Quarterly Investment Outlook

1st Quarter 2019 December 2018

ameliora
WEALTH-MANAGEMENT

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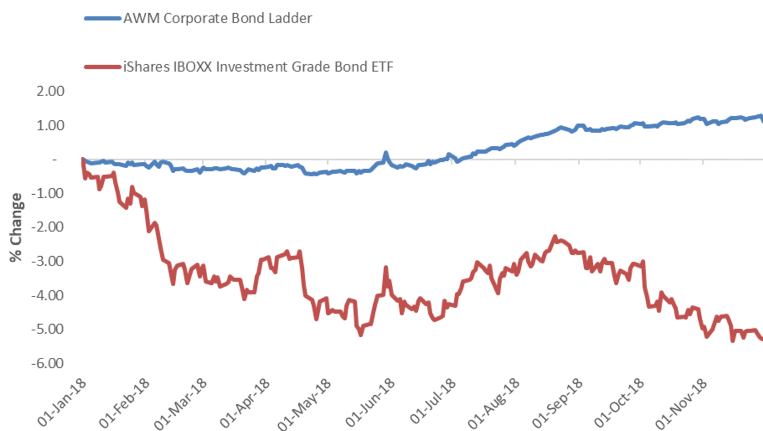
Advisor's Commentary

During the first quarter of this year, we discussed the appeal of venturing into USD corporate bonds as government yields and corporate spreads ticked higher (March Investment Outlook). However, rather than just accumulating investment grade bonds with the highest yield, we pointed out how stacking short term bonds in successive maturity buckets, called bond laddering, could prove rewarding. The properties of the strategy aim to lower duration but to also enhance the yield as proceeds are more frequently reinvested at higher rates. Although the overall yield in such a strategy on the surface looks low compared to the aggregate investment grade universe, the key principle is that of duration management. At the time of our March discussion the prevailing distributable yield on the investment grade universe was four percent compared to a three percent yield in a corporate bond ladder. Yet the duration was eight and three years, respectively!

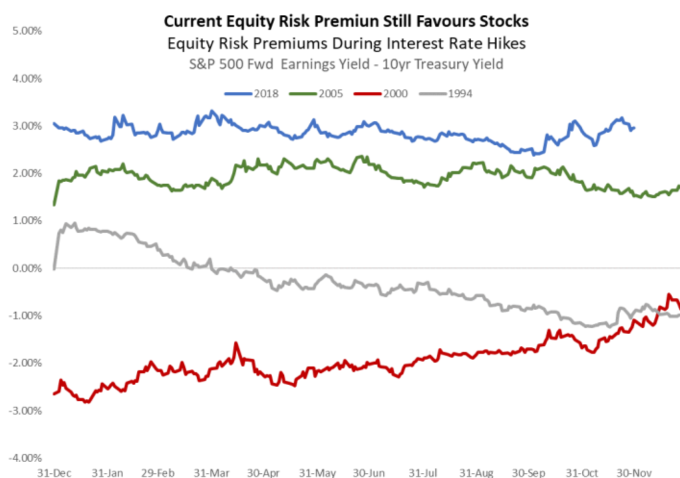


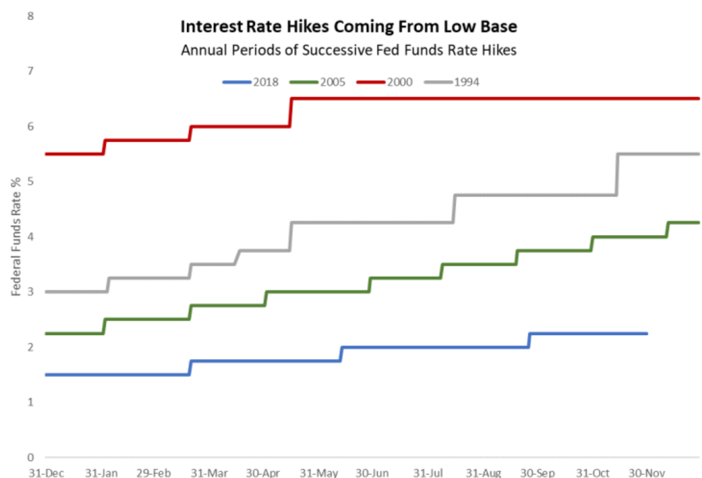
Sources: *Bloomberg LLP, AWM*

As we approach the end of 2018 it is evident that this year has been a testing time for bonds. Successive rate hikes by the Federal Reserve, corporate spread widening, and an end to global quantitative easing have all contributed to putting pressure on global bond markets. Despite all this ruckus, the aforementioned laddered bond strategy has held up quite nicely compared to the broader corporate bond universe. A significant part of the outperformance of the ladder strategy is attributed to the much lower bond duration than the corporate index. Even the credit risk is considered lower since the bonds in the ladder are of short maturities and thus less price volatility than longer dated peers. Additionally, such a strategy is more equally weighted as opposed to mostly capital weighted indexes.

We continue to think this approach has merit, especially now that for the same duration, of about three years, one can get almost a percentage point higher yield, close to four percent, than what was available nine months ago.

As monetary policy tightens the income properties of bonds brightens. Bond yields have trended upwards in tandem with the Federal Reserve's interest rate hikes throughout 2018. Coupons on both government debt and corporate credit have reached levels where even risk prone investors have taken interest, especially considering the frequent bouts of equity volatility this year. Suddenly, locking in three to four percent annual cash flows doesn't look that bad at all having seen the global stock market shed about five percent in the last 12 months. However, measured by the equity risk premium bond yields are far from superior to the expected earnings yield of equities. Corporate earnings are still too good to pass up. During periods of successive interest rate hikes, as observed this year and compared to similar periods in the past, one can spot that the current risk premium is noticeably higher than at previous comparable times. Some of this can be explained by the current lower level of nominal interest rates, but earnings growth has also been strong. And after the sell-off in the fourth quarter the expected earnings yield on US companies has risen to six percent compared to five percent at the start of the year. As such, we still think that the asset allocation mix calls for both bonds and equities, albeit at a new tilt towards fixed income securities. Our asset allocation strategies are detailed on the next page.





Sources: *Bloomberg LLP, AWM*

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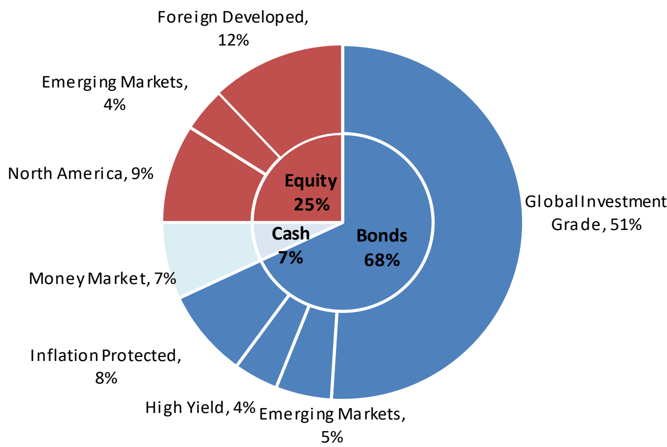
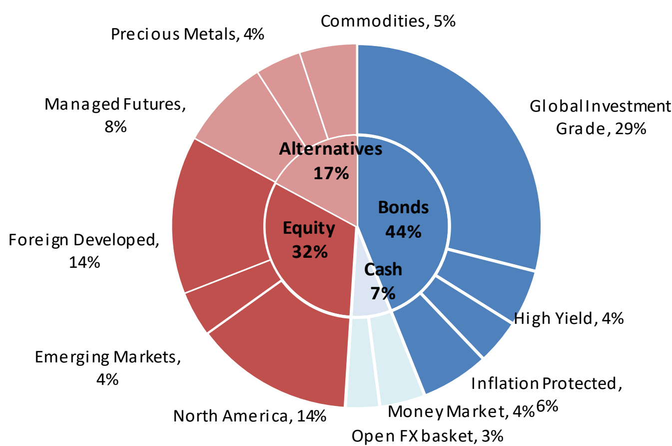
Asset Allocations

Income



Tactical Positioning Relative to Strategic Weights %		
	Balanced	Asset Class
		Cash
Bonds	-5	Domestic
	5	Emerging Markets
		High Yield
	-1	Foreign
Equity	-13	Domestic
	4	Emerging Markets
	11	Foreign Developed
Altern.	-5	Managed Futures
		Precious Metals
		Real Estate
	4	Commodities

Balanced



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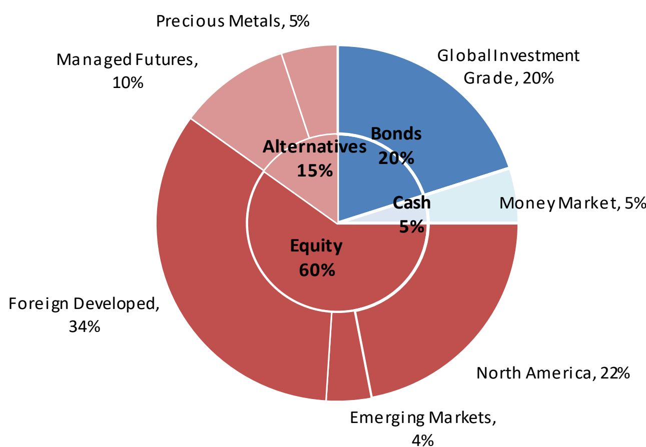
Growth



Tactical Positioning Relative to Strategic Weights %		
	Equities	Asset Class
	8	Cash
Bonds		Domestic
		Emerging Markets
		High Yield
		Foreign
Equity	-18	Domestic
	6	Emerging Markets
		Foreign Developed
Altern.	4	Managed Futures
		Precious Metals
		Real Estate
		Commodities

***Source**: Ameliora Wealth Management as of 1st December, 2018*

***Note**: Tactical asset allocations are subject to change without notice and represents investment strategies in USD. Tactical positions (over-/underweight) are deviations from strategic benchmark weights*

Disclosure: The information contained herein has been obtained from sources believed to be reliable but the accuracy of the information cannot be guaranteed. Past performance is no indication of future results.

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