FOOLS RUSH IN?

GLOBAL MACRO PORTFOLIO ALLOCATION – Q3 2019

MAY 20, 2019

Lenoy Dujon
Founder & Chief Global Macro Strategist
Lenoy@economicsglobal.com

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May 20th 2019

As 2019 progresses, the broad-based rally across asset classes continues to march onward, generating double digit returns in some cases. However, despite the optimism in the global financial markets, the global economy doesn't share the same optimistic tone. The global economy continues to be plagued by headlines risks, such as the ongoing trade spat between the United States ("US"), its trade allies, and China, macroeconomic stress coming out of Argentina and Turkey, tighter credit conditions and slowing economic activity in China, weakening economic growth in the Eurozone, and the normalization of monetary policy within G20 nations. Headline risks such as these have all contributed to the weakening global expansion. Consequently, we still believe that the balance of risks for global investors continues to be economic and geopolitical uncertainty, more so than market volatility as seen in 2018. The continuation of the aforementioned developments could disrupt the global economy and send financial markets to lower levels. Moreover, such tensions threaten to uproot the fabric of the global economy, by directly impacting global resource allocation and economic productivity. Further, concerns about China's economic outlook continue to weight on global and regional economies and markets as the country grapples with internal deleveraging, and a more hostile global economic and geopolitical environment. Lastly, measures of industrial production and investment continue to remain weak for many economies, with global trade still being plagued by the global trade war.

Global Growth

As we continue to march deeper into "late-cycle" territory, the pace of economic growth continues to become much less synchronized then in previous years. So much so, that we still believe that growth divergence on a global level will (continue) to be a pivotal theme for investors to be mindful of in 2019. This can be seen in the stark divergence within Developed Markets ("DM"), where the US is (still) leading the pack, with Japan not too far behind, and Europe still in last place. Uneven growth continues to be evident in Emerging Markets ("EM"), as a combination of volatile commodity prices, rising inflation, tighter monetary policy in DMs, increased geopolitical uncertainty, and financial market volatility have all wreaked havoc on EMs since early 2018. In fact, as the "era of easy money" comes to an end, the aforementioned factors have led to tighter capital controls, capital flight, foreign exchange and trade balance pressures for EMs, especially for countries with poor economic fundamentals and weak political institutions, such as in Argentina and Turkey. We are even beginning to see macro risks such as these spillover into other EM countries such as Indonesia, Malaysia, and South Korea.

Nonetheless, despite the headwinds, there are a few bright spots ahead for the global economy. We expect global growth to pick up slightly in the second half of 2019, which can be attributed to monetary policy accommodation.

Global Financial Market Conditions

Central banks in DMs continue to gradually normalize monetary policy, but also strike a more cautious tone, as the absence of inflation pressures around the world continues to be more evident. In the

US, the Federal Reserve ("Fed"), in response to mounting global risks, paused their interest rate hikes and signaled no further rate hikes for 2019. In other DMs, the Bank of Canada ("BOC"), the Bank of England ("BOE"), the Bank of Japan ("BOJ"), the European Central Bank ("ECB"), all struck a more accommodative tone, while in China, the country has deployed more fiscal and monetary stimulus to rejuvenate the economy.

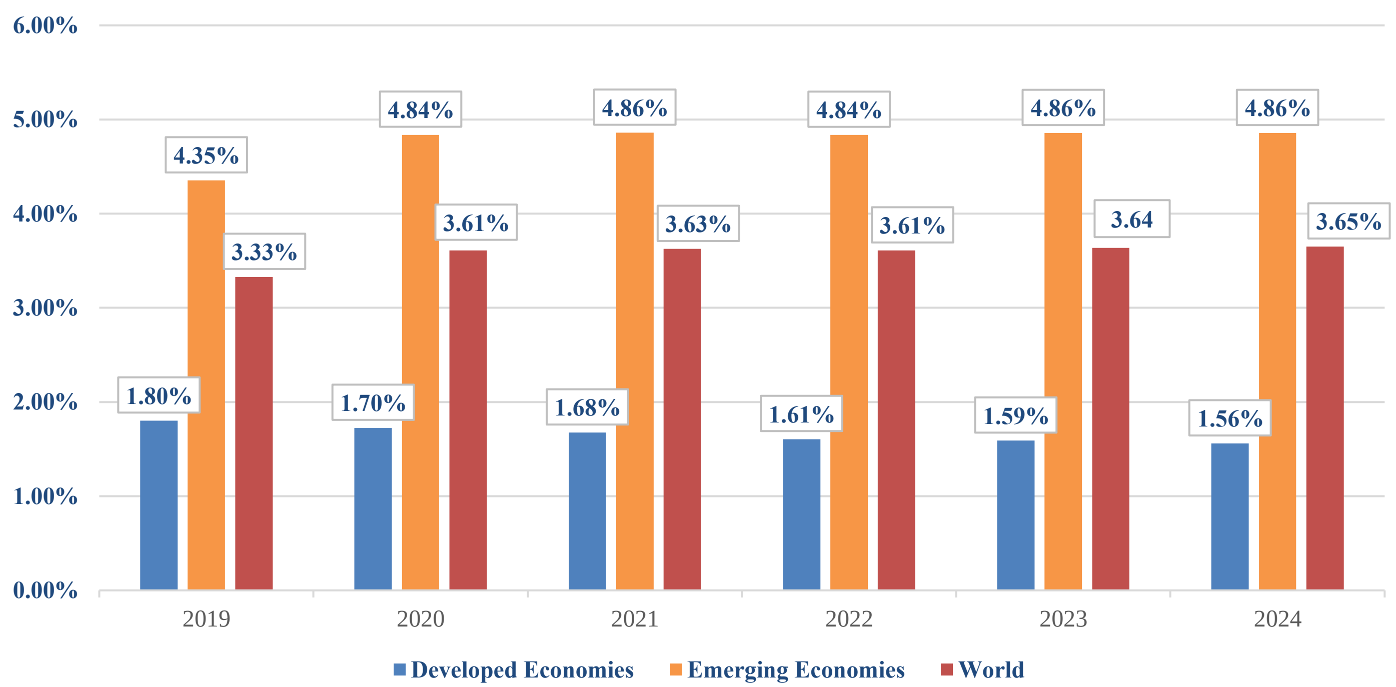
This change in policy stance has helped to reverse the tightening of financial conditions to varying degrees across both DMs and EMs. However, it must be stressed that this shift in policy does not negate the fact that central banks around the world are still embarking on the normalization of monetary policy. Instead, they have just "taken their foot off the pedal" for the time being. As a result, EMs have experienced a resurgence in investment, capital and portfolio inflows, a decline in regional bond yields, and strengthen currencies relative to the US dollar.

Global Growth Forecast

While 2019 started off on the backfoot, the global economy is expected to pick up slightly in the second half of the year. This lift in economic activity in the second half is expected to come from significant policy accommodation by major DMs and EMs such as more accommodative monetary policy stances by the Fed, BOC, BOJ, the BOE, and ECB increased fiscal and monetary stimulus from China, and the possibility of a trade deal between US and China. Into 2020, global growth is expected to be bolstered by growth in China and India, as both countries continue to increase their share of world income. Further growth in DMs are expected to slow gradually, as the impact of the US fiscal stimulus fades and as DMs continue to grapple with longer term trends such as an ageing population and low productivity growth. For EMs, growth will stabilize around 4.86 percent as they capitalize on a resurgence in global growth.

Overall, global growth was revised slightly lower in 2019 to 3.33 percent (down from 3.53 percent), and to 3.61 percent in 2020 (down from 3.63 percent).

Figure 1: Global Economic 2023 Growth Forecast



Regional Outlook: Developed Markets

Current global growth patterns continue to reflect the gradual slowdown in the growth rate of many DMs from above-average levels, back to trend. More specifically, growth in DMs was revised lower to be 1.80 percent in 2019 (down from 2.04 percent), and slow even further to 1.70 percent in 2020 (down from 1.73), due to the balance of risks mentioned earlier. However, despite the slowdown in growth, we still believe that his will not be distributed evenly among DMs, with the US still being the key economic growth engine on one hand, but with Europe (still) trailing far behind on the other.

In the US, GDP has been revised lower and is expected to be 2.3 percent in 2019 (down from 2.5 percent), and slow further to 1.9 percent in 2020 (up from 1.8 percent), as the fiscal stimulus from the 2018 tax cuts is expected to unwind. The downward revision in US growth in 2019 stems from the lower fiscal spending than previously expected. However, the slight upward revision in 2020 comes come from the more accommodative monetary stance from the Fed, as they are expected to pause the rate hiking cycle for the remainder of 2019. Nonetheless, the US economy is still expected to be a beacon for investors in 2019, as global interest for US assets, as well as US consumption, continues to remain strong in relation to their DM and EM peers.

In Japan, GDP was revised lower and is expected to grow by 1.0 percent in 2019 (down from 1.1 percent), and slow slightly to 0.5 percent in 2020. The revision to Japanese growth in 2019 stems from the expectation that the economy will be supported by additional fiscal stimulus from the Japanese government, an accommodative BOJ, and increased corporate governance measures adopted by Japanese companies. Escalating trade tensions and slowing global growth are expected to be concerns for Japan in 2019 and into 2020, but strong internal consumption demand is expected to make up for any decline in external demand.

In Europe, growth was lowered to 1.3 percent in 2019 (down from 1.6 percent) and (only) rise slightly to 1.5 percent in 2020 (down from 1.7 percent). The region continues to face increasing political and economic risks. Such issues include a decline in economic activity in France due to the ongoing street protests, a softening in the German economy, as weak consumption and industrial production, as well as subdued foreign demand weigh on the country. Further a slowing Italian economy, which is faced with rising borrowing costs and a deterioration in the quality of their sovereign debt is also weighing on the region. More so, on a regional level, Europe is also faced with rising populism in many countries, both in Central and the peripheral European countries, which is expected to put economic and political pressure on the regional bloc. Lastly on a global level, Europe will continue to suffer economic setback due to a slowing China, which the region is heavily dependent on.

Lastly, the United Kingdom is expected to grow at 1.2 percent in 2019 (down from 1.5 percent) and lift slightly to 1.4 percent in 2020, as the country continues to be plagued by the political turmoil over the Brexit process. So much so, that the country could experience a "Hard Brexit" from the European Union, which would have dire economic consequences on the country and UK assets. However, it is also expected that the UK government will table a fiscal stimulus in 2019 to try and offset any negative effects stemming from Brexit.

Regional Outlook: Emerging Markets

Given the global economic environment, growth for EMs is expected to fall slightly further to 4.35 percent in 2019 (down from 4.53 percent), before improving to 4.84 percent in 2020 (down from 4.87 percent). Similarly, to DMs, growth is not evenly distributed, with certain areas growing faster than others and offering better investment prospects to investors.

In the Middle East, growth in the region is expected to decline further to 1.5 percent in 2019 (down from

2.4 percent), before recovering to 3.2 percent in 2020 (up from 3.0 percent). The Middle East faces many challenges over the next 12-18 months, such as slowing growth in, and demand for, energy outputs, tighter financing conditions to stave off inflation and support weak regional currencies, increased tension between US and the Iran, and ongoing civil unrest in Iraq, Syria, and Yemen.

In Africa, the region is expected to grow at 3.5 percent in 2019, and then at 3.7 percent in 2020 (up from 3.6 percent). This is lower than expected, as weak commodity prices continue put pressure on countries such as Angola, Nigeria, and South Africa.

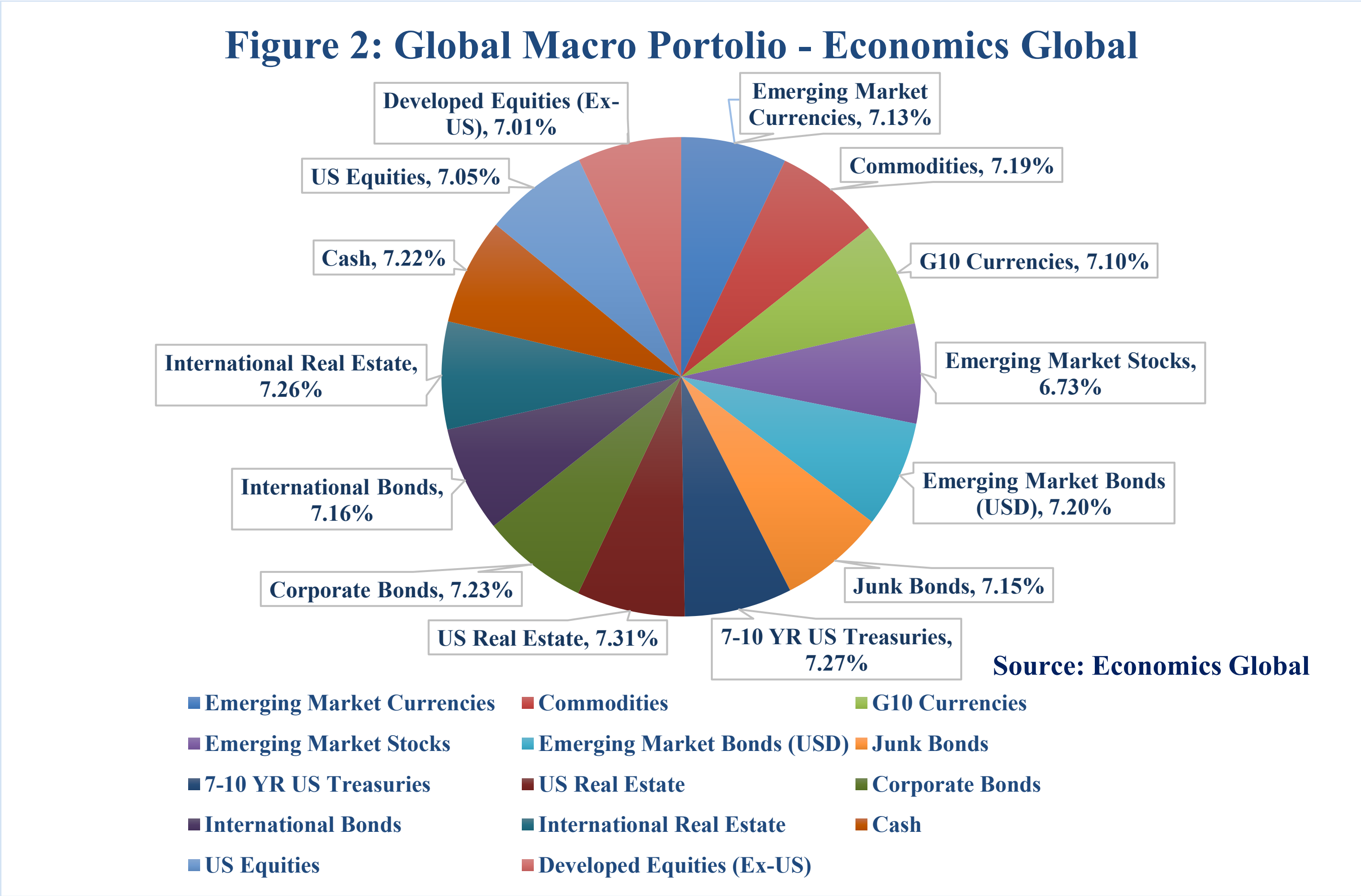
In Emerging Europe, growth is expected to be decline significantly to 0.7 percent in 2019 (down from 3.8 percent in 2018), before recovering to 2.4-2.5 percent in 2020. Despite the vibrant economic growth in Central and Eastern Europe, the region is expected to continue be hit by the deteriorating economic conditions in Turkey, where a decline in consumer demand and tighter external conditions are putting getter strain on the economy.

In Emerging Asia, the region is expected to grow at 6.3 percent in 2019, before growing at 6.4 percent in 2020. China is expected to continue to slow in the coming months due to a combination of a slowing global economy, financial and regulatory policy tightening, and the ongoing trade tensions with the US. However, the country is expected to be supported by domestic monetary and fiscal stimulus. In contrast, India is expected to be a bright spot in 2019, rising to 7.3 percent in 2019 and 7.5 percent in 2020, supported by continued recovery of investment and robust consumption, as well as easing commodity prices, and steady consumption demand.

Lastly, in Latin America, growth is expected to slow even further to 1.4 percent in 2019 (down from 2.0 percent) and rise steadily to 2.4 percent in 2020 (down from 2.5 percent). Brazil is expected to be a bright spot for the region, as the economic recovery is expected to continue for the country, under its new President. Growth in Mexico is expected remain under 2 percent in 2019 and 2020, as the country experiences a shift in policy direction under its new government. In contrast, Argentina is expected to remain a weak spot for the region, as the country undergoes a contraction due to tighter monetary policy and weakening domestic demand. Lastly, the region is expected to continue to be weighed down by the worsening political and economic crisis in Venezuela, as civil unrest in the country continues to escalate.

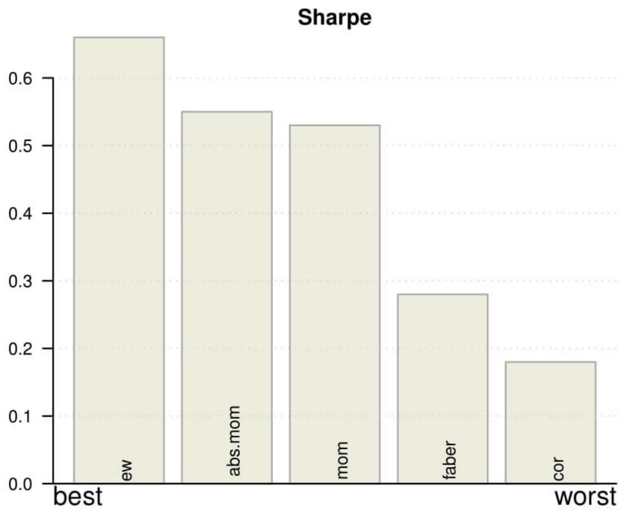
Asset Allocation

For investors looking to allocate their capital across asset classes on a global scale, we recommend the following equal weight ("EW") asset allocation:



Performance Analytics

System	mom	abs.mom	cor	faber	ew
Period	Sep2010 – May2019	Sep2010 – May2019	Sep2010 – May2019	Aug2011 – May2019	Jun2010 – May2019
Cagr	5.02	3.66	0.72	1.19	4.85
Sharpe	0.53	0.55	0.18	0.28	0.66
DVR	0.24	0.44	0.02	0.21	0.54
Volatility	10.33	7.04	4.5	4.61	7.66
MaxDD	−23.96	−16.05	−19.29	−8.03	−14.73
AvgDD	−2.13	−1.22	−1.2	−1.03	−1.16
VaR	−1.06	−0.72	−0.46	−0.47	−0.77
CVaR	−1.61	−1.1	−0.67	−0.74	−1.15
Exposure	99.95	99.95	99.95	99.95	99.96


Sharpe
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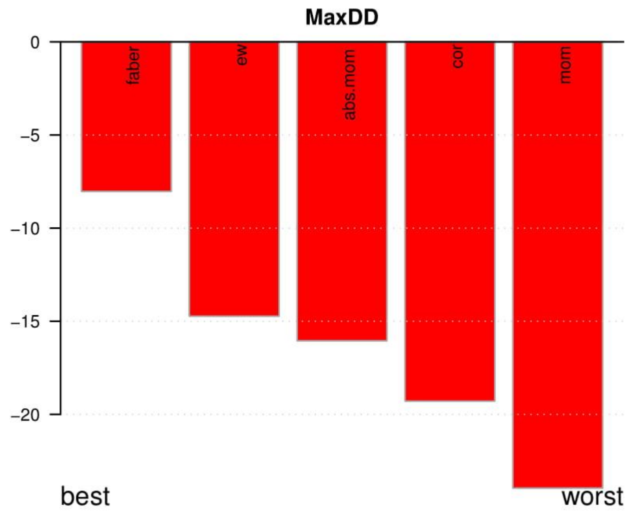
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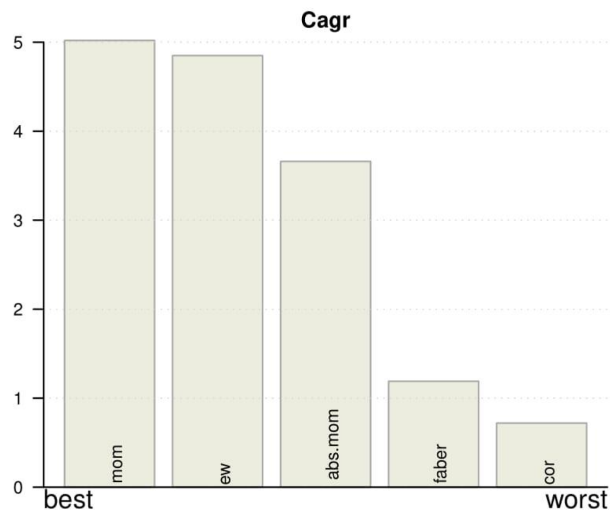
Cagr
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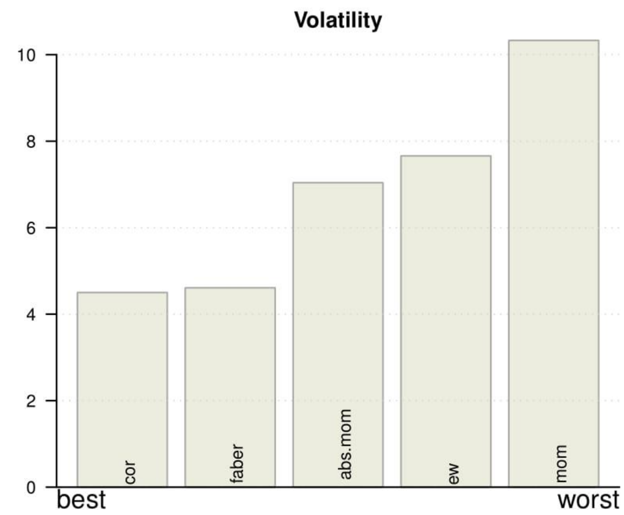
Volatility
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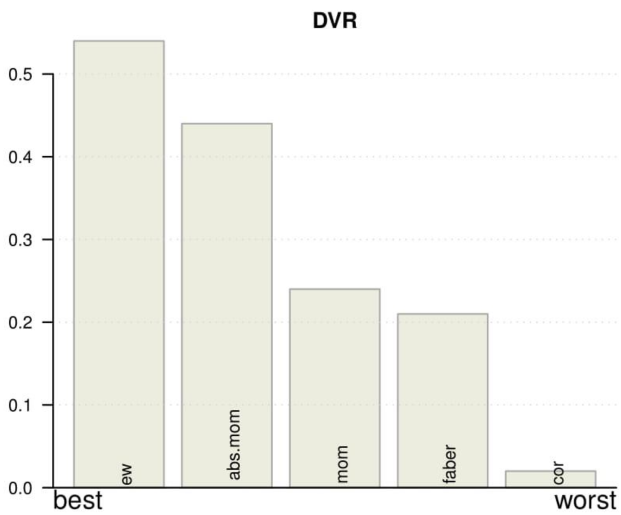
DVR
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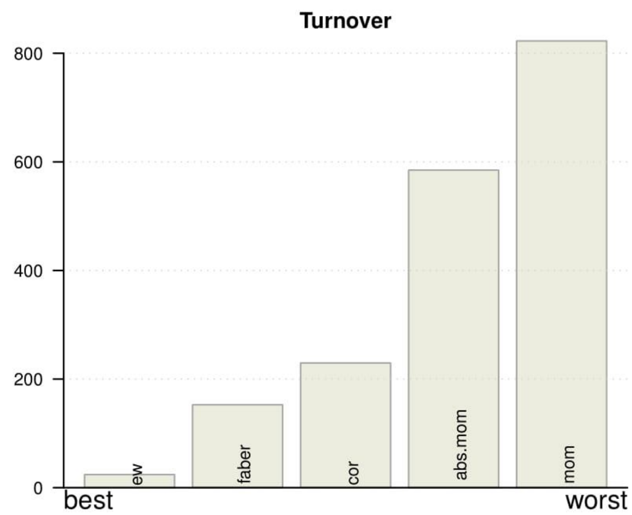
Turnover
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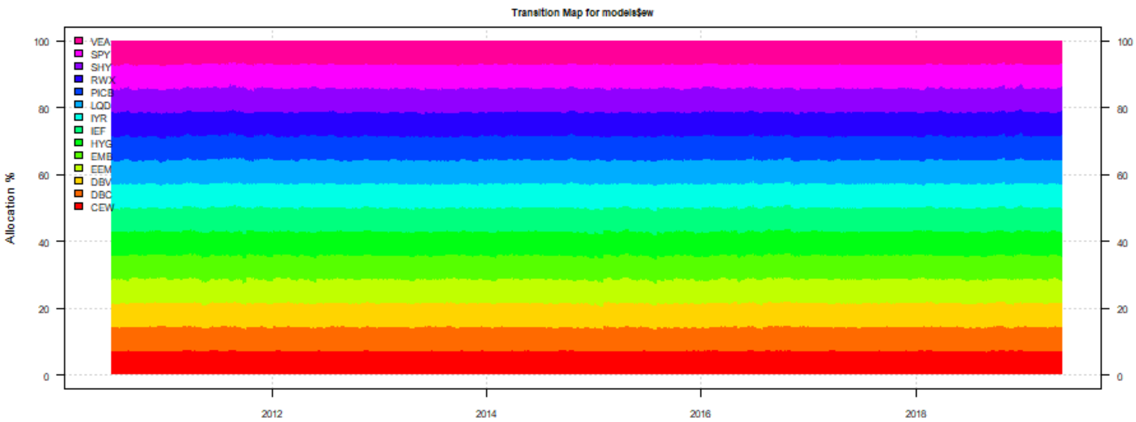
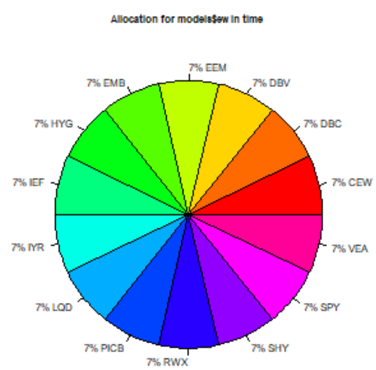
Portfolio Analytics



models$ew	2019-05-17
CEW	7.13%
DBC	7.19%
DBV	7.10%
EEM	6.73%
EMB	7.20%
HYG	7.15%
IEF	7.27%
IYR	7.31%
LQD	7.23%
PICB	7.16%
RWX	7.26%
SHY	7.22%
SPY	7.05%
VEA	7.01%

models$ew	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year	MaxDD
2010							6.2	-0.9	5.3	2.2	-2.5	4.0	14.8	-5.1
2011	0.5	1.7	0.7	3.3	-0.7	-1.0	0.5	-2.5	-7.5	7.1	-2.0	0.1	-0.4	-12.1
2012	4.2	2.7	-0.2	0.3	-5.0	3.7	1.9	1.4	1.5	0.1	0.9	1.7	13.5	-6.4
2013	0.9	-0.3	1.0	2.4	-3.5	-2.7	1.8	-1.9	3.1	2.1	-0.7	0.3	2.1	-8.9
2014	-1.5	3.0	0.7	1.1	1.5	0.9	-1.0	1.3	-3.4	1.3	-0.6	-1.9	1.3	-6.4
2015	0.0	1.8	-1.1	1.6	-1.2	-1.8	-0.8	-3.3	-1.2	3.3	-1.3	-1.5	-5.5	-9.9
2016	-2.0	0.2	5.3	1.7	-0.6	2.3	1.5	0.1	0.8	-2.0	-1.7	1.3	6.7	-5.3
2017	1.7	1.4	0.2	0.7	1.1	0.2	2.0	0.5	0.2	0.7	0.7	1.5	11.3	-2.1
2018	1.6	-2.9	0.7	-0.2	0.0	-0.7	1.1	-0.5	0.1	-3.2	0.4	-2.1	-5.5	-9.0
2019	5.6	0.5	1.4	0.8	-1.3								7.0	-1.9
Avg	1.2	0.9	1.0	1.3	-1.1	0.1	1.5	-0.6	-0.1	1.3	-0.8	0.4	4.5	-6.7

models$ew	System		Trade		Period
Period	Jun2010 - May2019			Win.Percent.Day	53.3
Cagr	4.81			Best.Day	2.6
Sharpe	0.65			Worst.Day	-3.7
DVR	0.54			Win.Percent.Month	63
Volatility	7.63			Best.Month	7.1
MaxDD	-14.73			Worst.Month	-7.5
AvgDD	-1.16			Win.Percent.Year	60
VaR	-0.77			Best.Year	13.5
CVaR	-1.14			Worst.Year	-5.5
Exposure	99.11				



Asset Class Commentary

Asset Class	View	Commentary	Recommendation
Equities	**Overweight**	We maintain our "Overweight" exposure to global equities as of this report. As money continues to move out of safe haven assets and back into riskier ones, a "Risk On" sentiment is still in play. We still stress to global equity investors to remain cautious on this asset class, as the global economy continues to show signs of slowing. Within DM and EM, we see opportunity in our selected countries, all of which have low unemployment and inflation, stable government debt/GDP ratios and current accounts, as well as the fact that both types of markets have continued to enjoy a nice run-up in equity prices. However, for investors who are exposed to EM (both broad and country specific), we would recommended hedged exposure to EM equities as market volatility has resurfaced due to the re-emergence of trade tensions between the US and China. On a sectoral basis, we recommend hedged exposure to Technology, Communications and Industrials as the "Risk On" sentiment in global markets have attracted global investors back into these spaces. However, we stress hedged exposure, as the resurgence of trade tensions has resulted in market volatility in global equity markets. We recommend this approach to global investors who want exposure to these sectors, but are worried about market volatility. We also recommend exposure to the Consumer Discretionary sector as global consumers are still showing strength, and are continuing to spend. Lastly, we also recommend exposure to the Real Estate sector, as declining global rates has improved supply and demand dynamics for property buyers, making this sector one of the best performing sectors for 2019 year-to-date.	**Macro:** **Developed Markets (Long):** Australia, Austria, Belgium, Canada, Finland, Hong Kong, Hungary, Ireland, Italy, Israel, Japan, Netherlands, New Zealand, Norway, Portugal, Spain, Switzerland, and United States **Emerging Markets (Long):** Chile, Mexico, Indonesia, Peru, Philippines, Poland, Russia, Singapore, Taiwan, Thailand, and Vietnam. **Emerging Markets (Short):** Brazil, Indonesia, Malaysia, Nigeria, South Korea, Turkey. **Sector:** Technology, Communications, Consumer Discretionary, Industrials, and Real Estate

Asset Class	View	Commentary	Recommendation
Fixed Income	**Neutral**	We are "Neutral" on fixed income. Despite central banks around the world taking a more "wait and see approach", many are still tilted toward raising interest rates and normalizing monetary policy. Within DM and EM, we see opportunity in our selected countries as they benefit from stable macroeconomic fundamentals and "Investment Grade" status from credit rating agencies. In terms of fixed income type, we are bullish on high yield bonds, both US and EM, as the “Risk On” sentiment is still in play and this asset class have been the best performing fixed income asset class year-to-date. Further we recommend exposure to EM sovereign bonds as investment grade EM countries are seeing an improvement in their macroeconomic fundamentals. Staying within EM, we also recommend EM USD bonds, as we see investors benefiting from improving EM fundamentals and a strengthening US Dollar. Lastly, we also recommend exposure to Long-Term Corporate Bonds as improving corporate balance sheets provide a great opportunity for fixed income investors. We are bearish against EM Local Currency bonds, as we believe that a strengthening US Dollar in 2019 will put pressure on EM currencies and prompt investors to flee the asset class and gain exposure to EM credit priced in US Dollars. Lastly, in terms of term structure, we still recommend exposure to the shorter end of the yield curve. Specifically, 1-3 Month T-Bills, as cash has now become an attractive asset class, and 1-3 Year Treasury Bonds, as a form of safety for investor portfolios. Lastly, we also recommend exposure to Floating Rate Treasuries for investors to capture higher yield, while still gaining protection through US Treasuries.	**Sovereign: Developed Markets (Long):** Australia, Austria, Belgium, Canada, Finland, Hong Kong, Hungary, Ireland, Italy, Israel, Japan, Netherlands, New Zealand, Norway, Portugal, Spain, Switzerland, and United States **Emerging Markets (Long):** Chile, Mexico, Indonesia, Peru, Philippines, Poland, Russia, Singapore, South Korea, Taiwan, Thailand, and Vietnam. **Fixed Income Type (Long):** US High Yield, EM High Yield, EM Sovereign Bonds, EM Bonds (USD), Long-Term Corporate Bonds **Fixed Income Type (Short):** EM Local Currency Bonds **Term Structure:** 1-3 Month T-Bills 1-3 Year Treasury Bonds Floating Rate Treasuries

Asset Class	View	Commentary	Recommendation
Commodities	**Neutral**	We are "Neutral" on commodities as an asset class as of this report, as global economic indicators are (still) pointing to the end of this expansionary cycle. However, it must be emphasized that there is still opportunity to be found within the asset class We are bullish on Energy, as supply constraints and geopolitical tensions in oil producing areas (Middle East, Venezuela) could lead to a supply shock to the space. As a result, we see Oil and Gasoline benefiting from such an occurrence. However, increased geopolitical and economic headwinds continue to put pressure on global demand for industrial commodities, such as copper and lumber. Thus, we are quite bearish on these two commodities Lastly, due to increased global oversupply, which will take some time to work through, as well as the resurface of trade tensions between the US and China, we are bearish on soft agriculture commodities such as Wheat, Grains, Soybeans and Livestock.	**Commodities (Long):** Energy (Oil and Gasoline) **Commodities (Short):** Soft Agriculture (Livestock, Grains, Soybeans and Wheat), Lumber, Copper

Asset Class	View	Commentary	Recommendation
Currencies	**Neutral**	We still maintain a "Neutral" stance on currencies. We recommend to be titled toward G10 currencies more so than EM overall, but to also have some exposure to select EM currencies as well. In DM, we still like the US Dollar as global demand for US assets are still high, and the US economy continues to do better, in relation to their DM and EM counterparts. Subsequently, we still caution against the Euro as political and economic headwinds continue to put downward pressure on the currency. Further, we would caution against the Swiss Franc, as "Risk On" and the country's negative interest rate policy is driving traders to shun this currency for more riskier assets. Lastly, due to a slowing China, as well as slowing economic fundamentals in their respective countries, we would caution investors against the Australian Dollar and the New Zealand Dollar. In EM, we are optimistic on the Russian Ruble, as the recovery in energy prices has helped ignite an impressive rally in the currency, and we expect this to continue in the short-term. Further, we are also optimistic on the Thai Bhat, as the Thai economy will see growth potential from private investments and tourism, as well as the establishment of an elected government, which will help to bring back global investment into the country. In contrast, we have pared back our optimism on the Chinese Yuan, as US-China trade tensions have reignited, with the US imposing new tariffs on Chinese goods in May 2019. If trade tensions deteriorate further than anticipated, we see further downside for the Chinese Yuan in the near term. Lastly, we would caution investors to avoid the Turkish Lira, as the countries deterioration economic fundamentals, and increased political tension will prompt investors to (continue to) flee the currency.	**Developed Markets (Long):** US Dollar **Developed Markets (Short):** Euro, Swiss Franc, Australian Dollar, New Zealand Dollar **Emerging Markets (Long):** Russian Ruble, Thai Bhat **Emerging Markets (Short):** Chinese Yuan, Turkish Lira

Risks

The global economy continues to face key risks that threaten to weaken the global economic outlook.

Despite the recent "Risk On" sentiment prevailing in the markets, financial sentiment continues to be of concern. Rising trade tensions, combined with weakening Italian fiscal conditions, rising global debt levels, and concern over the Chinese economy all threaten to undermine confidence within global financial markets. Further, in the US, the market-implied path of expected policy rates remains below the Federal Open Market Committee's projects, raising the possibility of a market reassessment of the expected policy path, if US economic data remains strong. This could lead to higher US interest rates, tighter financial conditions for DMs and EMs, a higher US Dollar and weaker EM currencies, and greater pressure on countries with poor macroeconomic fundamentals. Faster than expected deterioration in systemic economies or markets could lead to a significant decline in investor sentiment and in turn, a substantial decline in global asset prices.

Increased trade tensions continue to remain on investors' minds. Though progress has been made, such as the signing of US-Mexico-Canada ("USMCA") trade agreement, and trade dialogue between US and China, obstacles remain. The final outcome on the USMCA depends on domestic approval within each of the three countries, while China and the US still disagree on key provisions between their two countries. It must be noted that failure to resolve these differences could lead to higher prices for goods and services for end users, the disruption of supply chains, and lower global economic productivity.

Conclusion

As the global economy continues to chug along, it is clear that the expansion is wearing thin. As increased risks within the global economy continue to emerge, and as volatility within the global markets is here to stay, one thing is certain is that investors should get defensive. More specifically, we believe that investors should allocate their portfolios in accordance with our global macro asset allocation we recommend in our report, in order to achieve suitable returns for a slowing economy.

Sources

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- Systematic Investor
- Bloomberg
- Economics Global

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