-growth environment delivering returns in the low single-digits supported by accommodative central bankers.

Resilient portfolio construction is key to every investor's peace of mind. Below we have summarised ten convictions to position a portfolio for the year ahead.

Once again, much attention will focus on US politics. Americans elect a president in 2020 and if investors have learned anything in recent years, it is that one man can throw many spanners into the political machinery. Ironically then, given the Trump-inspired turmoil of the past three years, markets right now are most worried by any suggestion that he may be succeeded by Democrat Elizabeth Warren.

Trade is the single issue that has coloured the entire investment landscape. Much hinges on whether, in the final weeks of 2019, negotiations can hint at scrapping tariffs next year. If China and the US cannot settle their dispute before the US presidential elections, and if Trump side-steps impeachment and then were re-elected, he may even escalate tensions. Markets will react to every development.

The past year was notable for its political unrest. From France and the UK to Iran and Hong Kong, to Venezuela and Chile, there is increasing dissatisfaction with political systems and their abilities to manage change. For a range of seemingly unrelated reasons, whether the cost of living, fuel prices, political or climate change, widespread unrest points to easily shared disillusion through social media platforms.

Some of this also looks like a direct result of frustrations with rising inequalities. It is hard to ignore the role of unconventional monetary policy in exacerbating inequalities since the financial crisis. Over the last decade, central banks have helped to stimulate economies and support job growth. However, that also inflated asset prices with few of the benefits trickling down into real economies. Investors need to follow closely these profound changes in social structures.

Looking ahead to monetary and fiscal policy, Christine Lagarde has just succeeded Mario Draghi at the European Central Bank and Trump is likely to continue his criticisms of Jerome Powell and the Federal Reserve while pushing two Republican nominees to the Board's vacant seats. Germany may shake off its aversion to debt with a fiscal package that would boost the eurozone's fortunes, and China may provide more support to cushion its job market from a slowing economy.

As we prepare for the challenges ahead, it is our pleasure to wish you all a healthy, happy and prosperous 2020.

Stéphane Monier
Chief Investment Officer, Lombard Odier Private Bank

Key dates in 2020

- **21-24 January** – World Economic Forum's 50th Annual Meeting, Davos, Switzerland
- **31 January** – UK scheduled to leave the EU
- **February** – Iran holds parliamentary elections
- **February-June** – US Democratic Party primaries
- **3 March** –US Super Tuesday (peak Democrat primaries)
- **Early March** – Chinese National People's Congress
- **15/22 March** – French municipal elections
- **24 July – 9 August** – Olympic Games, Tokyo, Japan
- **3 November** – US Presidential election
- **9-20 November** – UN Climate Change Conference ('Cop26'), Glasgow, UK
- **21-22 November** – G20 meets in Riyadh, Saudi Arabia
- **31 December** – end of UK's Brexit transition (possible extension until 31 December 2022)

1. Stay diversified and nimble

Investors must pay particular attention to managing a well-diversified and resilient portfolio as we move into 2020. The inevitable surprises will challenge allocations. This means that investors must be clear about how they build their exposures, and keep appropriate levels of cash to remain flexible, while keeping their convictions top of mind.

2. Shield portfolios

To defend a portfolio's gains, investors should look at the Japanese yen and put options as well as gold. We prefer the Japanese yen to the Swiss franc, as the franc has shown weaker correlations to global risk since 2015. Put spreads on equity indices are a relatively attractive way of hedging a portfolio from a sharp market decline. Finally, if tactically managed, gold can still play a role as a portfolio diversifier, hedging against inflation and volatility (and market fears).

3. Identify yield through carry strategies

Traditional fixed income's low returns now demand a more active approach. Carry strategies, in particular in the high-yield segment, should perform well in this low-yield, moderate volatility environment. We also remain overweight in emerging market hard currencies and expect spreads to stay stable. EM growth should improve and China is already showing signs of stabilisation. Credit fundamentals are sound as companies have been conservative in recent years and so globally, EM net leverage is decreasing. Investors should focus on strong credit metrics when picking companies and look at the crossover (BBB/BB) segment. We prefer to move down the capital structure (into subordinated bonds and hybrids, for example) in fundamentally solid companies, rather than compromising on credit quality. We also like Corporate Sector Purchase Programme (CSPP) eligible issuers and their substitutes across currencies.

4. Focus on equity quality

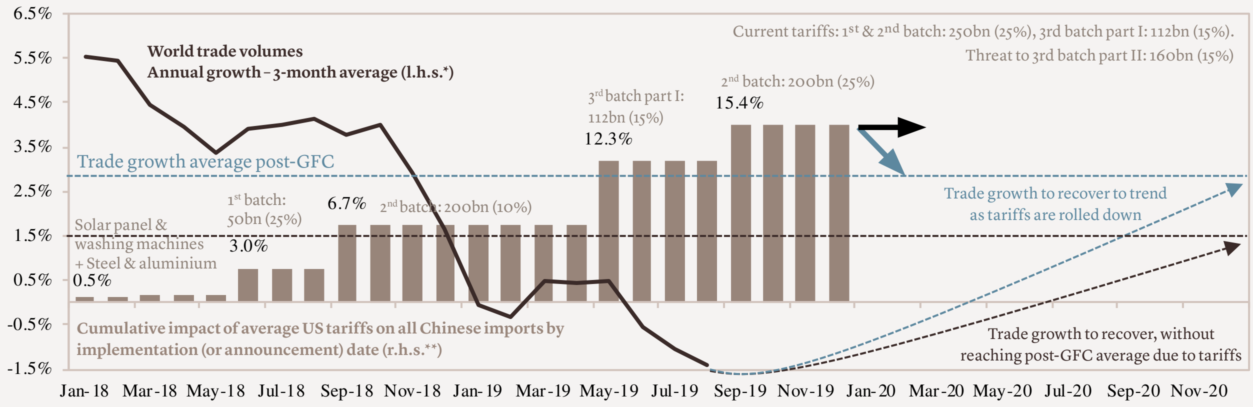
Pockets of equity quality and growth remain. We expect equities to post positive returns in 2020 with a potential for further market gains if, as seems possible, trade talks progress. Third-quarter results beat their low expectations and earnings growth remains weak. So, although not particularly attractive from a risk/return perspective, guidance for next year is holding up and valuations should stay supported by accommodative central bank policies. With lower liquidity in global small caps, we prefer larger names in value and growth stocks.

5. Equity sectors

With signs that manufacturing is bottoming out, investors should keep an eye on industrial names and balance exposure between defensive and cyclical sectors. The rotation in sector leadership should continue, which underlines the importance of this approach. Specifically, we continue to add to the healthcare and energy sectors, and we remain overweight in information technology. However, with currently high cash levels and risk arbitrage strategies still underinvested, there is a risk that investors will start chasing a rising market in 2020.

Chart 1 – Average US tariffs on all Chinese imports (USD 522 bn) versus world trade volume

In % - Substantial and systematic tariffs implemented



Sources: USTR, Lombard Odier calculations, * left hand scale, ** right hand scale

6. EM equities

We are cautiously upbeat on emerging markets for next year. Brazil is our top pick in Latin America: the country is making a macro policy shifts and a recovery should boost earnings growth. There are opportunities more widely in EM equities, including in China, especially if or when the trade dispute moves towards a resolution and when, as we expect, the dollar weakens.

7. Invest in real assets

Valuations in real assets, whether real estate, private equity, private debt or infrastructure, all look high for the moment but are supported by the low interest rate environment. It does not look that there is a bubble in these alternative asset classes because prices and fundamentals do not seem disconnected. While high valuations (much like many other asset classes) makes them vulnerable to any sudden shift in sentiment or environment, to some extent they remain insulated by their illiquidity. For eligible euro and Swiss franc investors, real estate remains one of the last asset classes to offer a reasonable return with limited volatility.

8. A weaker dollar

2018's dollar rally and 2019's resilience is explained by the interplay of trade tensions, the subsequent slowdown in global growth and the US's outperformance compared with the rest of the world, thanks mostly to fiscal stimulus. However, now that data suggests that the global economy is bottoming out and there are early signs of a trade solution, the tail risks are dissipating. This is likely to set the stage for a weaker dollar in 2020. We anticipate EURUSD at 1.15 and USDCHF at 0.97 in the last quarter of 2020.

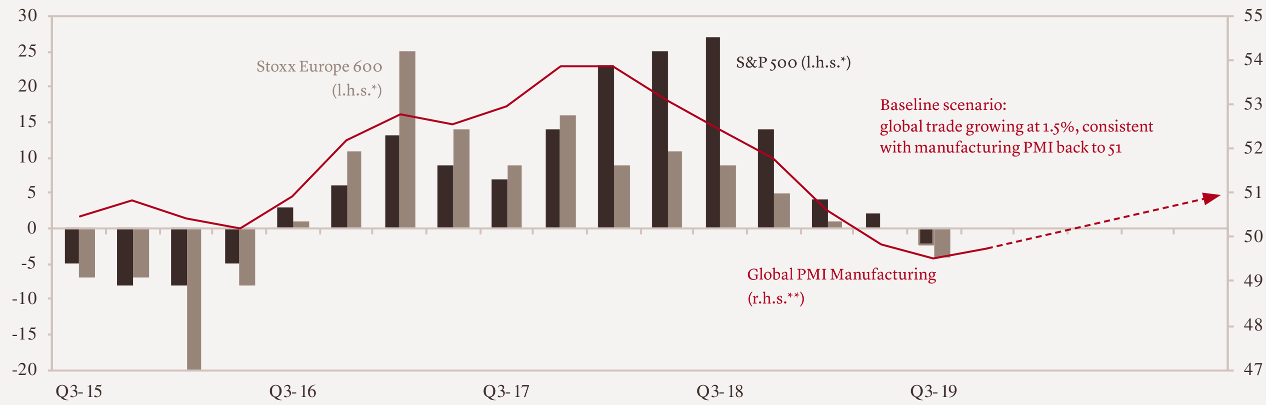
9. Sterling to capitalise on Brexit developments

We expect the Conservatives to win a parliamentary majority in the 12 December general elections, which should allow them to ratify the Withdrawal Agreement and pave the way for trade talks. This would support an undervalued sterling and should price out what is left of the no-deal Brexit premium. We expect GBPUSD to hit 1.35 in Q4 2020.

10. EM currencies poised for some upside

Emerging currencies continued to depreciate in 2019, hurt by slowing global trade. A stabilisation in trade (our base case), delayed impact from modest Chinese stimulus and significant EM policy easing, should encourage an EM growth recovery and provide some support to their currencies. While there is plenty of variation, on the whole, EM currencies look undervalued. Our central scenario points to a 3-4% spot return in JPMorgan's Emerging Market Currency Index. We favour the Russian rouble, Malaysian ringgit, Peruvian sol and Mexican peso: they are all undervalued, show sound external balances and will likely benefit from idiosyncratic drivers in 2020.

Chart 2 – Not a V-shape recovery, but a recovery still
EPS growth YoY, in %



Sources: Datastream, IBES, Bloomberg, Lombard Odier calculations

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