Quarterly Perspective

PLURIMI

From Plurimi Investment Managers CIO Patrick Armstrong

1 July 2019

Q2 2019 has seen most assets drift higher, driven by increasingly dovish central bank rhetoric. Global equities strengthened, credit spreads narrowed, and bond yields moved lower. Both the US Federal Reserve and the European Central Bank have indicated that more monetary stimulus is likely in the coming months. The Fed funds futures are now pricing in 80bps of cuts for this year.

We have moved to a neutral view on government bonds over the remainder of the year. Slowing global growth, low inflation, and increasingly easy policy should allow bond yields to remain supressed for the coming months. It will take stronger growth and inflation expectations to push yields higher. Long-duration US Treasuries are a valuable hedge against a further US trade policy mistake, despite offering a poor long term risk-reward profile at a 2% yield.

Consensus earnings and economic growth have been reduced during the quarter but remain relatively resilient. The driver for equities is balanced between cyclical headwinds and negative earnings estimates competing with liquidity tailwinds.

Our economic outlook is slightly more upbeat than the prevailing sentiment. The recent decline in bond yields and looser policy have reduced the odds of a poor economic outcome. US trade policy is the wild card that could trigger a recession, but we do not expect a significant deterioration in trade relations as it is in all sides interests to maintain or improve the status quo.

Global equities are approximately at fair value, but the rally is probably due for a pause. The next move will be driven by the direction of global economic activity. Markets other than the US are at depressed multiples and should outperform if global trade improves.

Gold, US 2/10 steepeners and dispersion trades will act as good hedges to our pro-cyclical view.

Q2 Review *p.2*

Eurozone equities and gold lead a strong quarter for most asset classes.

Asset Allocation Trades *p.3*

Japanese Equity, EuroStoxx 50 Dispersion, Oil and Gold auto-callables

Global Economy *p.4*

Global expansion has matured but is not yet over.

Central Banks *p.8*

The Fed has completed a dovish turn by indicating that their bias is to cut in July. Possibly provoked by the Fed, the ECB has also indicated a further softening of their policy is likely in the coming months.

Politics *p.10*

US/China trade relations look likely to hold on to a fragile truce over the coming months. We do not expect an all encompassing trade deal, but a ceasefire should be enough to maintain some buoyancy in risk assets .

Equities *p.12*

The direction for equities is balanced between cyclical headwinds and negative earnings estimates competing with liquidity tailwinds. The path of least resistance is a slow grind higher.

Fixed Income p.19

$12.7 trillion of bonds now have negative yields. Government bond yields will remain depressed in the coming months as central banks keep liquidity high. EM and spread products will outperform government bonds, but they obviously come with more risk.

FX p.20

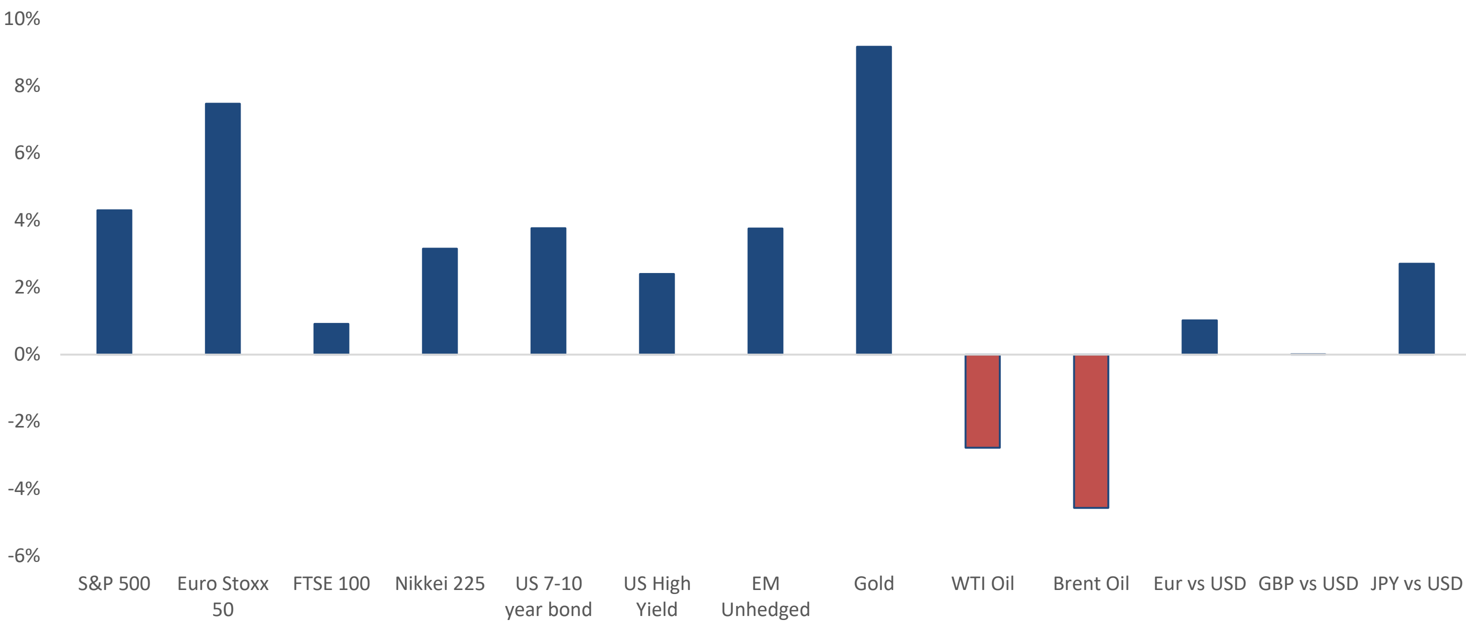
GBP will face increasing 'Hard Brexit' rhetoric over the summer. Euro and Japanese Yen supported by appealing valuations.

Commodities p.21

Gold prices should continue to be supported by dovish central bank policy. Oil prices have a geo-political floor with Iran tensions to remain elevated and OPEC adhering to and extending cuts to year end.

Q2 2019

Performance by asset class (% USD)



Source: Bloomberg, PIM

Asset performance in Q2 2019 was driven by very dovish policy indications from the US Fed and the European Central Bank. Eurozone equities and gold led the way higher and oil had a negative quarter based on increasing supply and a weakening demand outlook.

The first half of 2019 has seen a balanced 50% global equities and 50% global bonds portfolio rise by 10.5% in USD terms. This is the strongest half of a year since 2010.

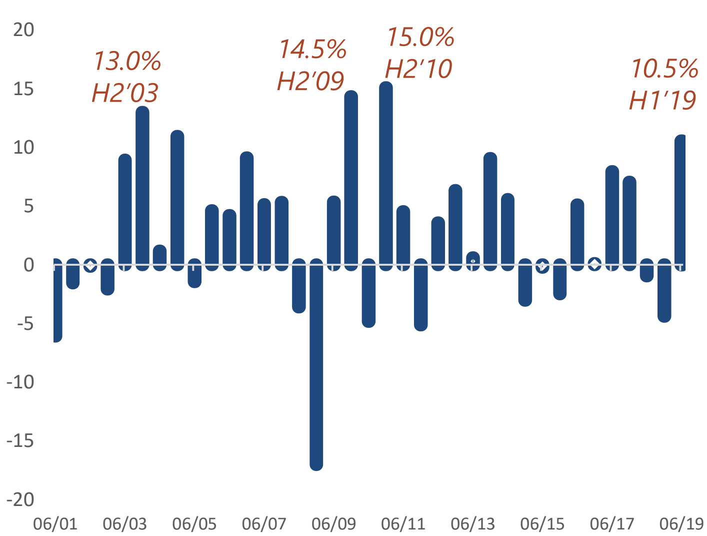
Risks assets recovered from a very weak Q4 2018 with global equities delivering their strongest Q1 since 2010. High yield and emerging market bonds saw significant rebounds, and oil rose by 30%.

The magnitude of the rally contrasts sharply with the deterioration in the economic and corporate fundamentals. Earnings estimates for the S&P 500 and global economic growth forecasts from the IMF and consensus were reduced in recent months. No positive progress was made on Brexit, and little was accomplished on US/China trade.

US equity markets seems to be pricing in a low probability of a normal recession, while US treasuries are pricing in a high probability. The question for the remainder of the year is which market is more accurately reflecting the state of the economy. Is the bond market overly cautious, or is the equity market complacent and overly confident in earnings?

Risk assets and safe havens have rallied together on dovish monetary indications, producing the strongest first half for balanced portfolios in 20 years.

Global equity & bond performance (% growth)



Half year returns based on 50% Barclays Global Aggregate and MSCI World (USD)

Source: Bloomberg, PIM

Asset Allocation

Late in the cycle, with increasing liquidity

Overall	--	-	N	+	++
Equities		→	■		
Fixed Income			■	←	
Cash		■			
Commodities		■			
Alternatives					■
Regional Equities	**--**	**-**	**N**	**+**	**++**
Australia		■			
Canada		■			
Euro Area				■	
Japan				■	
Switzerland				■	
U.K.			■	←	
U.S.	→	■			
Emerging Markets				■	
Global Equity Sectors	**--**	**-**	**N**	**+**	**++**
Consumer Discretionary			■		
Consumer Staples		■			
Energy			■		
Financials			■		
Health Care			■		
Industrials				■	
Information Technology			→	■	
Materials		■			
Real Estate			■	←	
Telecom Services			■		
Utilities		■			
Commodities	**--**	**-**	**N**	**+**	**++**
Gold				■	←
Oil		→	■		
Industrial Metals					
Energy		■			
Agricultural		■			

Fixed Income	--	-	N	+	++
Duration		■			
Government Bonds		■			
Yield Curve				■	←
Inflation Protection				■	
Investment-Grade			■		
High-Yield				■	
EM Sovereign USD				■	
EM Sovereign Local				■	
Government Bonds	**--**	**-**	**N**	**+**	**++**
Australia				■	
Canada				■	
Euro Area		■			
Ex- Germany		→	■		
Germany	■	←			
Japan		■			
Switzerland		■			
U.K.		■			
U.S.			→	■	
Currencies vs USD	**--**	**-**	**N**	**+**	**++**
Australia		■			
Canada		■			
Euro Area				■	
Japan				■	
Switzerland			■		
U.K.		■			
Emerging Markets				■	
Alternatives & Structured Opps.	**--**	**-**	**N**	**+**	**++**
Dispersion Euro Stoxx 50 stocks					■
Dividends EuroStoxx			■	←	
Covered Call on EU Integrated				→	■
Long Oil vs AUS and CAD				■	
Steepner Warrant (Embedded Note)				■	
Reverse Convert Fed Funds				■	
Oil and Gold Autocallables				■	
Dispersion Dax stocks (removed)	←				

→ Increase from previous quarter

← Decrease from previous quarter

Source: PIM

Global economic dashboard

Indicator	Derivative 1st	Derivative 2nd	Interpretation & outlook
Growth			
Global leading economic indicator	-	-	Slightly more positive than negative, but slowing throughout Q4.
ZEW/IFO	-	-	Moved lower and negative throughout 2018 in US and Germany.
US ISM manufacturing new orders	0	0	Mildly expansionary, with a small bounce in June.
Consumer confidence	+	-	Still strong but below Q4'18 peak.
Business confidence	0	0	Positive.
Global PMI	0	-	Barely expansionary but with a persistent negative trend.
G7 employment	+	0	Positive and no signs of slowing yet.
Global trade volume	-	-	Sluggish and weakening in recent months.
Oil prices	+	0	Oil prices moving higher in June on risks, rather than demand.
Policy			
Real policy rate	+	+	Fed has indicated a July cut and policy remains accommodative throughout the world. Potential competitive policy is a real possibility in the coming year.
Nominal GDP-bond yield gap	+	0	Positive gap is reflationary.
G7 credit growth	+	0	Positive and stable.
Financial stress	+	0	Ample and growing liquidity and low default rates through 2019.
Fiscal thrust	0	+	Fiscal drag disappeared, with US stimulus, while Europe may be moving away from austerity. MMT next?
Inflation			
Core CPI	0	0	Deflation risks have dissipated, but there are no signs of inflation outside of the UK.
Wage growth	+	0	Wage growth > inflation in developed world.

Source: Bloomberg, PIM

Global Economy

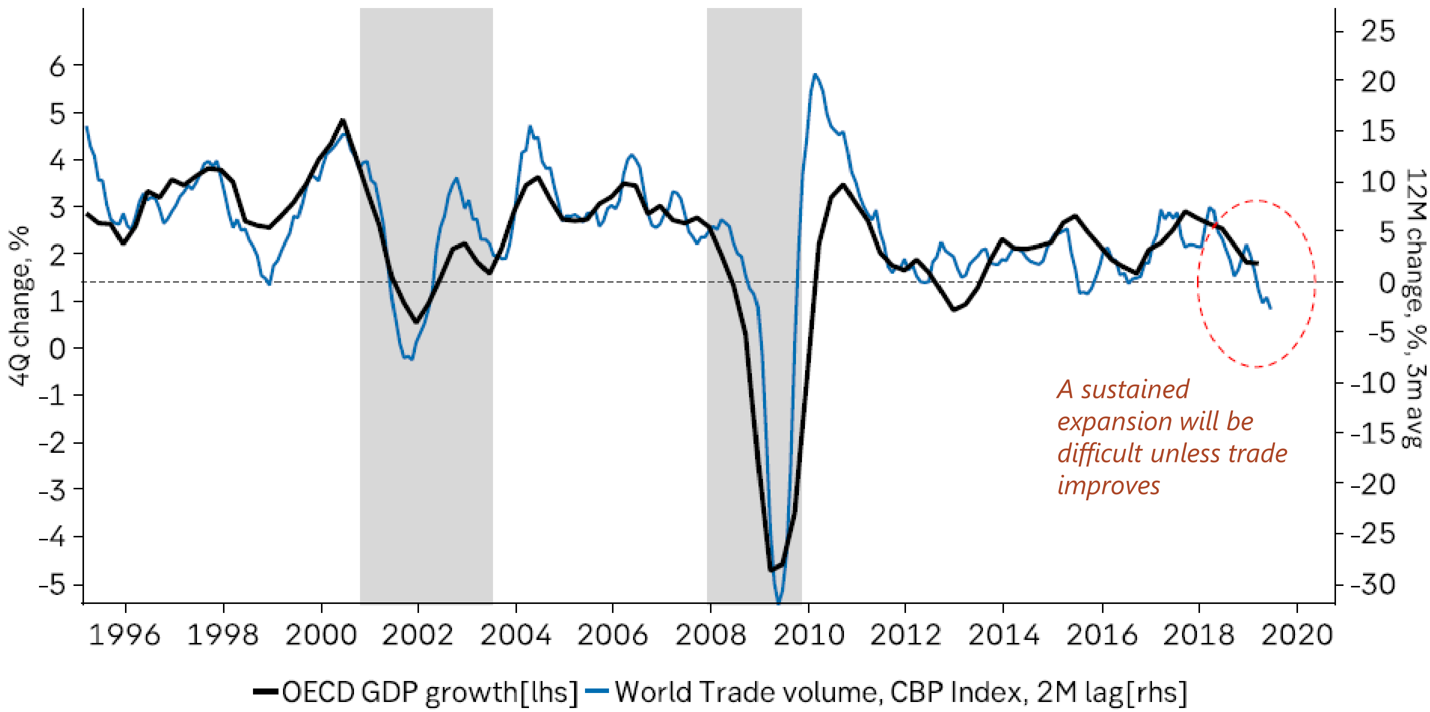
Expansion is long in the tooth, but should continue

Our global economic dashboard shows an economy which is expanding, but well past peak growth. Policy rates remain supportive for growth and we expect they will move into more accommodative territory in the coming months. Trade and manufacturing data has been weak across the globe. Services indicators have been relatively strong, but are not given the same importance as slowing manufacturing numbers.

Uncertainty created through trade wars leads to lower business confidence and investment.

The uncertainty surrounding US/China trade was not resolved in the first half of the year. We had previously expected positive developments to remove a significant question to global growth, but an all encompassing trade deal is now appears to be a long way off. US President Trump and his Chinese counterpart, Xi Jinping have outlined a tentative peace accord reached at the G20 summit in Japan. For now it is a trade truce, ending further escalation, and a commitment to engage in further negotiations. This should to be enough to restore business confidence and keep some buoyancy in equity markets for now. Long term implications on trade will remain. There are already indications that companies such as Apple are looking at their supply chains to mitigate future tariffs. Any uncertainty created through trade wars or even threats to trade lowers business confidence and investment. These are small headwinds in the short term, but over time they may keep the global economy below its potential. So far, trade tensions have only modestly impacted confidence, and the global economy still has a good chance to improve should tensions ease.

Global trade volumes and OECD growth



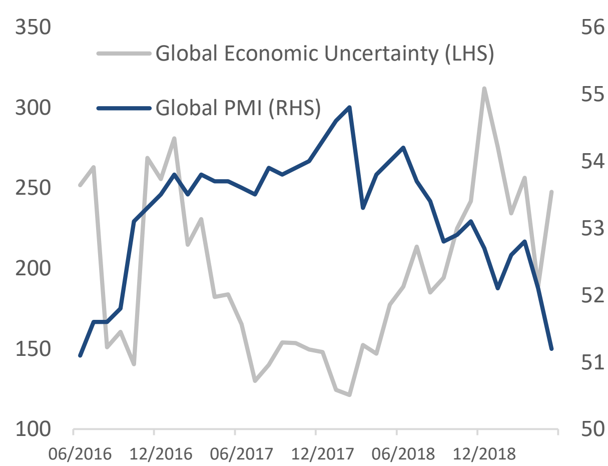
Source: Bloomberg SEB, PIM

While China and the US have a fragile trade truce in place, the prospects for a resumption in growth of global trade are not necessarily there. We expect the United States to keep in place the existing tariffs on Chinese goods for months to come. Companies will almost certainly respond by shifting some of their supply chains out of China. As long as tariffs and the threat of increases remain, companies will to de-risk supply chains as much as possible. Leaving tariffs in place for the indefinite future is a sub-optimal solution for the global economy. As expected Global PMI has had a negative correlation with the economic uncertainty index. Global PMI remains in expansionary territory but has fallen significantly since 2017, while economic policy uncertainty has increased markedly.

The Americans want fundamental economic policy changes in China, and an implementation process to ensure any deal reached is enforceable. Beijing officials want the tariffs dropped entirely. For now, a sub-optimal trade agreement is enough to end the most negative scenario of new tariffs, but it does not address the worrying trend of slowing global trade volumes.

Uncertainty created through trade wars leads to lower business confidence and investment.

Economic policy uncertainty vs Global PMI



Source: Bloomberg, PIM

For the remainder of this year and the next, we expect a continuation of the moderate growth and low inflation environment that has prevailed over the past two years. Growth will be muted by sluggish productivity gains and aging populations in the developed economies, and a structural slowdown in China. Risks to growth are broadly balanced, with potential upside from productivity growth as technology benefits spread, fiscal stimulus vs. downside risks from rising political populism and trade wars.

We have essentially maintained our growth forecasts for 2019 from 3 months ago. We project Global real GDP will expand by 3.3% annually over this year and next. This is slower growth than recent years, but not falling into the recession many are worried about. Emerging markets will continue to significantly outpace the developed markets growth, although also slowing somewhat compared with the past decade. We expect the eurozone to lag the developed world growth, but see some improvement next year based on increased monetary stimulus and the lagged benefits of a weaker currency.

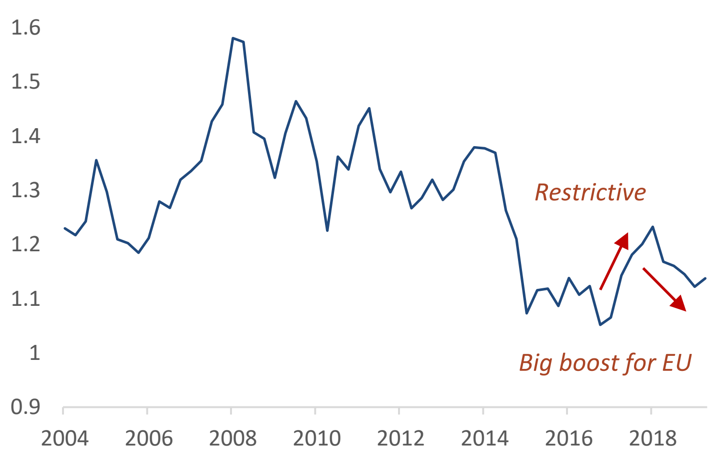
Global GDP growth

	2017	2018	2019e	2020e
World	3.8	3.7	3.3	3.3
Developed	2.4	2.3	2.1	2.0
Emerging	5.0	5.1	4.7	4.8
US	2.2	2.9	2.4	2.1
Euro	2.5	1.9	1.1	1.3
China	6.9	6.6	6.1	6.0
India	6.2	7.5	6.7	6.9

Source: Bloomberg, OECD, PIM

The global economy will see some stabilisation from China and Europe as the US economy decelerates

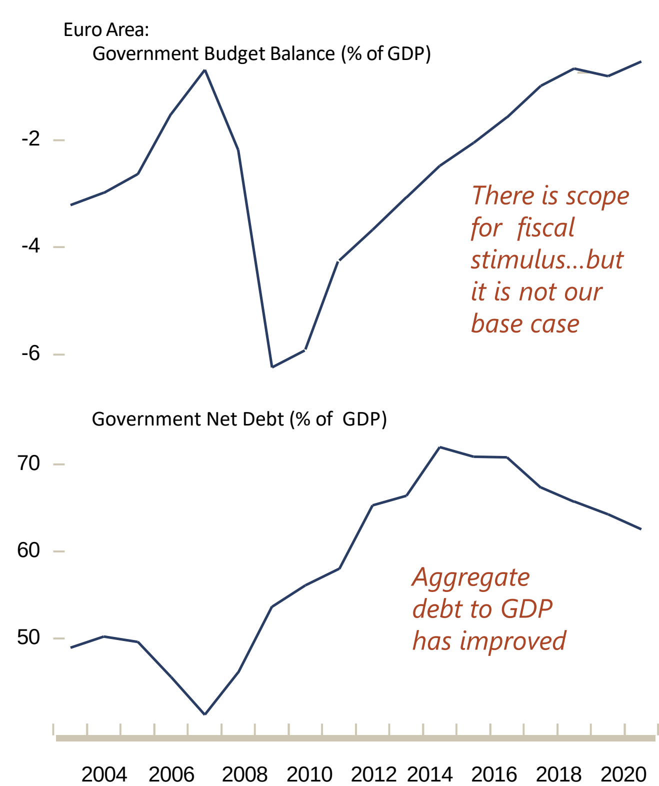
EUR vs USD



Source: Bloomberg

An economy with a strong balance sheet, growth below potential, significant unemployment and a sizeable current account surplus should be engaging in more fiscal stimulus, but it is hard to see a meaningful change here in the near term. Populist forces may start to move the dial in France, Italy, and Spain. At least as far Germany allows it to happen.

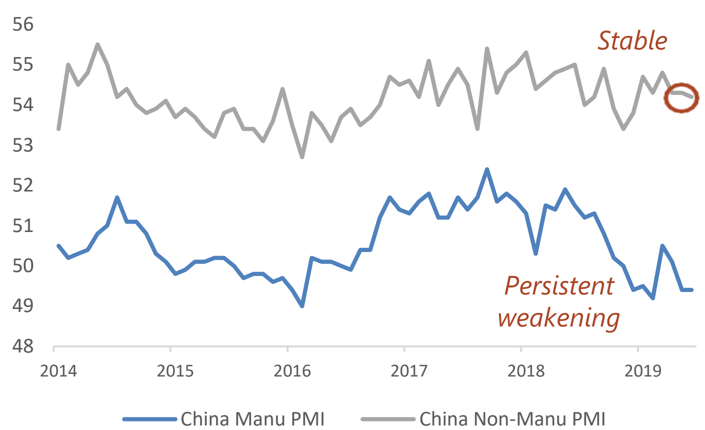
The Euro Area should ease fiscal policy



Source: Bloomberg, MRB, OECD forecasts

The Chinese economy has been the primary driver of global growth in recent years. A string of weak manufacturing and export numbers have many questioning the resilience of the Chinese economy the face of US tariffs and generally weaker global demand. Recent easing in policy and a pickup in credit growth should create a base for growth. Chinese services have stayed strong over recent years, while June's manufacturing PMI has fallen into contractionary territory.

China PMI

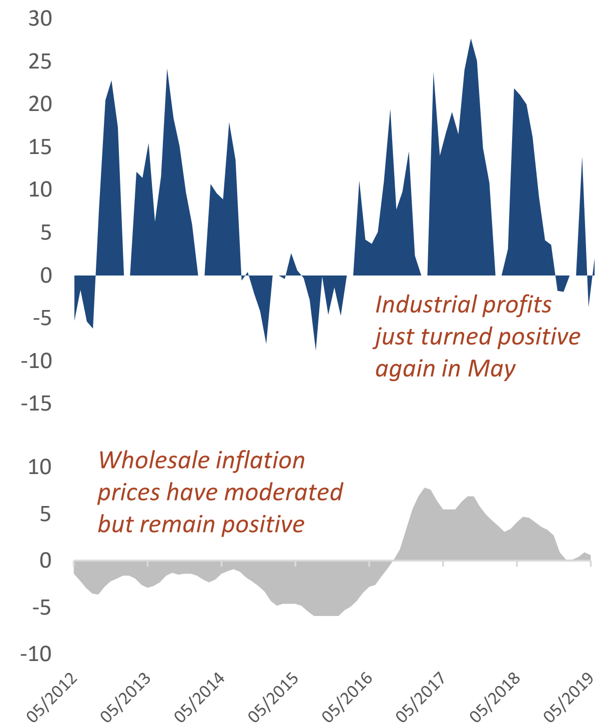


Source: Markit Bloomberg, MRB

China's growth will slow, reflecting the ongoing deceleration of productivity growth and virtually flat population growth. The deteriorating trade and strategic relationship between the US and China is a significant and increasing risk for the economy. China is vulnerable to a sharp slowdown or recession should the White House add additional tariffs it has previously threatened.

While risks have increased and past growth rates are no longer achievable, we expect coordinated stimulus and thawing trade relations will lead to continued expansion in line with Chinese government targets. Retail sales are growing at 7.2% and industrial profits have turned positive again in May. We think this is indicative of China continuing to grow at greater than 6.0% for the year.

China industrial profits and producer prices (%)



Source: Bloomberg

China's changes in industrial profits and producer prices are consistent with stable nominal growth in Q2.

China's manufacturing is contracting while the services sector remains strong. We expect a gradual economic slowdown rather than a hard landing.

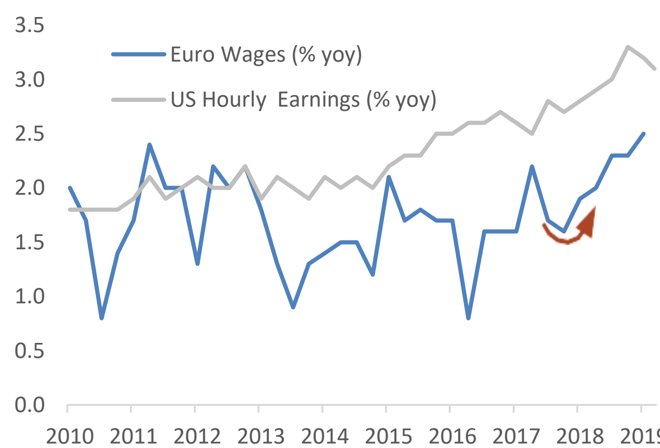
Central Banks

The Fed's 180 degree turn takes place in July

In our opinion, central bank policy has been the most important determinant of asset prices over the past decade. In Q2 2019 this continued to be the case, as assets rallied once the Fed indicated a July cut was probable.

Although all central banks left interest rates unchanged during the quarter the Fed sent a clear dovish signal at its June meeting. We now think the Fed will cut rates by 25bp In July. The market is pricing in a certainty of a cut, with a 75% chance of 25bp and a 25% chance of a 50bp cut. We think a 50bp cut is unlikely unless the economic numbers slow significantly in July. Interestingly while rate expectations have fallen dramatically this year the expectation for US growth has remained firm, and continues above trend. Wage growth and unemployment continue to look strong, so any moves from the Fed would have to be viewed as insurance at this point. These types of cuts have typically been 25bps in the past. Even one of the most dovish Federal Reserve members, James Bullard, indicated that he thinks a 50bp cut in July would be too much.

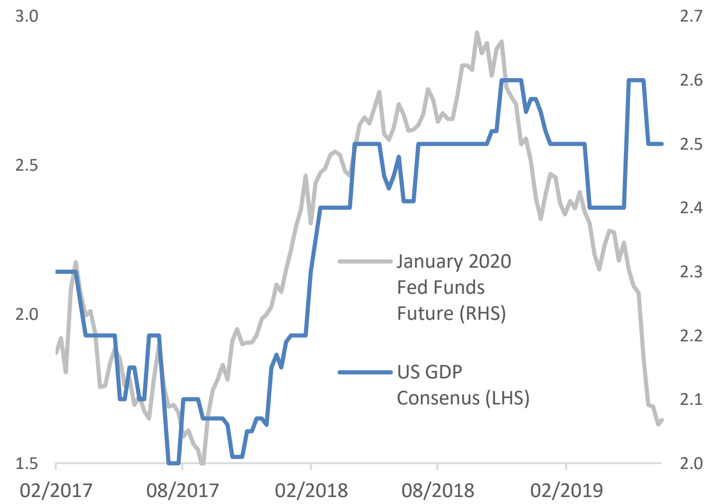
Wage pressures are actually picking up



Source: Bloomberg

In Europe the economic outlook has turned more negative. Geo-political tensions and weaker global trade have created headwinds for Europe. This weakness and a need to compete with a dovish Fed has led the ECB President Draghi to express a willingness to act. We now expect a resumption of quantitative easing and a 10bp cut from the ECB for each cut the Fed makes.

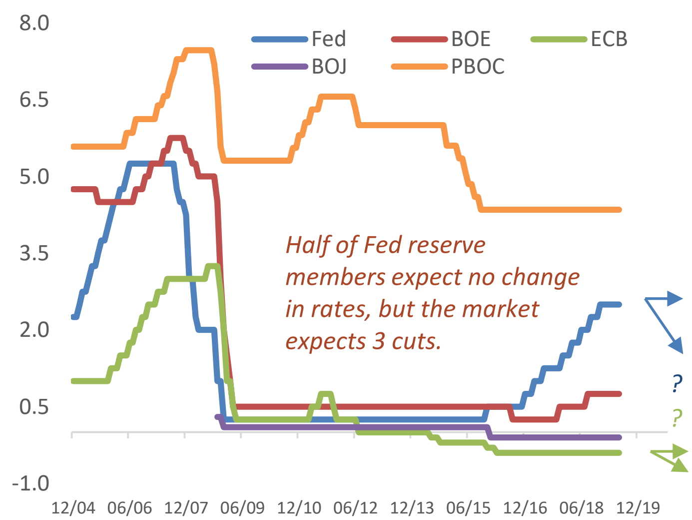
January 2020 Fed futures and consensus GDP



Source: Bloomberg

The Fed fund futures and consensus GDP have uncoupled this quarter. A recoupling will happen, but the direction is the question.

Major CB policy rates



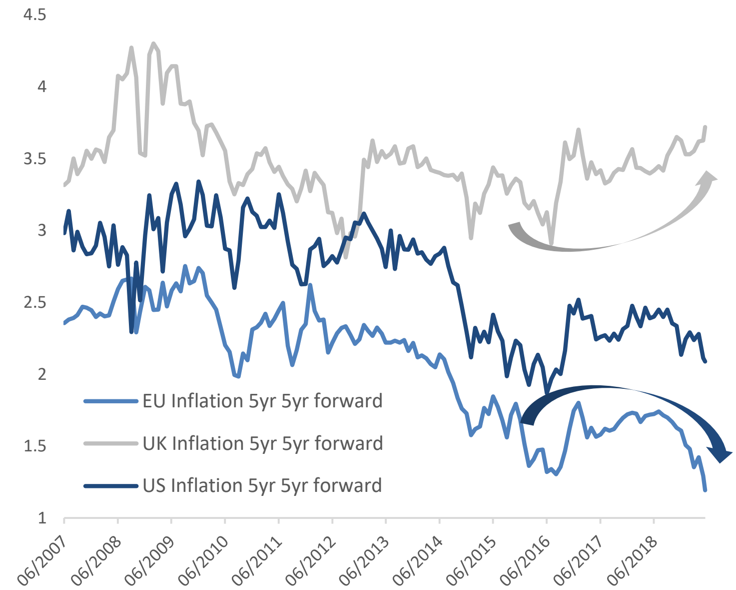
Source: Bloomberg

The Fed and ECB have indicated cuts are coming, and the lack of inflation expectations is a significant factor in this. Euro 5-year, 5-year forward inflation swaps have fallen below 1.5% and the US has fallen below The Fed's 2% target.

Draghi's speech in Sintra last month was an attempt to re-anchor inflation expectations. He emphasised that various policy options were on the table, including enhancing the forward guidance, further interest rate cuts, a tiering of deposit rates and restarting the bond-buying scheme. He will never admit it, but all of these actions have an explicit goal to weaken the euro. Imported inflation is the most realistic option to return to the ECB's target. While we now expect more QE as part of a limited set of options from the ECB, it will be difficult to have a meaningful impact unless they raise issuer limits.

The Bank of England is the one central bank which has not seen inflation expectations plummet this year. This is precisely because of the risk of imported inflation following a hard Brexit. Brexit uncertainty will keep the BOE on hold, but an orderly Brexit may even lead to a 2020 hike given where inflation expectations have moved to.

US, Euro, and UK inflation swaps

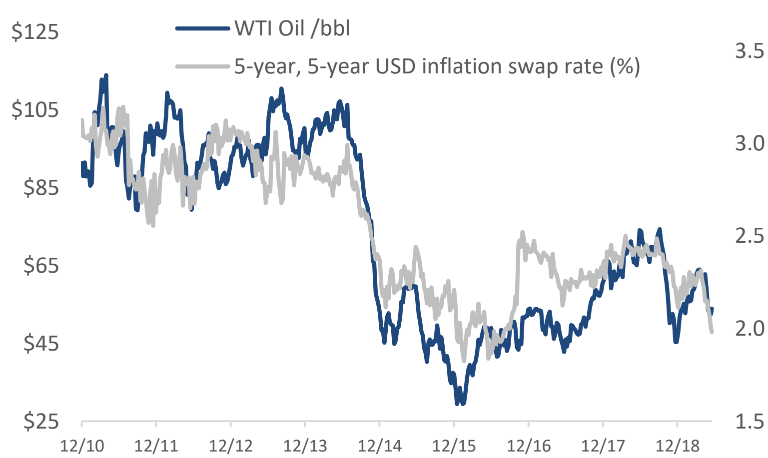


Source: Bloomberg PIM

While lagging growth indicators are strong, the Fed and ECB need to stoke inflations expectations with stimulus.

The price of oil seems to have an unduly large impact on medium term inflation swaps. The tensions with Iran may actually help the Fed re-anchor inflation expectations.

As goes oil prices, so goes US inflation expectations



Source: Bloomberg PIM

Global Politics — Impossible to ignore

Politics is always a potential wild card to the direction of both capital markets and the global economy. 2018 saw a massive late cycle stimulus in the US in the form of tax cuts, which boosted the economy and stock markets. It also saw the continued rise of populism as a successful election strategy around the world. The repercussions were felt in increasing global trade tensions, protectionist policies.

The main geo-political risks for the remainder of 2019 are:

US / China trade: We had previously expected a deal to be agreed by this time. We remain confident a truce will be struck in the coming weeks, but find an all encompassing deal, a very low probability. This should remove some of the overhang on the economic outlook for the world, and for China in particular. Flare ups throughout 2019 are to be expected, but given both sides desire for trade we do not expect a major deterioration. The Trump Administration may actually attempt to provoke some trade uncertainty until Trump has got enough Fed rate cuts. We expect hawkish trade rhetoric from the White House at times when strong equity markets and economic numbers are on his side. Should these indicators turn, and as we get closer to next year's presidential election, Trump's trade rhetoric and policy should soften.

Positive surprises to some of the specific risks are possible, but big picture issues around populism, and global alliances may worsen.

US / Iran: Tensions in the Persian Gulf have heightened sharply during June. The possibility of a military confrontation between Iran and the US is now greater than any other time in past decade. The US has recently added additional sanctions on Iran as a last minute alternative to military strikes. While both sides have a strong interest to step back from the brink, the risks are mounting of accidents triggering actions that are in neither sides interests. We expect tensions to remain high for the remainder of the year. The implication for global capital markets are for more volatility, and creating a floor under oil prices.

Brexit : Another risk which we thought may be concluded in the first half 2019. The majority of British MPs and the public do not want a 'No Deal' Brexit, but it is difficult to get an agreement on ANY alternative. Boris Johnson is expected to be the UK's next PM, and wants to make sure Europe knows that a no-deal Brexit is on the table. This should mean 'No-Deal' risks will be played up over the summer. This will create headwinds for GBP and investment in the UK. We expect a scenario which avoids a crashing out. Should the next PM not get enough votes for their plan (New deal, or no deal) extending article 50 with a view to a general election or a new referendum are possible. The chaos the UK has faced around this issue may drag on for years to come, as the only thing there is a consensus on, is that there are no great solutions to the issue.

Odds of a general election in the UK before November are greater than crashing out of the EU.

EU: Italy and France have populist led discord. Risks around continuity of leadership of the CDU party in Germany have now passed, but the post Merkel era nears. Most of what ails the Eurozone comes from the anaemic growth it has delivered. Should growth improve, we expect political risks will quiet, but another year of disappointing growth or recession and these risks will only intensify. This year's Italian budget can be seen as a one off miss, but the 2020 budget is another looming problem. This row will reignite this again in Q419 unless other more important political issues take precedence.

Asset Allocation

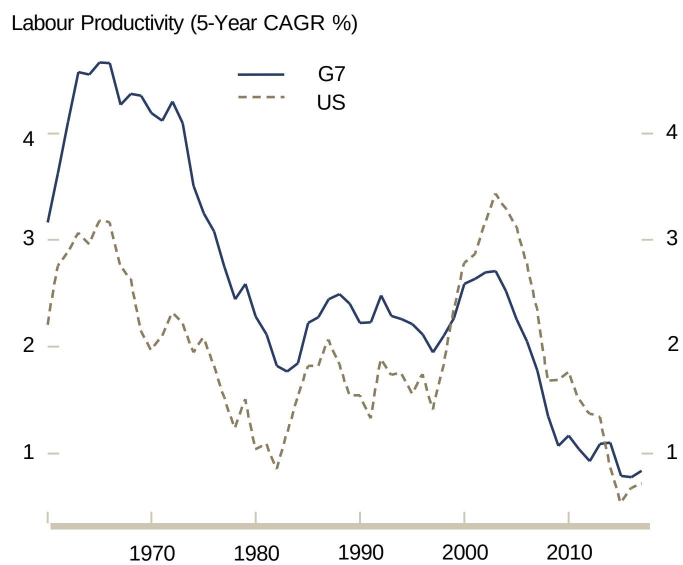
Long term outlook

	Economic Forecasts (2019-2029)			Historical 2008-2018
Country/Region	Real GDP (% CAGR)	Population (% CAGR)	GDP Deflator (% CAGR)	Real GDP (% CAGR)
Brazil	2.8	0.6	3.6	1.2
China	4.4	0.11	2.1	7.9
Euro Area	1.1	0.1	1.8	0.8
India	6.9	0.9	4.1	7.5
Japan	0.3	-0.4	0.7	0.7
Switzerland	1.2	0.6	1.4	1.5
UK	1.3	0.5	2.0	1.3
US	1.8	0.7	2.0	1.8
Developed Markets	1.3	0.3	1.8	1.3
Emerging Markets	4.1	1.1	3.5	5.0
Global	2.6	1.0	2.6	2.7

Sources: IMF World Economic Outlook, MRB and Plurimi calculations. Population forecasts from UN, Compound annual growth rate

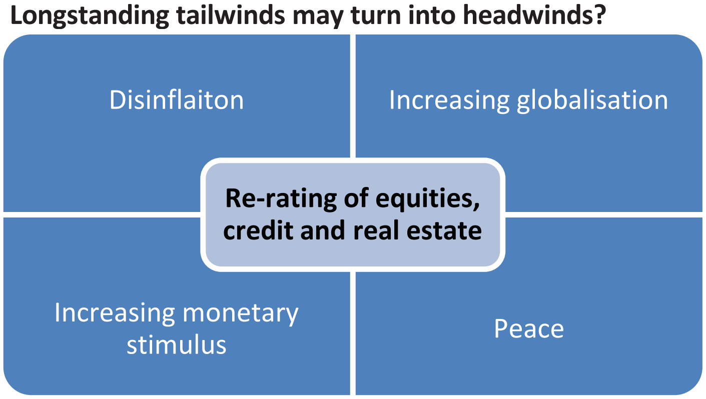
The current economic expansion is now the longest on record and has delivered solid returns for global multi-asset investors. Favourable tailwinds from globalisation, disinflation, relative peace, and record level of monetary stimulus have led to a significant re-rating of bonds and risk asset classes. Global equities have delivered a 12% real compound annual return over the past decade (effectively since the 2009 bottom), while a basket of G7 10-year government bonds has produced a real compound annual return of 1.6%. While we forecast economic growth in the coming decade will roughly match the previous decade, the tailwinds that have boosted returns across all asset classes in this cycle and for most of the past four decades are fading, and may swing the other direction. The consequence will be below average returns on balanced portfolios.

Productivity gains have constrained GDP growth



Source: US Conference Board, MRB

Longstanding tailwinds may turn into headwinds?



Falling labour productivity has curtailed growth, but is an area which may positively surprise in the coming years.

Equities — World (Neutral)

MSCI WORLD	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	17.88	37	21.01	19.76
BEst P/E Ratio	16.01	59	15.80	15.67
Long Term Price Earnings Ratio	23.09	67	22.06	21.58
Price to Book Ratio	2.37	56	2.38	2.33
Price/EBITDA	9.42	84	7.62	7.21
Price to Sales Ratio	1.65	92	1.30	1.30
Enterprise Value/EBITDA	11.63	77	10.61	10.54
Profit Margin	8.85	93	6.13	6.50
Operating Margin	12.00	83	10.41	10.36
Dividend Yield	2.51	69	2.25	2.23
10Y Yield	2.01	10	3.96	3.95

Source: Bloomberg. Jan 1995 to June 2019

Following the strong start to the year global equities are now trading at average 67th percentile on a range of valuation indicators. The market looks attractive vs bonds, 'fair' value on earnings & book, but expensive on ebitda & revenue measures.

We expect earnings growth will be achieved in 2019, but may fall short of the 4.5% consensus estimate. If our macro scenario broadly pans out, we expect equity market leadership to shift away from the US market.

The direction of markets will be more dependant on the competing forces of slower economic growth, and increasing liquidity.

Earnings outside of the US should be positive and grow at a faster rate than the US. We expect US corporate profit growth will be very low as the US tax cut drops out of earnings growth, and margins are squeezed by higher labour costs and interest rates.

The health of the global economic expansion will be a key driver of relative equity market for the remainder of the year. Should the global expansion regain any momentum Europe, Japan, and emerging markets will have greater potential to outperform. A global economy falling into a trade war induced recession will likely see relative 'leadership' from Switzerland, the US, and even the UK.

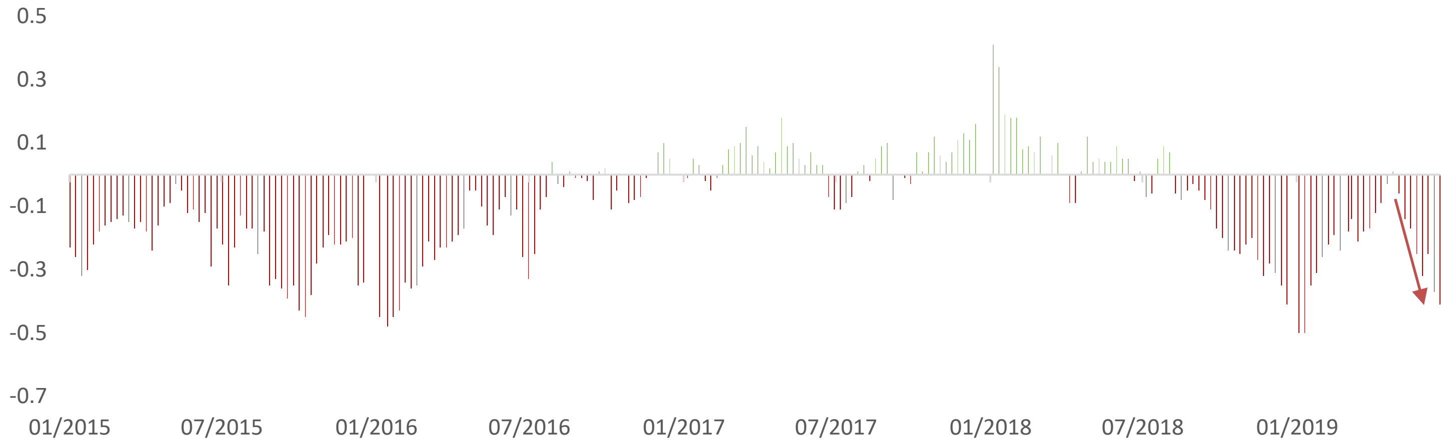
Key inputs for Global ERP

Risk premium	4.8%	Consensus growth '19	4.5%
Normal	4.0%	Consensus growth '20	10.4%
Min	1.5%	Medium-term growth	4.4%
Max	7.3%	Long-term growth	3.4%
10 year bond	2.0%	Payout ratio	40%
IRR	6.8%		

Global equity risk premium

Source: Bloomberg, SocGen, PIM

Citigroup Global Earnings Revision Index

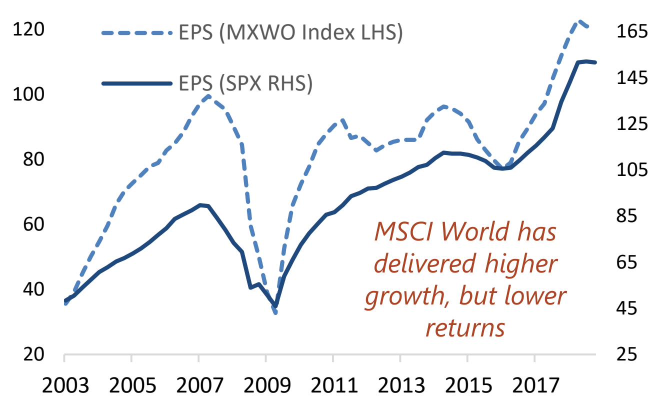


Measures the number of equity analyst revisions upgrades (positive) and downgrades (negative) globally. Source: Bloomberg, PIM

Global equity earnings expectations have moved lower since the end of April 2019. Global equities sold off in May as estimates were lowered, but rallied in June despite continuing earnings downgrades. The 'Powell Put' seeming to move risk assets higher.

We expect in a good economic environment countries delivering below average ROE may catch up, but the US will be rewarded in a weaker growth environment because of its stability in earnings.

MSCI eps vs. S&P 500 eps



Source: Bloomberg, PIM

We expect the US to lag in an economical positive scenario, but it may outperform should the world economy slow more than our base case. The US trades at premium multiples, but generally offers lower earnings beta than the rest of the world. The US has the highest ROE both in absolute terms (16.6%) and relative to its historical norm. Mean reversion may indicate potential US earnings risk. The flipside, however, is that the US has the lowest ROE standard deviation among the major markets. Its earnings cycle is the most stable of the major markets. In a good economic environment we anticipate countries delivering below average ROE may catch up, but the US will be rewarded in a weaker growth environment because of its stability in earnings.

Regional Return on Equity (ROE)

Country	Current ROE	Deviaiton from avergae	ROE Volatility
Global	13.1	1.2	1.8
Euro Area	10.0	-1.0	2.7
Switzerland	14.1	2.2	3.3
UK	12.5	1.4	3.2
US	16.6	2.4	2.3
EM	12.0	-0.1	2.8

Source: Bloomberg, PIM, MRB

Equities — US (Underweight)

S&P 500	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	18.85	54	19.59	18.63
BEst P/E Ratio	17.29	64	16.95	16.41
Long Term Price Earnings Ratio	26.28	78	22.23	21.31
Price to Book Ratio	3.35	82	2.87	2.77
Price/EBITDA	11.18	97	7.73	7.37
Price to Sales Ratio	2.14	94	1.48	1.50
Enterprise Value/EBITDA	13.18	93	10.56	10.68
Profit Margin	10.26	99	6.69	7.25
Operating Margin	13.29	87	11.59	12.07
Dividend Yield	1.94	46	2.09	1.97
10Y Yield	2.01	8	4.52	4.46

Source: Bloomberg. Jan 1995 to June 2019

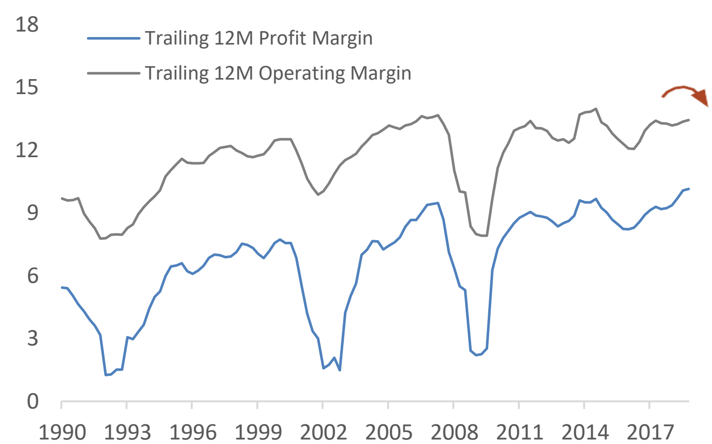
US equities trade at elevated multiples, with exception of price to trailing earnings, where the market trades in line with its historical average. US equities delivered a total return in line with the world in Q1. The region is unambiguously expensive on ebitda, sales and book value. We expect US companies to meet revenue forecasts, but worry profits may miss expectations as margins decline. Higher wage costs and possibly increased regulatory costs for large cap technology could be the negative surprises in the second half of 2019.

The large weight of dominant technology companies is a positive for US equities. A steeper yield curve should also improve financial sector fundamentals.

Should the global economy slow more than our base case we will upgrade US equities to neutral. Relative earnings may lag in an expansion but would lead in a slowdown.

The 2Q earnings season begins on July 15 and consensus expectations are for aggregate earnings to decline by 1%. Margin contraction outweighs positive sales growth. Premium valuation combined with falling EPS estimates is usually problematic, but 'bad news' has been 'good news' for US equities last quarter, as the 'Powell Put' makes equities more attractive. US equities may benefit more than other regions on new monetary policy because the Fed has a greater capacity to cut interest rates than other central banks.

US profit margin is record high… may mean revert



Source: Bloomberg. Jan 1990 to March 2019

Premium valuation combined with falling EPS estimates is usually problematic, but 'bad news' has been 'good news' for US equities last quarter, as the 'Powell Put' makes equities more attractive.

Equities UK (Neutral)

FTSE 100	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	17.44	50	25.06	17.43
BEst P/E Ratio	12.86	56	12.66	12.46
Long Term Price Earnings Ratio	16.76	60	16.28	14.78
Price to Book Ratio	1.73	18	1.95	1.88
Price/EBITDA	7.07	37	7.44	7.30
Price to Sales Ratio	1.21	53	1.18	1.19
Enterprise Value/EBITDA	8.66	41	9.11	8.81
Profit Margin	7.64	52	6.91	7.23
Operating Margin	11.42	68	10.49	9.98
Dividend Yield	4.82	93	3.82	3.77
10Y Yield	0.83	1	3.15	3.36

Source: Bloomberg. Jan 1995 to June 2019

UK equities are one of the few regions which is trading below its historic average on book, ebitda. UK equities offer the highest yield in developed world. Multiple expansion from a good Brexit scenario may push stocks higher, but near term risks are skewed to the downside.

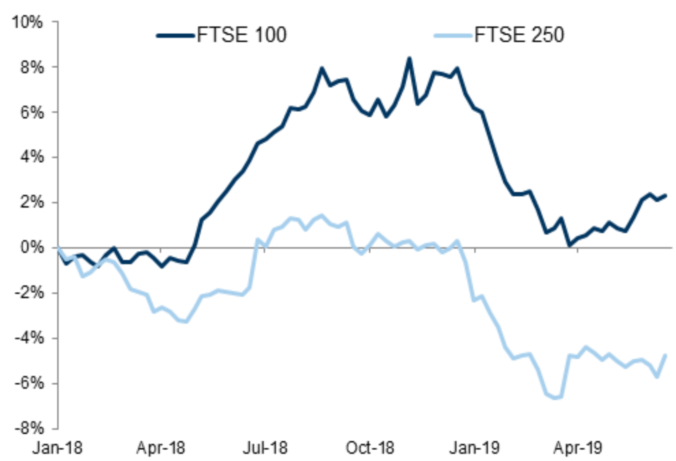
UK equities offer the highest yield in developed world. Multiple expansion in a good Brexit scenario may push stocks higher, but near term risks are skewed to the downside.

Brexit hangs over the market, especially a financial sector and small caps. UK banks will see higher costs and potential reduced asset quality in a messy Brexit. The threat of a hard-Brexit has increased in recent months with a euro-sceptic soon to become PM.

In the event of a general election, which we think is becoming a distinct possibility, the hard-Brexit bias of the Conservative party is set against the prospect of a Labour party victory. Both these outcomes would be negative for equities in a completely different ways.

Within the UK we prefer large cap oil, healthcare, and the multi-national banks as ways to invest in the listed UK market, rather than the more cyclically exposed and domestically orientated mid cap companies.

Cumulative change in earnings estimates for UK



Source: Goldman Sachs, PIM

Equities — Europe (Overweight)

Stoxx 600	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	17.62	46	22.52	18.85
BEst P/E Ratio	14.19	61	13.39	13.31
Long Term Price Earnings Ratio	19.45	64	17.56	17.44
Price to Book Ratio	1.76	39	1.86	1.84
Price/EBITDA	7.77	77	6.49	6.30
Price to Sales Ratio	1.26	84	1.07	1.10
Enterprise Value/EBITDA	9.81	72	9.11	9.16
Profit Margin	7.58	68	6.13	6.27
Operating Margin	10.96	77	9.74	9.29
Dividend Yield	3.77	83	3.38	3.38
10Y Yield	-0.25	0	2.45	2.99

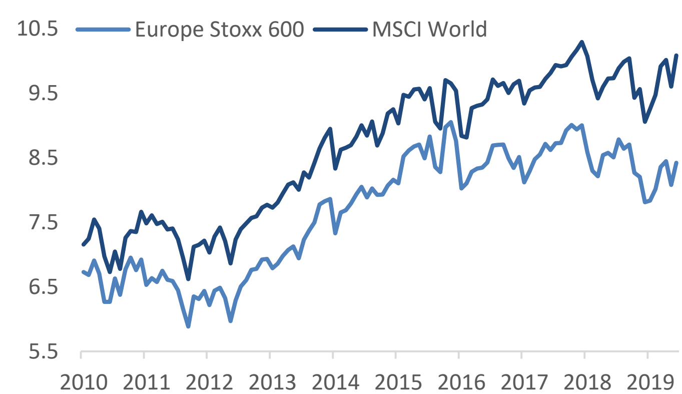
Source: Bloomberg. Jan 1995 to June 2019

European equities are cheap vs. other regions and cheap vs. their own history. The question remains, are they cheap enough given the lacklustre growth and political issues facing the region. A dividend yield nearing 4% should support equity prices while interest rates are set to move further below zero. European companies may begin to be their own catalyst. As the cost of debt has fallen (to almost zero in some instances), we expect companies to follow US styles share buy backs. More than 80% of European companies have dividend yields higher than their corporate bonds, so buy backs will actually be cash flow positive.

80% of European companies pay dividends greater than their corporate bond yields.

The potential for growth will be driven primarily by earnings expectations. Any positive outcomes that result in the EU muddling through with growth of 1.1-1.2% will be viewed as a positive surprise for markets. A relaxation of the US trade threat that has weighed on European cyclical stocks is our base case. This assumes no new issues on US trade, but this continues to be a risk that needs to be monitored. This is also an area where Europe may deliver a positive surprise in 2019. In a positive economic environment we expect Europe will be a major beneficiary of a rotation from more expensive US equities to equities which are pricing in a very pessimistic economic outlook.

Europe vs World EV/EBITDA (estimate 1 year)



Source: Bloomberg

Despite outperforming in Q2, European companies are now trading at the largest discount to the world on EBITDA this decade.

Equities | **Japan (Overweight)**

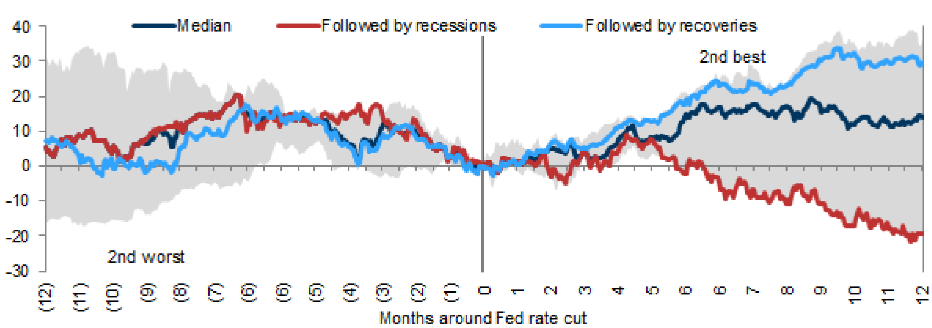
Topix	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	13.77	4	59.97	22.00
BEst P/E Ratio	12.54	4	20.41	15.78
Long Term Price Earnings Ratio	19.34	22	28.13	24.28
Price to Book Ratio	1.13	17	1.58	1.52
Price/EBITDA	5.88	40	7.05	6.19
Price to Sales Ratio	0.70	55	0.70	0.69
Enterprise Value/EBITDA	7.47	2	10.67	9.75
Profit Margin	5.09	93	2.21	2.21
Operating Margin	7.45	85	5.24	5.58
Dividend Yield	2.50	95	1.41	1.13
10Y Yield	-0.16	1	1.46	1.34

Source: Bloomberg. Jan 1995 to June 2019

Japanese equities have never been much cheaper than they are currently. A dividend yield of 2.5% is above its historic average and much higher than 10 year bond yields. This should support equity prices while interest rates stay near zero for the foreseeable future. Japanese exports and production have been weak in recent quarters, based on slowing global trade. Japanese companies would be big beneficiaries of improving global trade, and conversely be hampered by any escalation in trade tensions.

Japanese stocks are pricing in a recession, we think that is too pessimistic.

Japanese equities around Fed easing cycles



Source: Goldman Sachs

Japanese equities have been significant beneficiaries of Fed easing while the economy is not moving towards a recession.

Japanese equities have also been significant beneficiaries of pre-emptive Fed easing, when the Fed cuts rates without a recession. This is our base case, and it should bode well for the Japanese the equity market. The downside scenario is a trade war and a global recession. Japanese equities would be expected to underperform. Should Japan avoid recession and deliver any earnings growth we think the progress in labour market and governance reforms should lead to a re-rating of Japanese equities. The BOJ will continue to be net buyer. Japan should also benefit from foreign buying, as a crowded US long position is eventually unwound.

Equities — Emerging markets (Overweight)

Topix	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	13.39	49	14.82	13.45
BEst P/E Ratio	12.73	76	11.49	11.80
Long Term Price Earnings Ratio	16.05	52	16.61	15.90
Price to Book Ratio	1.54	49	1.56	1.54
Price/EBITDA	6.08	69	5.24	5.51
Price to Sales Ratio	1.21	60	1.15	1.13
Enterprise Value/EBITDA	8.44	81	7.00	7.26
Profit Margin	9.36	59	8.80	8.90
Operating Margin	12.70	44	12.90	13.00
Dividend Yield	2.82	82	2.43	2.43
10Y Yield	2.01	10	3.96	3.95

Source: Bloomberg. Jan 1995 to June 2019

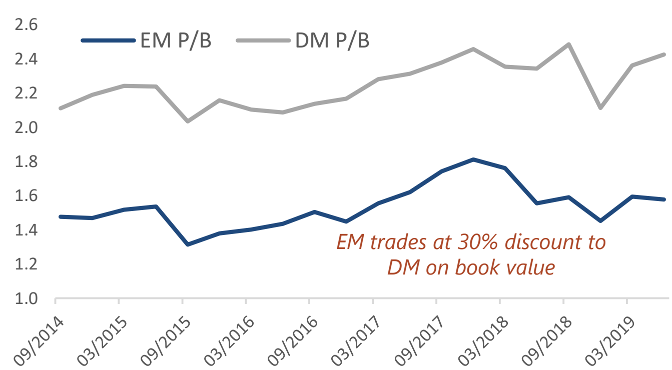
The balance between an easing Fed and risks of a weak and vulnerable global trade cycle are most pronounced in emerging market (EM) equities. A soft US dollar reduces the risks of slowing trade, and monetary stimulus provokes risk taking. This is the bull argument for EM equities. The direction of equities is geared toward China and semiconductors in Asia, and commodities in other EM markets.

EM equities lagged in Q2, as trade risks increased, but given our view on small improvements in trade and incrementally more dovish monetary policy we remain overweight EM equities.

While our long term outlook is positive for emerging markets, the climate will be choppy in the near term. As recessionary fears fade we expect EM to outperform based on longer term stronger demographic and purchasing power trends.

EM are the biggest beneficiary of improved financial conditions following Fed's U-turn.

EM vs World on P/B



Source: Bloomberg, PIM

Fixed Income

Government bonds don’t offer value but do provide insurance

We are neutral on the cyclical outlook for G7 government bonds, but bearish on the long term. One of our longstanding themes has been that the deleveraging drags in the global economy have progressively faded over the past decade, with the healing of household and bank balance sheets in the US and euro area. G7 government bond yields will remain anchored while the economic outlook is cloudy, but will remain vulnerable should a healthier macro backdrop occur. Over the long term a country’s bond yield is roughly equivalent to its nominal growth. Should bond yields converge with our expectations for nominal growth over the next 7 years, real returns for bond investors will be significantly negative.

Bonds (during pre-emptive fed cuts)

	1995	1996	1998	1999	2019 ytd
10 Year Treasury	23.7	-0.1	13	-8.4	7.4
2 Year Treasury	11.1	-4.6	7.2	2.02	2.6
Investment Grade	21.5	3.4	8.7	-1.9	9.3
High Yield Corporate	20.4	11.3	3.0	2.5	10.0

Source: Bloomberg. MRB, PIM

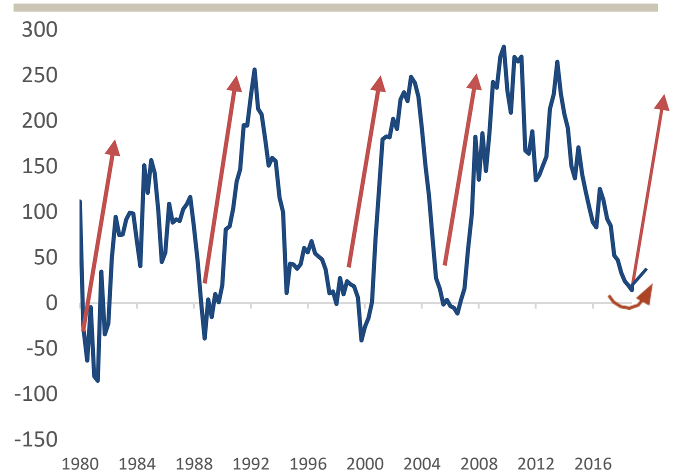
During pre-emptive cuts 10 year treasuries rally in year 1, and underperform in year 2.

This quarter we have upgraded US bonds to neutral from underweight. We characterise the coming Fed cut as pre-emptive, meaning the economy is not expected to fall into a recession. The Fed’s last two mid/late-cycle rate cuts (1995 and 1998) provide some insights for the current environment. In 1995, the Fed cut rates three times ending in January 1996. Reducing rates from 6% to 5.25%. Slowing growth spurred the cuts after the Fed had hiked rates aggressively by 300 bps the prior year. The Fed cut rates three times in 1998 to 4.75% during the Asian financial crisis. In both cases 10 year bonds were the best performer early, but lagged the following year. Credit outperformed in the year after the cut. Should the stimulus return the global economy to its growth path, we would expect a similar pattern to occur.

Within fixed income we believe the curve flattening that has occurred in the US since 2014 has now run its course. Much of the US yield curve has inverted, and at the end of the quarter, 3 month paper yielded more than 10 year yields. This has been a good indicator of a coming recession, but has been great at is predicting is a future steepening. Should a recessionary environment emerge, the Fed will almost certainly cut rates, and the curve will steepen as has happened in all previous recessions. Should growth pick up, the Fed has indicated it may let the economy run hot, which should push 10 year yields higher, but keep the front end anchored.

Bloomberg Barclays Global-Aggregate YTM

US Calendar Spreads

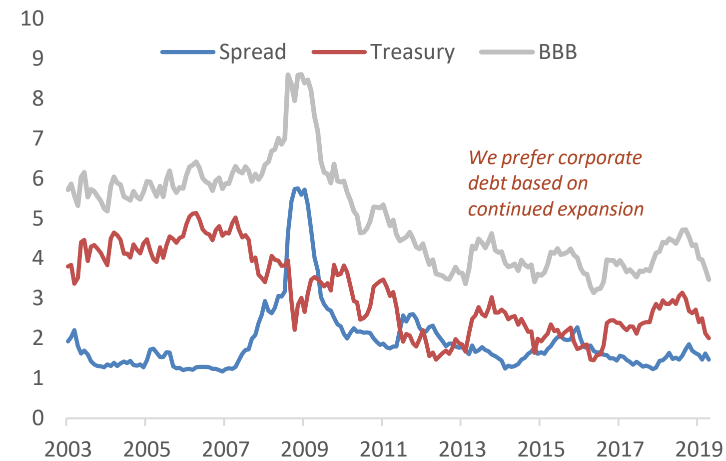


Source: PIM, Bloomberg

The US economy is set to slow in the coming year and will provide support to the bond market in the near run. Longer term we expect 10 year yields to converge with the US expected nominal economic growth potential.

Corporate and emerging market bonds looks attractive to us over a market cycle, given their carry and re-investment benefits. Should the economy avoid recession as we expect, high yield and leveraged loans will continue to see low levels of defaults.

10 year treasury vs BBB



Source: Bloomberg. PIM

Foreign Exchange — Favour Yen & Euro

We utilise a six factor model to assess foreign exchange movements: relative growth, interest rate differentials, capital flows, trade flows, valuation and technicals. Trade flows, relative growth and policy differentials lead to negative scores for AUS, CAD and GBP vs. the USD. Valuation and technicals favour the euro and JPY.

The bounce in the US dollar from its February 2018 lows has been driven by better economic growth and interest rate differentials. The recent weakness has been driven by a closing of those differentials. Looking ahead to next year, fundamental support may gradually erode for the US dollar. The US dollar is expensive, and political risks may dampen demand for both the US dollar and eventually treasuries.

We expect US economic growth to continue to lead the rest of the developed world, but expect it to slow towards its long term potential of about 2% per annum. We prefer to be long currencies which offer better value, and the potential to surprise on pessimistic economic outlooks. In 2018 speculative positioning in the euro was very long. As we enter Q319, investors are short the euro. Given its significant current account surplus, this may quickly reverse on any positive surprises in the euro economy. The longer term trend for euro should be supported by appealing valuations.

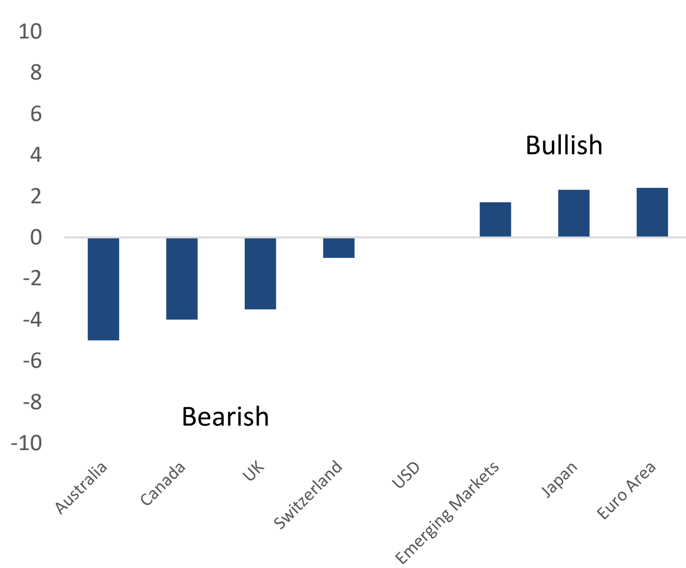
Structural improvements in the domestic Japanese economy and its attractive valuation also should lead Japanese Yen to drift higher. We expect it will deliver a major appreciation in the next global recession.

Major currency vs USD on Purchasing Power Parity

	PPP Consumer	PPP Producer	BIG MAC
CHF	8.85	-7.62	20.67
GBP	-15.41	-27.40	-23.00
EUR	-2.72	-8.59	-14.11
JPY	-28.96	-28.53	-33.86

Source: Bloomberg. PIM

Factor Analysis



Source: Bloomberg. PIM

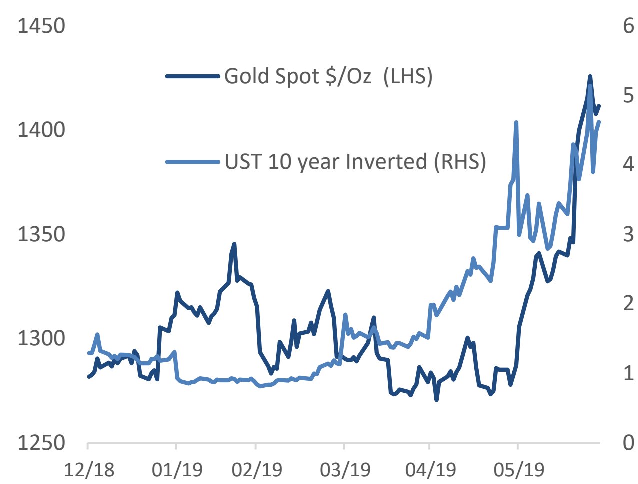
Commodities Gold, Oil

Commodities indices were generally flat in Q2. Oil and industrial metals sold off on demand concerns driven by an escalation in the trade war and policy uncertainty. Gold was the positive exception, as it beat both equities and bonds in Q2. Gold is a commodity which will benefit from the lower interest rate environment we are heading for. It should also provide a hedge against deteriorating trade relations, and broader geo-political risk. As trillions of dollars worth of government bonds are now providing negative yields, the attraction of a zero yielding gold is looking more appealing.

Should our base case of moderate economic growth and a lasting trade truce occur, the safe haven benefits of gold may not be as attractive. However we do expect gold will see increased demand as a reserve asset in any economic scenario. Central bank demand is gaining momentum and we expect 2019 purchases to be well over 700 tonnes vs 650 tonnes last year. China has added to gold holdings every month this year.

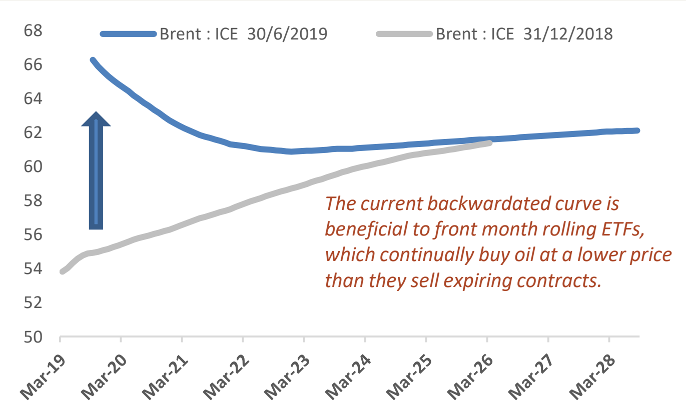
Going forward we are now more attracted to oil. Tensions between the US and Iran are unlikely to fade in the coming months. Global demand has slowed, but OPEC has met its pledged production cuts. We expect it to extend cuts with its allies throughout the remainder of 2019. Inventory levels in China have returned to 2016 highs, but in terms of days usage it is much lower. Implied volatility on Oil has risen from 22% in April to 32% at quarter end. Selling down and in put options on a Brent oil etf is an effective way to monetise the volatility and backwardation of the futures curve.

Gold and inverted 10 year yield



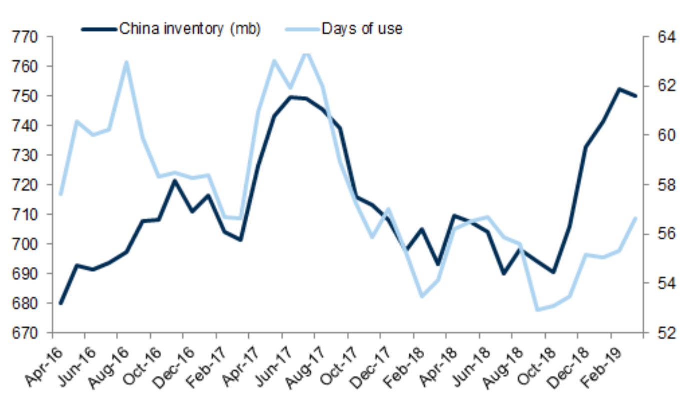
Source: Bloomberg. PIM

Brent Oil curve



Source: PIM Bloomberg

China oil inventory (LHS) and days of use (RHS)



Source: Goldman Sachs

Summary

Global economy supported by liquidity likely to beat subdued expectations

- Trade truce keeps sub-optimal policies in place, but supports risk assets
- Euro and Yen appreciate vs USD while GBP depreciates
- Steepeners, equity dispersion and gold offer attractive hedges to our pro-cyclical view
- Geopolitics and OPEC support crude prices
- Fed will cut in July, but not as much as market is pricing this year

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