FIS GROUP

October 2019

MARKET OUTLOOK Q4 2019

TINA BYLES WILLIAMS
CIO & CEO

In the third quarter, both of the leading anglo-liberal democracies lurched towards the political abyss and even potential constitutional crises, while global growth continued to decelerate on the back of trade policy uncertainty and the end of an aberrantly long economic expansion. Against this backdrop, the USD rose, gaining +4.3% against the Euro, +3.2% against the GBP, and even +2.2% against the Swiss Franc. The JPY was broadly flat against the USD and Japanese equities were the leading performer of major economies gaining +3.1% in USD terms. Looking ahead to Q4, we see some niche tactical opportunities, which we cover in detail in our Q4 country and sector outlook (see TABLE 1 on PAGE 2 and TABLE 2 on PAGE 3), but the longer term direction of the market remains at an apparent crossroads. This has prompted many investors to ask whether we are at the precipice of further risk off events that necessitate a rethink of portfolio allocations or whether monetary or even fiscal policy could keep the long bull market going. We seek to answer these questions and more in our three-part series on derisking. You can access each section below:

BATTENING DOWN THE HATCHES


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BATTENING DOWN THE HATCHES
Part 1: Why Should Investors Derisk & What Should They Consider?

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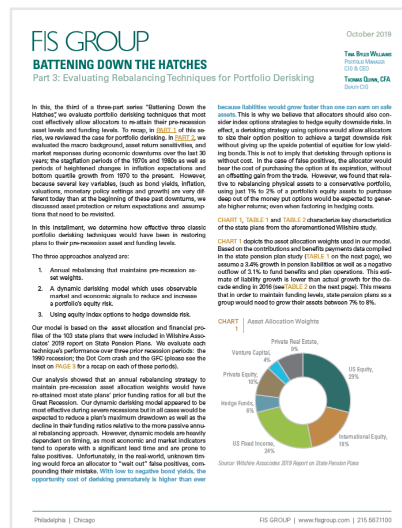
Part 2: How Should Investors Derisk?

Part 2: How Should Investors Derisk?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BATTENING DOWN THE HATCHES
Part 3: Evaluating Rebalancing Techniques for Portfolio Derisking

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TABLE 1 | Global / Country Positioning

Region / Countries	-		N		+	
Developed Markets			●			We continue to remain neutral to developed market equities vis a vis emerging markets, lacking clearer directions in the near-term for major markets. Within developed markets we continue to focus on long-term strategic themes favoring the defense sector and healthcare while expressing short-term tactical views in Australia and with gold miners while retaining modest defensive exposure in Switzerland.
United States			●			Neutral. Overvaluations in the U.S. are tempered by short-term imbalances in dollar liquidity that are bullish USD assets. Further USD liquidity and the specter of slowing growth are bearish U.S. risk assets in the medium-term.
Core Europe			●			Neutral. Within Europe we remain overweight in Swiss stocks, albeit at a lower conviction than earlier in 2019. We flipped our Spanish overweight to underweight amid diminished market dispersion and cut our Italian overweight initiated last quarter.
Japan		●				Underweight. Our tactical models pointed to overweight Japan in Q3 and were right, but we ignored those in favor of higher conviction calls in Australia which modestly disappointed. But we continue to believe the near-term outlook in Japan appears weak and are not inclined to believe the effects of the impending sales tax hike are quite fully priced in.
U.K.			●			Neutral. With no direction on UK at the macro level, we remain neutral and hopeful that policy missteps from London do not cause contagion in financial markets.
Australia				●		Tactical Overweight. Our tactical models continue to point to high confidence near-term outperformance based on a high degree of valuation dispersion among Australian stocks and we will stay in this trade for now. We have shifted part of this Australian exposure into gold mining mid and large cap stocks as a hedge on global market tail risk.
Canada			●			Neutral. Our tactical models cite low quality at reasonable valuations so we see no clear view in Q4. We have shifted part of this exposure into gold mining mid and large caps as a hedge on global market tail risk.
Emerging Markets			●			We remain neutral to emerging markets because of the countervailing trend of weak exports and a sideways U.S. dollar versus some early signs of recovering global LEIs and economic stabilization in China.
Emerging Markets Asia						
China			●			Neutral. China is clearly implementing gradual financial market reforms that should yield positive results in the medium to long-term, but the current environment remains one of decelerating growth and uncertainty.
Korea			●			Neutral. Long-time market reform has taken a back seat to a deteriorating earnings outlook for now. We are mindful of historically depressed valuations and looking for a new entry point, but do not see it yet.
India		●				Underweight. Our long-term positive view on India was strengthened by the unexpectedly large win for Modi in the May elections, but we expect this to take a few more months, at least, to reignite investor appetite for one of the more expensive emerging markets.
Thailand				●		Overweight. Thailand remains buoyed by inflows of foreign investment, a stable domestic capital base, and is a defensive safe haven amid uncertainty across emerging markets.
Emerging Markets Europe						
Russia				●		Overweight. Russia continues to outperform based on defensively cheap valuations, radically high dividends, and steady improvements in corporate governance (albeit from a low base).
Emerging Markets Africa						
South Africa			●			Neutral. While we have low expectations for South Africa, we also are cognizant of the coiled spring in local positioning within the market as "SA Inc." remains deeply underowned.
Emerging Markets Latin America						
Brazil				●		Overweight. Low inflation, positive economic reforms, and signals from our tactical model citing positive momentum and attractive valuations keep us overweight Brazilian equities.
Mexico			●			The Mexican market is at a 10-year valuation low based on both P/B and P/E, while the peso is among the cheapest currencies in the world based on Real Effective Exchange Rates, but policy uncertainty surrounding President Obrador ("AMLO") remains a headwind. Our tactical models also cite poor quality and low momentum.

TABLE 2 | Sector Positioning

Sector / Style / Capitalization	-		N		+	
Early Cyclicals Consumer Discretionary, Financials		Developed	Emerging Markets			We neutralized our Q2 underweight to DM financials as our tactical models' leading indictor turned positive (though yield curve and momentum signals remain negative), but we remain underweight consumer discretionary within DM to fund higher conviction calls elsewhere. Within EM, our country calls have led us to a broadly neutral position in both sectors.
Late Cyclicals Energy, Industrials, Materials, Technology, Communication Services		Developed	Emerging Markets			We have trimmed our energy overweight back to neutral as our tactical models are flashing negative across nearly all relevant factors, conflicting with our macro view that geopolitical and growth surprises both skew to the upside. We also remain underweight IT and communications to fund thematic overweights within industrials and materials. In industrials we remain in our long-held (and highly accretive) theme of European defense stocks while in materials we have taken a position in international (mostly Canadian and Australian) gold miners as a hedge on market tail risk and also to exploit attractive valuations and sentiment.
Counter Cyclicals Consumer Staples, Health Care, Utilities			Emerging Markets	Developed		We remain tactically positioned in DM consumer staples, partially as a by-product of our Swiss overweight. We remain overweight our long-term strategic theme in healthcare stocks and neutral to utilities.
Large vs. Small Cap			Developed Emerging Markets			We are underwhelmed by high valuations in U.S. small cap stocks, but large cap stocks are not so much more attractive and with signs of wobbles in some of the U.S. tech giants we remain neutral. In Europe and Japan, we are no longer overweight small caps, having recently ended our long-term strategic overweight. In EM, we believe a trade slowdown and rising protectionism could hit large cap EM stocks worse than small caps, but are simultaneously cognizant that a rebound in EM risk assets will likely accrue to the more liquid segment of the market first.
Value vs. Growth			Developed Emerging Markets			The long running outperformance of growth over value will end at some point, perhaps even soon, but we are not quite so sanguine yet to express this as a factor overweight.

● Developed ● Emerging Markets