Quarterly Investment Outlook

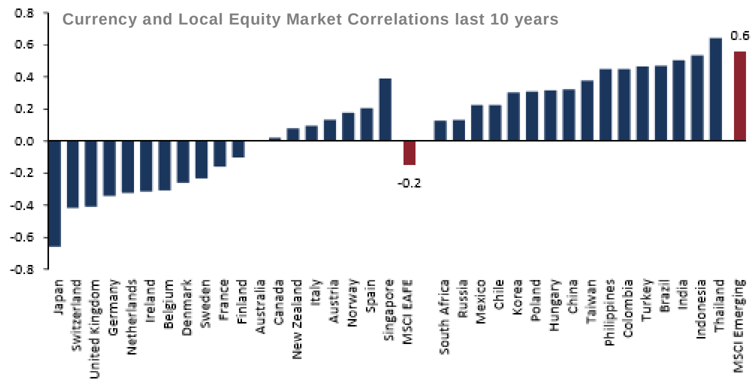
4th Quarter 2018 September 2018

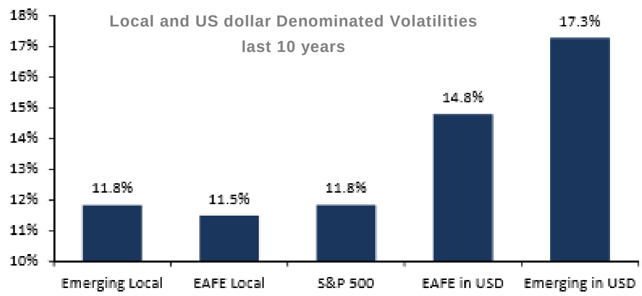
ameliora
WEALTH-MANAGEMENT

Advisor's Commentary

As the summer lull dissipates two central investment themes are re-surfacing throughout the global financial circuit. One theme, touted by a leading US money manager as the preferred asset class to be in, is the recent negative developments in emerging markets. The other, often cited as the surest way of predicting a recession, is the discussion around a flattening US yield curve. Both themes have been presented by the community as possible harbingers of global financial doom, but we think otherwise.

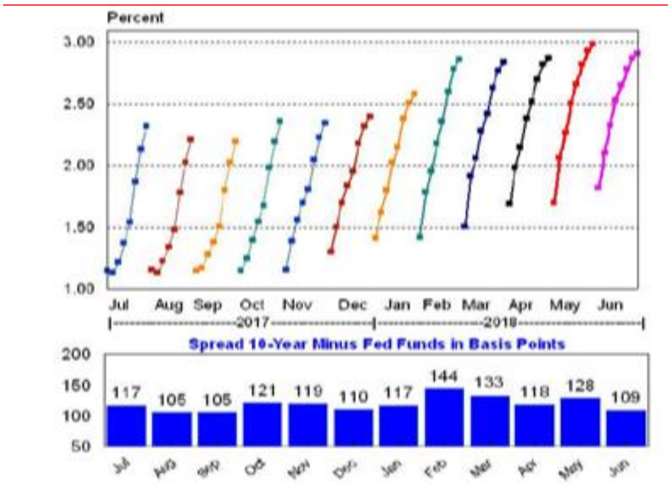
In the case of the former, a once beloved asset class due to its relative low valuation and high growth properties has witnessed a drastic turn of events. Fuelled by a stronger US dollar and American enforced trade sanctions, emerging market equities are now in a bear market. Such a violent price movement understandably gives cause for concern but is also given added unwarranted support by both the trading public and financial media as these pundits start inducing what ramifications this rout will have on global markets. As to why this asset class is perceived to be more risky, the mentioned money manager diligently points out that emerging countries' currencies have a positive beta to global stock markets, i.e. developing nations' stock markets tend to fall when their currency weakens. Most developed nations' stock markets, on the other hand, normally benefit when their currency weakens usually ascribed to the positive impacts of increasing exports. However, a significant source of volatility in emerging markets is the currency translation effect. As major EM indices are valued in US dollars the inherent "riskiness" is amplified by the strength of the dollar. Measured domestically, which is a more realistic barometer of the actual business climate and the local stock market developments, emerging markets are no more volatile than developed nations.

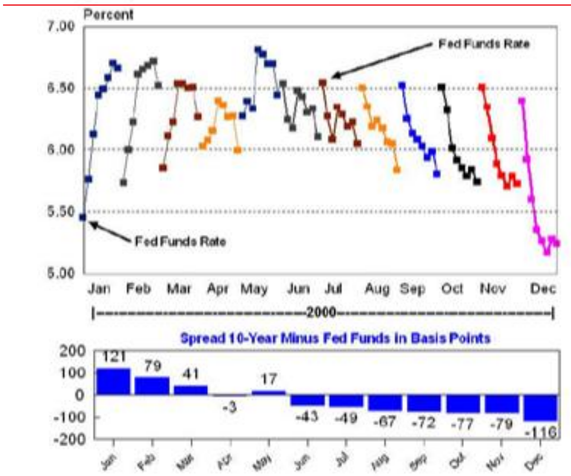




Sources: GMO

The shape of the US yield curve is often cited as a valuable indicator for predicting the next recession. Since an inverted curve, where short term interest rates are higher than longer term ones, has preexisted before numerous US recessions, the indicator has been given merit. However, the timing of the recessions has varied significantly and in some cases no recession has ensued despite its inverted state. Yet, the current rhetoric is that successive Federal Reserve rate hikes have flattened the curve and future hikes heighten the possibility of a Fed induced recession. This is a misnomer in two aspects. Firstly, the US yield curve is more "compressed" than flat as highlighted in the first chart below. The various colored lines represent the yield curve encompassing the main maturities over a recent 12 month period. The lowest point on each of the colored lines represents the Fed Funds Rate and the highest point the 10-Year Treasury Note. The "shape" of the curve is the same. The second chart depicts what happened during the 2000's when the Fed stopped hiking rates by summer leaving the curve inverted. Notice the significant different shapes during the period. As the rate hikes ended long term rates continued dropping signaling possible economic weakness. The official recession that ensued happened one year later in 2001. Currently, long term rates have INCREASED together with the Fed Funds Rate which fits well with recent US economic data. This brings us to the second misconstrued point, that the Fed's activity invokes recessions. The Fed controls the shortest of interest rates and operates within the prevailing economic climate. Its actions are responsive rather than predictive, meaning that the time to worry is when it stops hiking rates and long term rates starts declining.

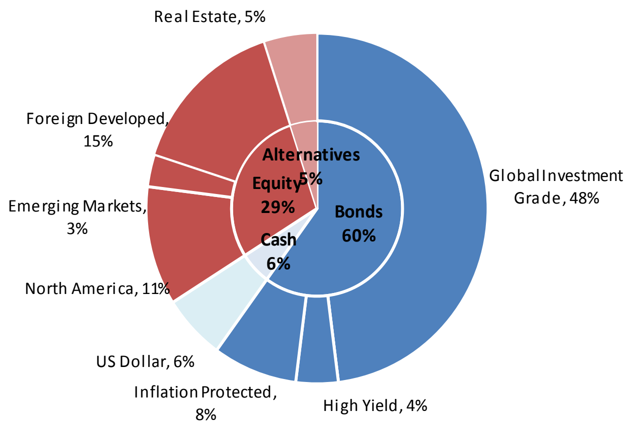




Sources: Dashofinsight.com, courtesy of RDLB, Inc.

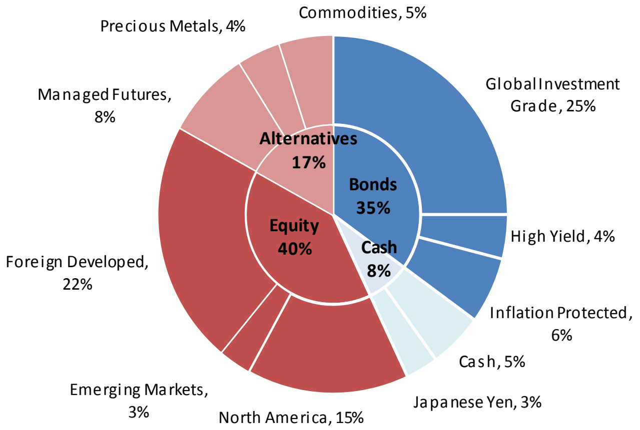
Asset Allocations

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



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
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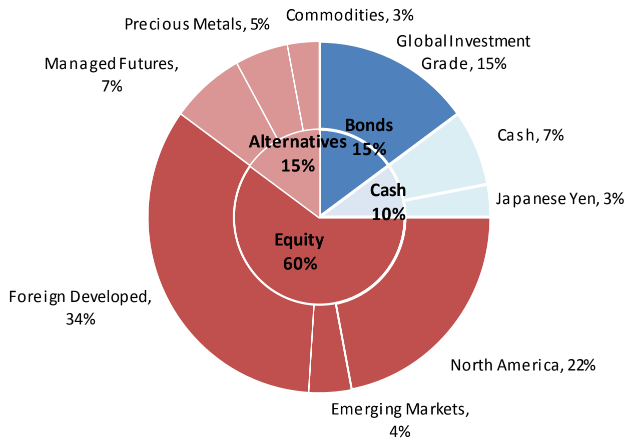
Growth



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 September, 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*

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