

## CIO Viewpoint

# The late bull market and new approaches

### Investment Solutions

2 October 2019

Ten years and counting since the start of the bull market in March 2009, investors are alert to any sign of the cycle spinning to a halt. This article is the fruit of the most recent event in a series of regular Lombard Odier seminars, gathering our equity investment specialists and external guests.

The adage says bull markets don't die of old age, but fright of recession. An overheating economy, or a central bank raising rates to stifle inflation, have historically tended to kill off bull markets. For now, neither threat seems to be on the horizon. However, we can add another potential trigger; the fear that goes with uncertainty.

While it is arguable that US equity markets are currently trading at fair value, with the S&P 500 at a price-to-earnings ratio of [22 times](#) compared with its historical average of just over 16, the danger is a volatility shock.

Around half of capital invested in US markets is [in passive strategies](#), and/or trading on algorithms on behalf of investors who are especially sensitive to their portfolio's risk exposure. Indeed, in this low-yield world, many investors are much more focused on balancing risk. That means any disruption to liquidity is bound to have a dramatic impact on the overall market. Liquidity in the fourth quarter of 2018 for example, fell to its lowest level in a decade, exacerbating the market's 17% decline over the three months.

### The whims of trade

What is driving investor fears? Trade is the single biggest drag on the business cycle, but a drag that is uniquely dependent on the whims of the US president's tweets. In recent days, the situation has escalated further with reports that the US may [limit capital flows into China](#), or the ability of Chinese companies to trade in the US.

In the meantime, the impact has not yet passed through to American consumer sentiment, which still accounts for more than three-quarters of the US economy. With the benefits of the 2018 US tax breaks on the US economy now neutralised by the US/China import tariffs, investors should remain alert to any sign of a US consumer spending slowdown, which risks tipping the economy into a wider decline. As we move into the last three months of the year, we should not let favourable year-earlier, quarter-on-quarter comparisons with late 2018 artificially inflate our understanding of the health of the underlying economy.



Stéphane Monier  
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### Key takeaways

- Trade remains the biggest driver of uncertainty and the US/China dispute is getting harder to solve
- Any slowdown in US consumer spending is a potential catalyst for a market downturn
- Quantitative approaches to novel data sources are becoming mainstream but still need specialist analysis
- Sustainability criteria will continue to add value and offer the best risk-reward approach over time.

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It is also becoming clear that the impact on Chinese trade is not what was expected. China's exports to the rest of the world remain flat, thanks to its investments in logistics and ability to use third-party countries such as Vietnam or Cambodia, as export intermediaries. While China is suffering from rising unemployment, China's economy has now made the transition to a mostly service-oriented economy, making it less dependent on US imports and helping to mitigate the impact of the trade dispute.

Yet as the tensions drift on without sign of resolution, the likelihood of the global economy slowing, or a US recession, rises. If the trade dispute is not resolved next year as part of a presidential election/re-election campaign, even the Democrats in the US, who are no more in favour of free trade with China than Trump, just for different reasons, may not look to settle the dispute quickly.

### **New data sources**

For now, central banks' liquidity support, starting with the US Federal Reserve, have underpinned valuations in this low-yield environment.

With this change to the market's fundamental support, investors are looking for new sources of alpha from the equity market. We see two broad themes in the search for performance: integrating sustainability factors when selecting names for client portfolios, and using alternative sources of data in the investment process.

As the bull cycle matures further, public consciousness is rising about the dangers and extent of the climate challenges facing us. That evolution in public sentiment, and ever-better scientific [quantification of the damage](#), coupled with an ongoing search for investable yield, is also behind the rise of awareness in the role that environmental, social and governmental (ESG) factors can play in portfolio decisions.

Lombard Odier is convinced that sustainability will drive investment returns and offers significant opportunities, through technological advances and solutions for generating growth while improving efficiencies and limiting our footprint on resources. Companies who understand these changes, and are looking to mitigate the risks, are best positioned to generate [sound performance](#) in the future and have a competitive edge. We refer to these companies in our recent marketing campaign as "[eagles](#)," and their less nimble competitors, as "[ostriches](#)."

Part of that understanding process comes through a proprietary investment framework at Lombard Odier. This is founded on three investment pillars; the sustainability of financial models, business practices and models. Then we analyse companies' exposure to controversies and how they measure up against the United Nations' Sustainable Development Goals. This helps us to build portfolios to match our clients' values.

Data is key to understanding the evolving investment landscape, and identifying new opportunities. However, traditional data, available to all, no longer provides that edge in investments, whether in the form of earnings estimates, interest rates or a government's economic forecasts.

### **The learning edge**

Instead, the investment community is seeing quantitative approaches to novel sources become mainstream. Quant approaches are using artificial intelligence, mixed with social media sentiment on a company, for example. They are taking data from satellites, aggregating credit card transactions or mobile phones locations, and developing machine learning. Technology is creating trading signals, and potential competitive advantages.

Nevertheless, no matter how sophisticated the data, the usefulness of these approaches still depends on asking the right questions and interpreting results. Investors looking for threats to the bull market using alternative sources also have to understand the difference between a potential early indicator, and noise. Ultimately, their track records will be the most telling evidence of success or failure.

We believe that applying sustainability criteria to a long-term portfolio continues to make sense, and even once this bull market eventually ends, will still offer the best risk-reward approach over time.

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