CHAHINE CAPITAL
Performance Engineering

28/01/2020

STRATEGY OVERVIEW

Is the party over?

Summary

Following all that champagne at the end of a remarkable 2019, equity markets carried on partying into January. The immediate cause was the so-called Phase 1 US-China trade deal, but volatility was so low that it looked as though investors would be untroubled by anything coming their way. The new coronavirus outbreak is a stark reminder of the unpredictable and has raised fears of a slowdown in Chinese activity. US stock market volatility has climbed from 12% to 18% at the time of writing, and after an historic 31.6% progression last year plus a peak of another 3% so far in 2020, the MSCI US has fallen back to its 2019 close.

The Phase 1 agreement certainly favours the USA, but will it be respected? It is supposed to enforce intellectual property rights, end forced technology transfer, remove administrative barriers to farm exports, open financial markets, rule out currency market manipulation and will require China to import $200 billion-worth of goods over two years, of which $32 billion in farm products. The problem is that there is no neutral dispute resolution mechanism and either side can walk away from the agreement at its own risk. This is why Donald Trump has made only the smallest gesture by cancelling recent tariff hikes.

While the legal part of Brexit is finally over this week, it marks only the start of more – and probably more difficult – negotiations. The British would like the free flow of goods to continue, but without tying themselves to the EU rulebook and at the same time opening up new trade agreements with mainly English-speaking countries elsewhere. Fishing rights are a serious bone of contention and the end-year deadline for a trade agreement is far too tight. In the meantime, the UK's attractiveness as an investment platform with access to the Continent is bound to wane. European financial institutions are already migrating back to base and some industrial firms are doing the same. The big international risks this year will be Iran and the Middle East, with a serious risk of interruptions to oil supplies. The North Korean missile threat has not gone away, either.

America is providing a steady trickle of upbeat macroeconomic news to counteract a generally sluggish global picture. Its construction sector has gone from strength to strength on the back of low interest rates, consumer confidence is at its highs, employment remains buoyant and the services ISM index has rebounded. But the composite leading indicators index is down, indicating a slowdown in the future, and that echoes a drop in 2020 GDP growth forecasts from 2% to 1.8%. US inflation is showing no sign of acceleration and the Fed is on hold. It may even lower rates as a result of the coronavirus: the markets think so, as the curve has inverted out to 3 years and the 30 year is down to 2.12%. In contrast, the ECB has no scope left to lower rates and it may yet resort to helicopter money in 2020. Food prices have been rising faster than overall inflation over the past 15 years in China and India, and apart from kindling fears of a world crisis, renewed pressure now could cause inflation rates to spike in both countries. The implied consensus growth rate for world GDP this year is down to 2.62%, with many revisions stemming from Asia. French GDP is expected to increase 1.5% this year, above the European average.

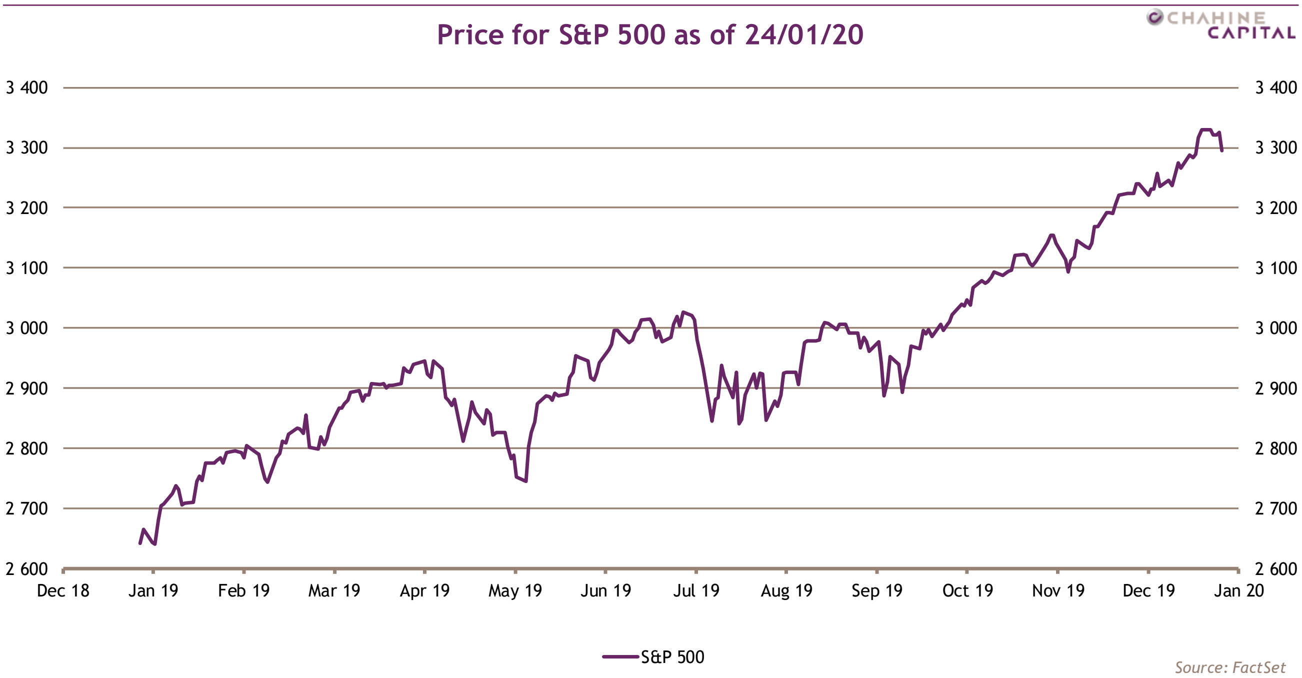
S&P 500 profits will have been unchanged in 2019 and we expect an 8% gain this year. That estimate could fade if the coronavirus ends up hitting international activity. Our valuation model has raised our year-end objective for the S&P 500 from 2,897 to 3,051 points, and to 3,200 points using current long rates. The index multiple of 18.7x 2020 is still high. The theoretical objective for the MSCI EMU index 142 points, compared with last week's close of 133 points, and a very generous 3.5% dividend yield can be added to that. We are maintaining our equities underweight relative to our benchmark (35% vs. 40%), and have no intention of being swept up in the prevailing panic as this is a long-term allocation. We have consistently argued in favour of keeping cash in dollars rather than at negative interest rates in euros; this strategy has proved its worth for a very long time, notwithstanding dollar appreciation and Fed easing.

Jacques Chahine

Time to pack up?

Following all that champagne at the end of a remarkable 2019, equity markets carried on partying into January. The immediate cause was the so-called Phase 1 US-China trade deal, but volatility was so low that it looked as though investors would be untroubled by anything coming their way. The new coronavirus outbreak is a stark reminder of the unpredictable and has raised fears of a slowdown in Chinese activity to mark the Year of the Rat. US stock market volatility jumped from 12% to 15% immediately and to 18% at the time of writing, while the quarantining of several cities and the cancellation of Chinese New Year trips by millions of people immediately cut oil prices by $10 per barrel. The world's media, starved of alternative scandals or crises, wound up the story to the point where it worsened fear rather than calmed them. We have yet to determine whether the illness will be dealt with swiftly or spread to pandemic proportions.

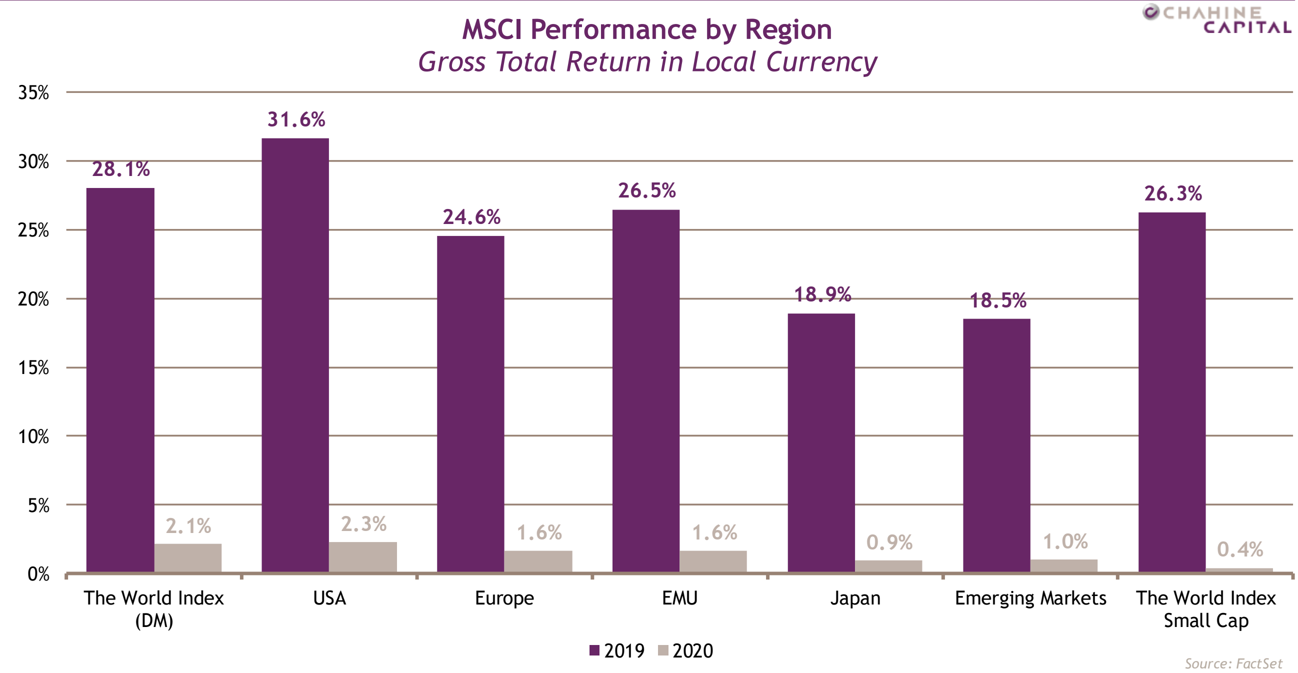
Wall Street's gravity-defying rise



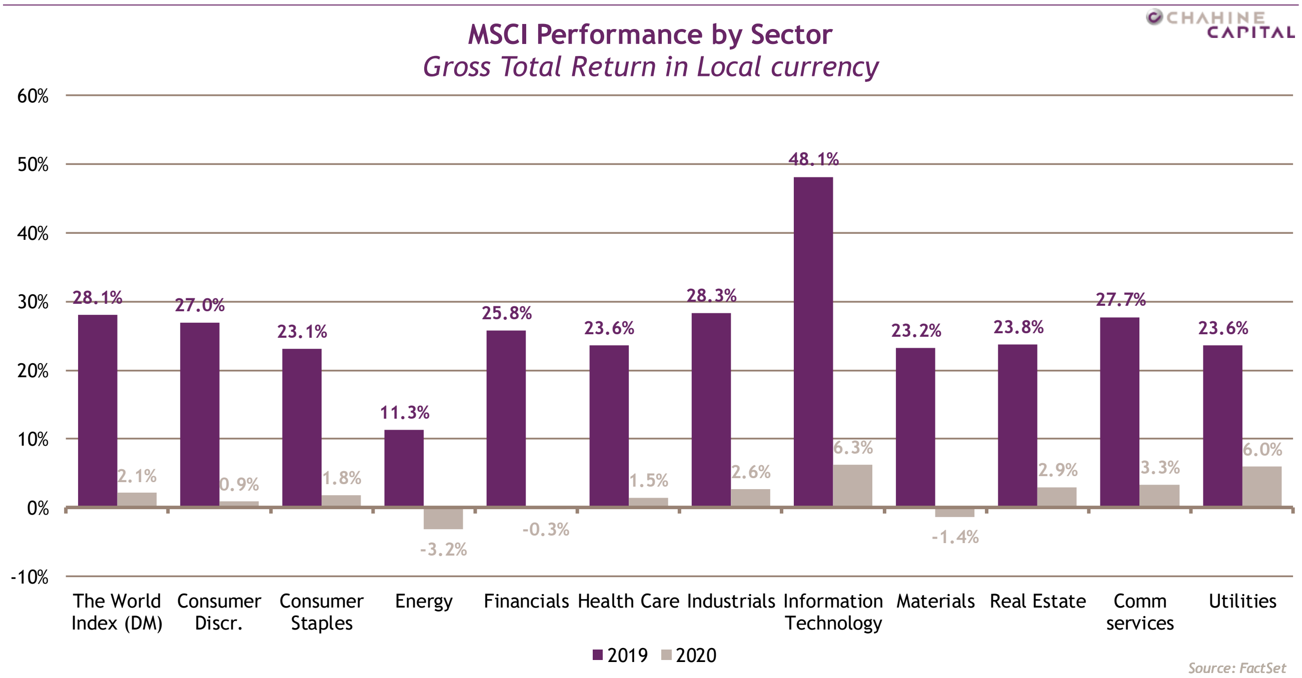
Following a total return of 31.6% last year (i.e. including reinvested gross dividends), the MSCI US index is up another 2.3% this year even after a 0.9% drop last Friday. For its part, the MSCI World index is up 2.1% in local currency after 28.1% in 2019, with all regions posting gains.

IT is still roaring along. It jumped 48% in 2019 and has so far added another 6.3%, more than any other sector. In contrast, energy continues to struggle and together with basic materials has lost value this year. It now represents just 3.9% of the S&P 500. The important healthcare sector is underperforming the index because of a serious threat to exorbitant drug pricing in the USA. Both Democrats and Republicans are determined to curb healthcare costs, but so far the industry's lobbyists have proved implacable foes. In 2019 – a good year – financials were the only firms to report profits growth in the 8% area. 2020 is expected to deliver a more modest 3.5%.

A good start to 2020



IT setting new records, energy struggling



A very good deal with China. But will it be respected?

The markets welcomed the news of an agreement between the USA and China on trade, partly because it reduced uncertainty and partly because they had taken it as given at the end of last year.

The agreement is not easy to decipher, however. We have tried to summarise it below while remaining faithful to the spirit in which it was drafted. The main elements are as follows:

1) ***Intellectual property***. The agreement insists in no uncertain terms on the protection of intellectual property, affirming that China has reached such a level of maturity that it will need such protection itself to add higher value to its output. When patent owners have solid evidence, the burden of proof on disputes over patents now lies with the accused party. China has to adopt urgent measures to end the fraudulent use of intellectual property, and complainers no longer have to put a cost on prejudice suffered in order to initiate proceedings. Confidential data and business secrets shared with the authorities cannot be divulged. Medicines are largely covered by patents of at least 14 years and a fast-track approval system. The internet retail giants Alibaba and Amazon are to be legally obliged to tackle piracy and counterfeiting over their networks and can be pursued in the courts if they fail in that duty. Place of origin denominations (Parma ham, for example) must be protected. It will become illegal to make or export pirated or counterfeit goods, including medicines and other healthcare products. Any such goods that are seized will have to be destroyed. Legal proceedings are to be swift, with a reduction in the amount of paperwork required, and penalties must be at the maximum level provided for in law.

2) ***No more forced technology transfer***. Companies will be free to establish themselves in both countries without particular conditions. Technology transfers are to be agreed on market terms. The government cannot support a company in order to acquire its technology for its own purposes. Neither country will require administrative authorisation or a licence from a company in return for technology transfer, and the authorisation process has to be transparent. Companies will not be forced to reveal business secrets in return for a licence, and any information received has to remain confidential.

3) ***Farm products***. These provisions account for almost three quarters of the agreement. They detail all the products that can be traded and the standards the apply to each. China will import such goods as dairy products, baby food, poultry, beef, pork and fish, while America will be open for Bonsai trees, pears and jujubes, for example…

4) ***Financial liberalisation***. An institution’s solvency will no longer be assessed solely on the basis of its assets in China but with regard to its parent company. The USA will accelerate its approval process for Citic. Credit agencies will be allowed into China, as will Visa, MasterCard and Amex. Investment firms will have more operational freedom, including the vultures that feed off non-performing loans. Insurers will also be able to set up in China.

5) ***A reciprocal commitment to refrain from manipulating the exchange rate*** for competitive advantage.

6) ***Imports***. China will import $200 billion more goods and services in 2020 and 2021 than it did in 2017. That is to include increases in farm products worth $12.5 billion in 2020 and $19.7 billion in 2021. Manufactured goods are to account for $77 billion and energy for $52 billion. These purchases are to be made at market prices. China will have a get-out if it encounters difficulties in sourcing these goods.

On paper, this agreement goes well beyond expectations, especially in terms of intellectual property and forced technology transfer. Its most serious drawback is the lack of any mechanism to ensure that it is respected, however. Its dispute resolution provisions lack teeth, amounting to committees upon committees all the way up to vice-president level and, if there is no resolution at that level, the process can only end with withdrawal from all or part of the agreement. We are not surprised that Mr Trump is maintaining a 25% tariff on some $250 billion-worth of imports, restricting himself to reducing tariffs on $120-billion-worth of consumer goods from 15% to 7.5%. Although we found the agreement more than honourable, plenty of commentators have criticised it on the grounds that the Chinese will simply not respect it. Too good to be true, in other words. It should be compared with the modest deal with the EU on protected place of origin labels that covers 100 products such as Parma ham and champagne. That took eight years and 22 rounds of talks and was signed last year to take effect only at the end of this year.

The areas to be covered in Phase 2 are more complex, notably subsidies to companies that undercut their rivals. It is hard to see how that could work in a planned economy where growth is decreed by the central committee of the ruling party. The other difficult issue will be e-commerce, for which China obliges companies to store their data locally (we can see why!). Google has no presence in China, for example, and competition is badly distorted.

Getting Brexit done

The other piece of good news is that Brexit will finally become a legal reality at the end of this month. The catch is that it will mean the start of what are likely to be tortuous negotiations over a trade deal between the two parties. The problem areas are fishing, financial services and divergence from the EU rulebook.

Right now, EU countries – and notably France – have free access to UK waters to catch their fishing quotas. Scottish waters are particularly productive from this point of view. Brexit promised to return UK waters to UK control, and the fishing industry’s political importance far outweighs its limited economic weight.

At the same time, the fact that Boris Johnson wants to depart from EU regulations to strike trade deals with other countries, particularly Britain’s ex-colonies, will collide with ambitions to keep frictionless trade in goods with the EU. Given that a free trade agreement with Canada took years, the tight deadline of end-2020 for a trade deal could reduce the scope of any agreement to a strict minimum. Chancellor of the Exchequer Sajid Javid has already ruled out alignment with the EU rulebook and membership of a customs union, and says that the UK will not take orders from Brussels… Mr Johnson would like a Canada-type deal with added bits covering such issues as services and digital data. The EU wants the UK to stick with its social and environmental laws as well as its rules on tax competition and State aid. Even if agreement is reached on zero tariffs, non-tariff barriers are inevitable when regulations diverge.

In the meantime, the UK’s attractivenesss as an investment platform with access to the Continent is bound to wane. European financial institutions are already migrating back to base and some industrial firms are doing the same. AstraZeneca in France is a good example. The debate over Scottish independence may well be revived, too. But then the British have always found a way to rebound and London remains the global financial centre *par excellence*.

International risks in 2020

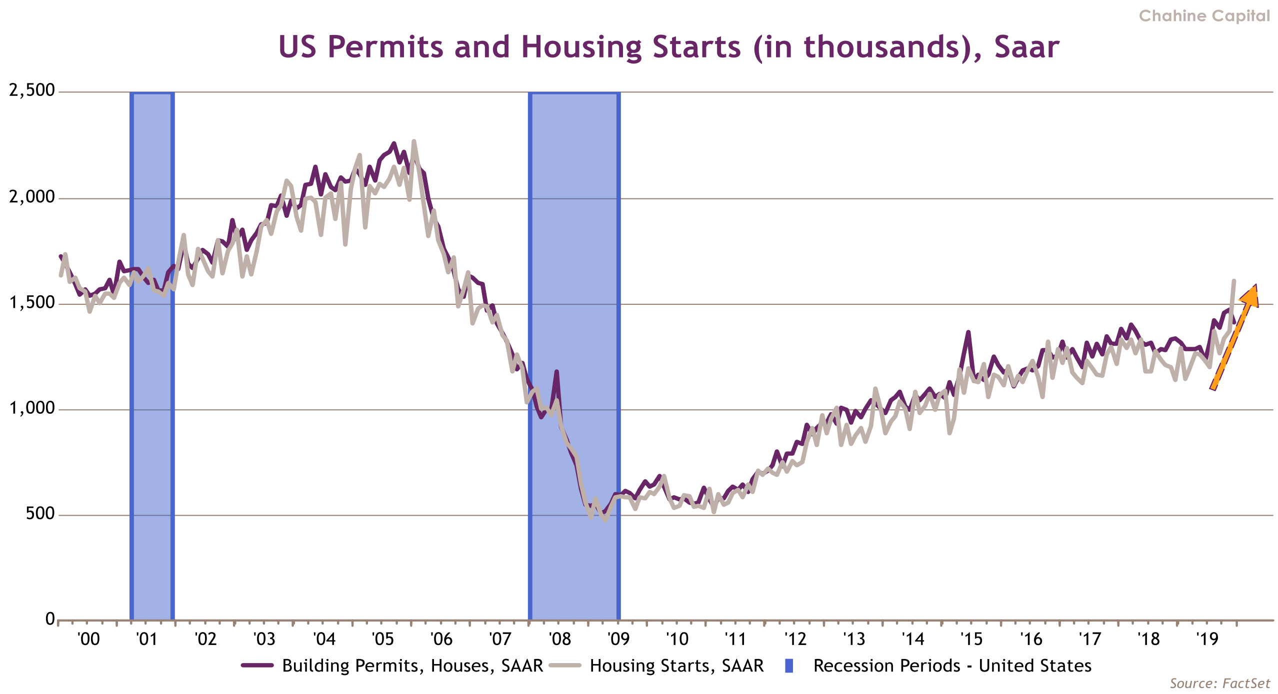
The other main risks in 2020 concern Iran, Iraq and the Middle East in general, and what that might mean for oil supplies. Although Iran does not have the military capability to threaten the USA or Israel, has plenty of scope to interfere with oil supplies. It can easily block the Strait of Hormuz, and as we have seen its missiles can hit Gulf oilfields. The resumption of its uranium enrichment programme is bound to trigger a reaction, and given America’s energy independence it would be Europeans that take the brunt of any implications for oil. The US peace plan for Israel and Palestine offers at least a ray of hope, not least because many Arab countries are sick to death of this interminable conflict and the Gulf States may see Israel as a future ally against Iran.

In the meantime, North Korea continues to remind Mr Trump of its existence by testing increasingly sophisticated missiles, so far without any response.

A sluggish backdrop, but some good macroeconomic news too

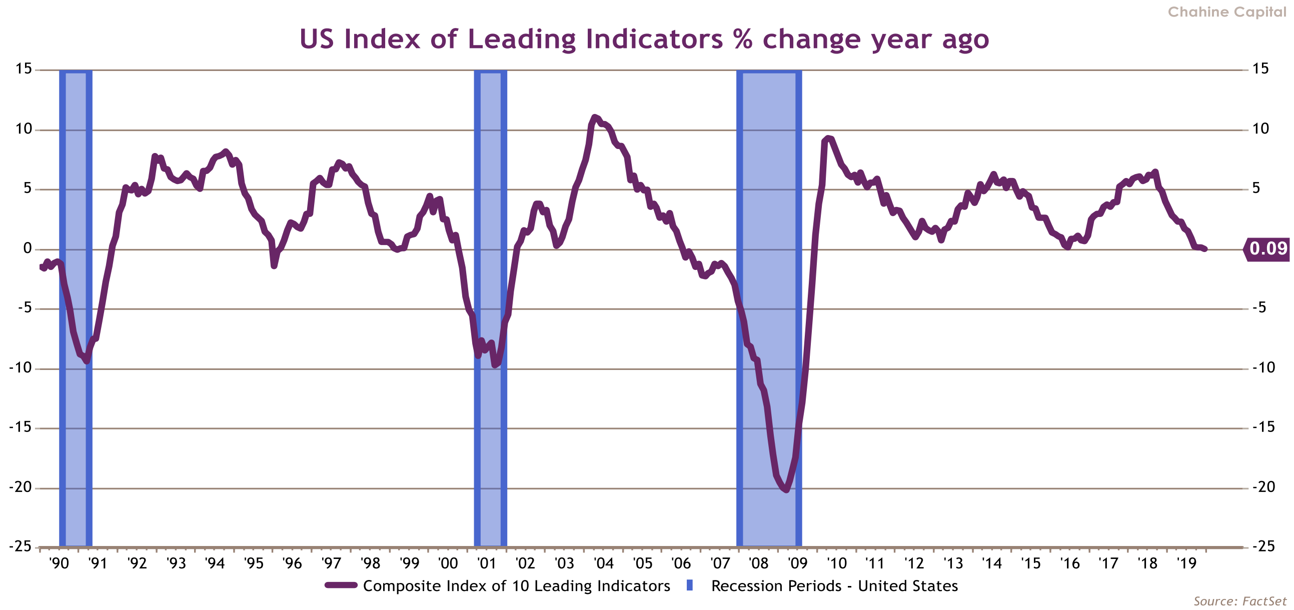
The US economy offers some cheer. The significant decline in long rates has bolstered the construction sector, with a surge in building permits to pre-crisis levels. We are not in bubble territory, however. New homes sales are at new highs and the stock of unsold existing homes is at a low. The Case Shiller house price index is relatively tame, showing increases limited to under 2% per year.

Lower rates mean a more buoyant construction sector

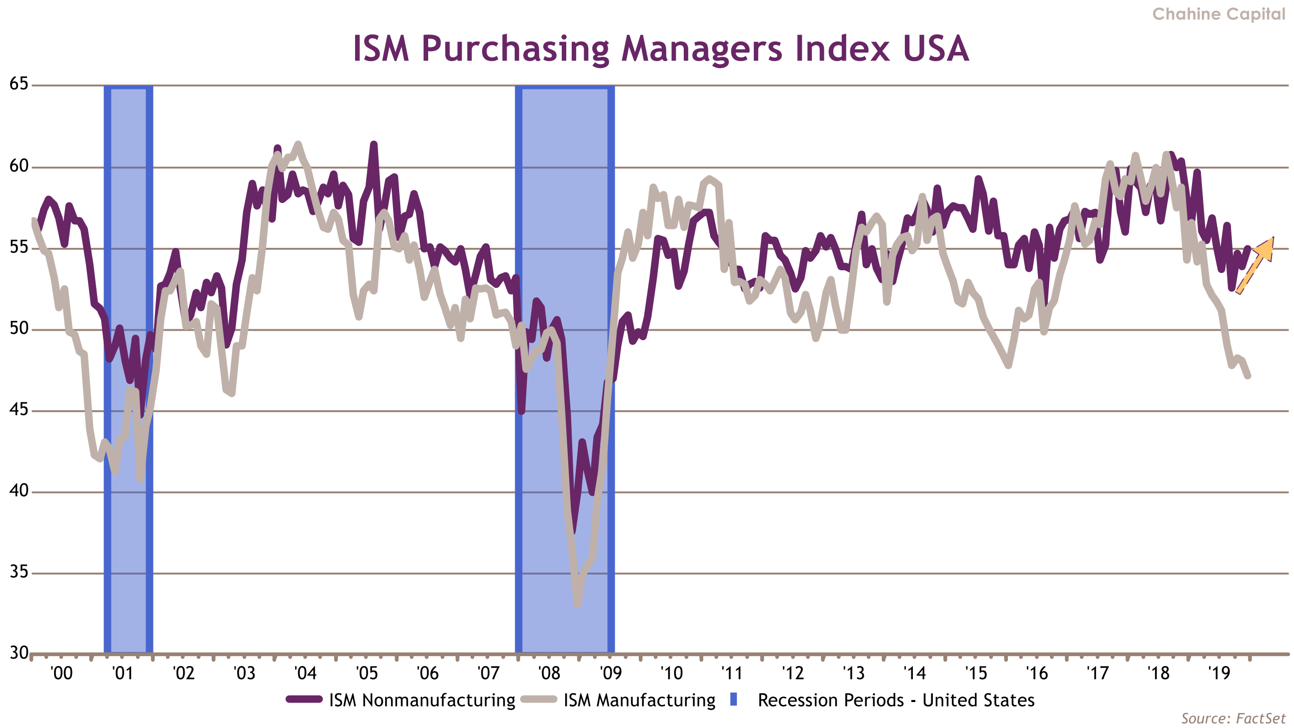


Following a period of faltering ISM indices and PMIs, the past couple of months have seen a rebound in services. Manufacturing indices continue to slide, but then manufacturing accounts for just 19% of US GDP and the halt to production at Boeing probably explains part of these results. Consumer confidence is still riding high, but the Conference Board's index of leading indicators points to slower rather than faster economic growth. That would be consistent with a forecast deceleration from 2.3% in 2019 to 1.8% in 2020. Growth in Q4 2019 is expected to have been an annualised 1.8%, while Q1 2020 is at 1.7%. Some economists believe that the situation at Boeing – specifically, rising stocks of unsold aircraft – could trim 0.5% from GDP in Q1. The labour market is still dynamic, but we are talking mainly about low value-added services jobs in hotels and restaurants, for example. Hourly wages are rising by 3% a year, but that means less than 1% after inflation is taken into account.

Leading indicators point to slower US growth



A welcome rebound in services activity



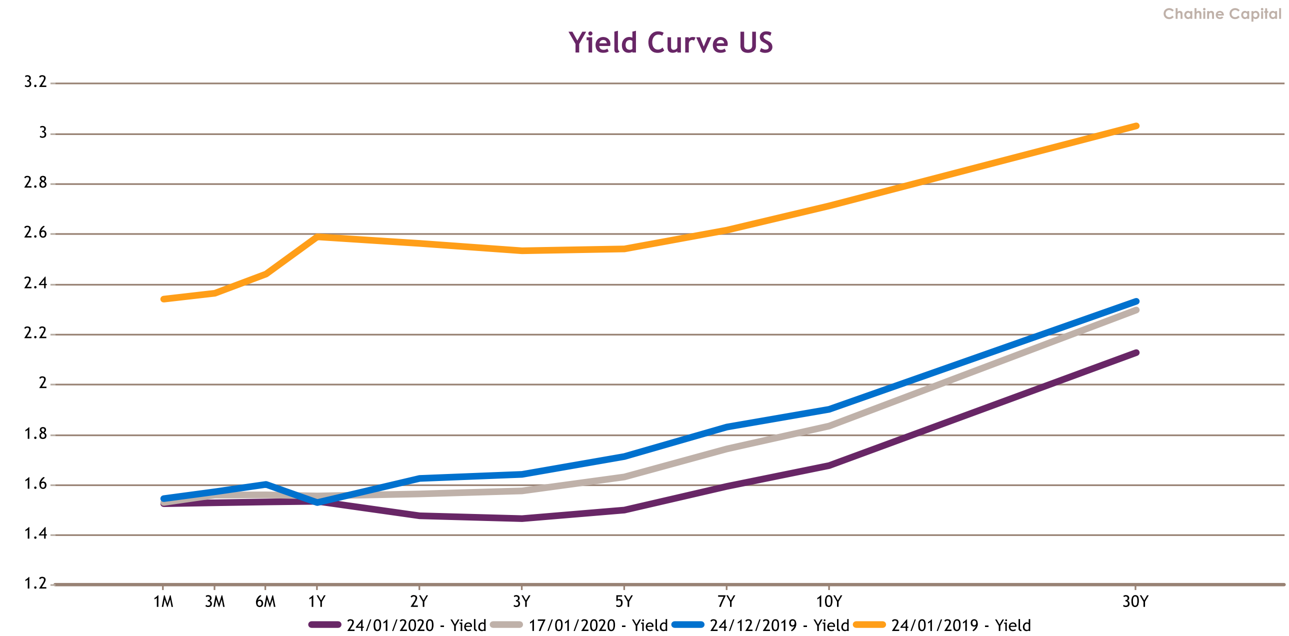
US inflation remains tame and few observers expect it to pick up significantly this year. The Fed refers to the PCE deflator, which is rising by less than 2% per year, but the headline CPI is rising by 2.2% per year and services inflation is around 3%. That said, slower growth this year would contain price pressures. This is not the case in China, where the inflation rate has jumped to 4.5% after a swine fever outbreak lifted food prices 15%. Food prices are also to blame in India, where inflation is running at over 7%. For these two most populous countries in the world, increased requirements for imported food could affect world prices.

While food prices have tracked the general price level worldwide in 10-year moving average terms, they have climbed 2.7% more on average since 2007, according to FAO. This suggests that population growth and climate change are affecting prices, and a food crisis cannot be ruled out.

Down go interest rates, yet again

The coronavirus panic unnerved the markets and prompted another flight to government bonds. In the space of a week, the whole US curve shifted lower and inverted out to 3 years. The 30-year Treasury yield is down to 2.12%, which implies a low-interest rate environment for a very long time indeed. Investors fear that the coronavirus will affect the Chinese economy enough to dampen already sluggish world activity. The German curve is also inverted out to 3 years, but in this case we are talking about even more negative interest rates. 30-year German debt is now yielding just 0.18%, compared with 0.28% a week ago. The dollar has strengthened somewhat, as we would expect given its safe haven status, and at the time of writing was trading at 1.1022 to the euro. The Fed sees little reason to intervene for the moment but would not hesitate to ease if Asian growth slowed markedly. The ECB would have little room for manoeuvre, given that its rates are negative already. Its next gambit could be helicopter money, i.e. some universal cash handout to spur European activity.

Inverted out to 3 years



Source: FactSet

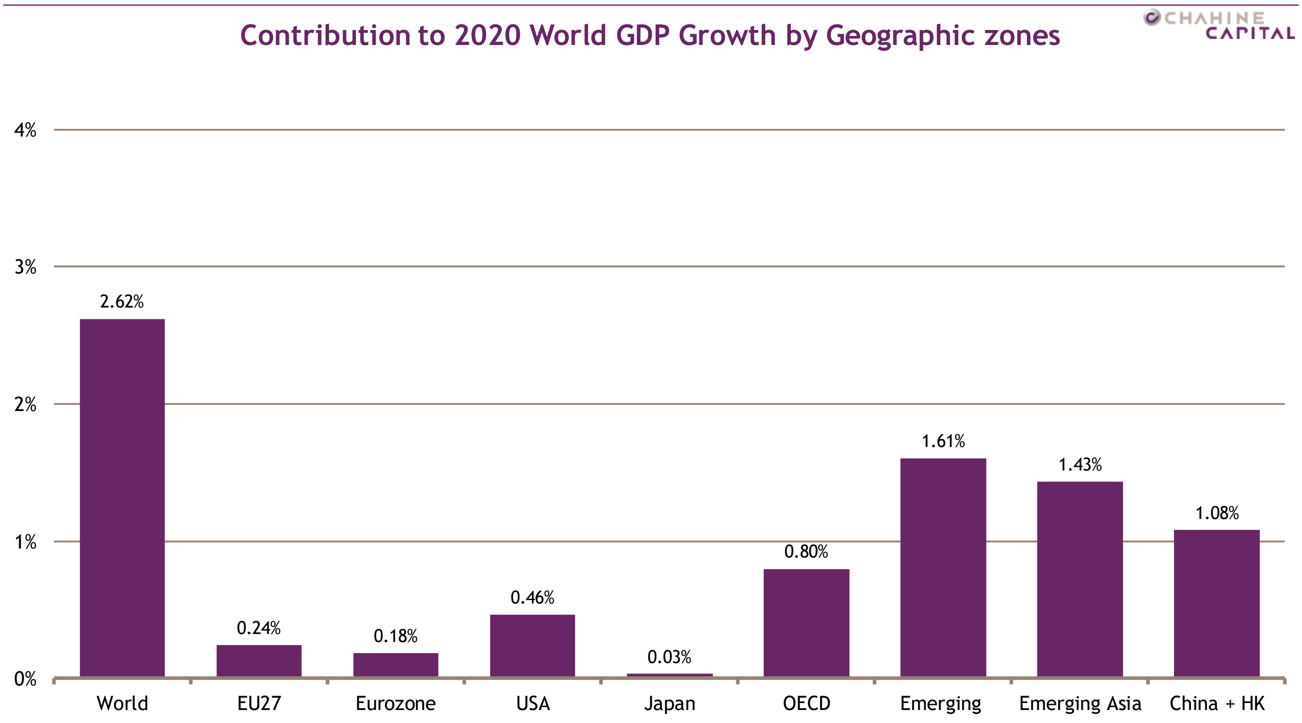
No rebound in growth this year

The implied consensus for world growth in 2020 is down from 2.66% a month ago to 2.62%. This stems from mainly Asian revisions, particularly for Hong Kong, India and South Korea, plus an adjustment to Australia, and is calculated in local currency terms rather than the PPP used by the IMF (which adds 0.2%). US is still at 1.8%, while the euro zone is down slightly at 1%. Germany is down to 0.7% but France is up from 1.1% to 1.15%. The French government is making progress on its reform programme, despite a very complex (and reluctant) domestic environment. Major changes to the labour market, the abandonment of wealth taxation, a less punitive tax regime for capital, reforms of the State railway system and new laws to simplify procedures for businesses are extremely ambitious, not to mention the current attempt to tackle pension deficits by eliminating special arrangements for certain public sector workers. No government has had a go at doing that since 1995, when Alain Juppé was prime minister. These reforms will result in job creation, renewed investment and growth rates above the European average.

World GDP growth in 2019 is not yet known. Following a 0.1% adjustment from China and revisions from India, Hong Kong and Japan, among others, the latest estimate has slipped from 2.72% to 2.68%. The euro zone is expected to post 1.2%, up from 1.1% following adjustments from smaller economies such as Finland and Greece. As emerging countries, especially in Asia, are driving world growth, investors are especially nervous of any deceleration in Chinese activity.

All in all, world growth remains as sluggish as was expected after the financial crisis and it is hard to see where a return to 3% per year could come from. Even Mr Trump has given up on that figure.

Asia continues to drive world growth

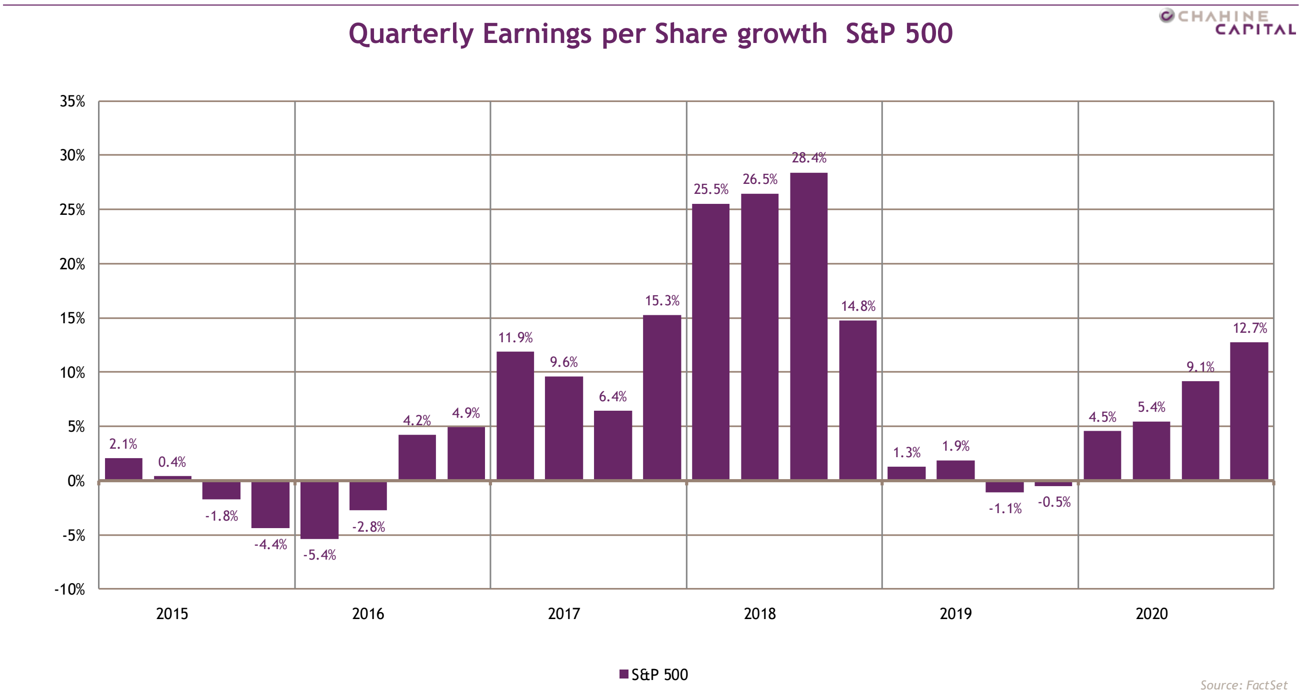


Chahine Capital methodology

No change in US profits in 2019, an estimated 8.6% in 2020

The US quarterly results season is in full swing but no big surprises are in store. Some banks have published good results, but Wells Fargo came in with $2 billion less than expected at the end of December. The firms that have published already were 3.1% ahead of the end-December consensus, but the pipeline contains some big downward revisions, such as Exxon (down $1.5 billion), Philips (down $400 million) and Boeing (who knows?). We acknowledge good numbers from Intel, but most of the positive surprises have been banks. The change in EPS for the quarter is currently -0.5%. It remains to be seen whether the IT giants can do anything about that; either way, the overall change in US profits in 2019 was around zero. Consensus estimates for 2020 add up to around 8.6% overall, but most of that is to come in the final two quarters. We have been using 8% for some time. The rate of downward revisions has slowed, which makes a change from a 2019 where all of the market's gains went into PERs.

If confirmed, decent profits growth in 2020

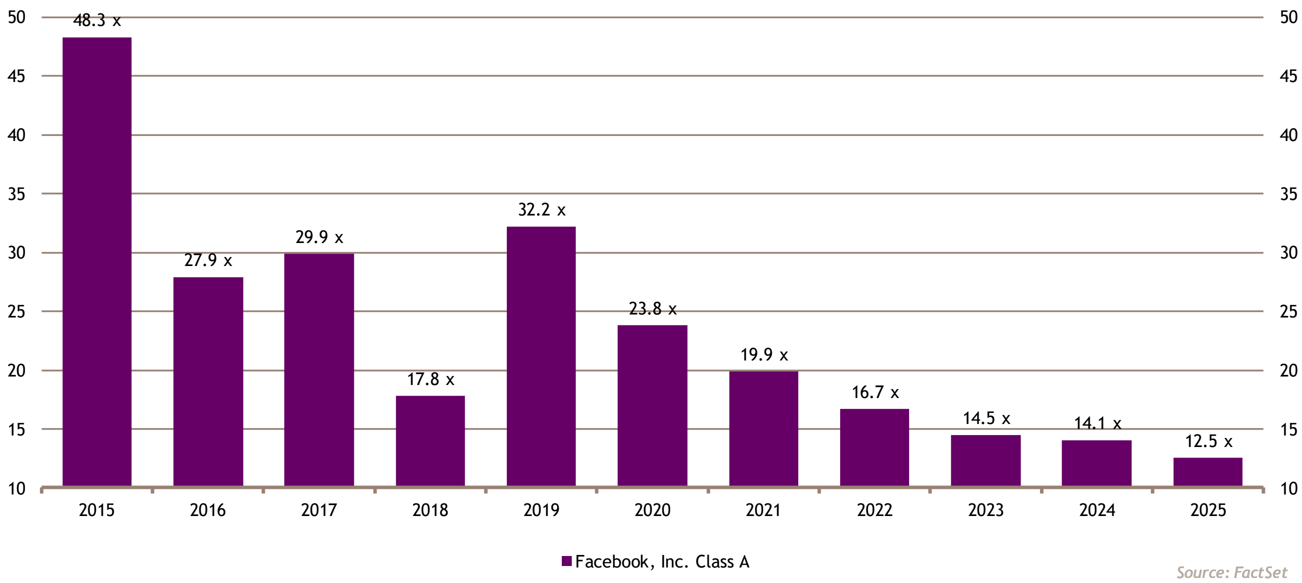


The sectors contributing the most to higher EPS include energy, which ought to rebound from poor performance in 2019 but may suffer from the recent, coronavirus-inspired correction in oil prices. By company, the big rebounds include Boeing, incredibly, and Facebook with $22 billion in profit after $15 billion in 2019.

To give you some idea of how Wall Street assesses growth stocks, we have highlighted Facebook's PERs below. For past years, we are talking about the year-end share price and the year's profits; for future years, it is the current price over expected future profits. We see that PERs appear huge at the start but dilute over times as rapid growth kicks in. The danger of course is that if this growth halts unexpectedly, the share price will drop like a stone. Apple is enjoying a second childhood with expected growth of 10% in 2020 and 15% in 2021. It is now trading at 23.6x 2020, so watch out for any potholes!

How Wall Street values growth stocks: an example

Mean P/E for Facebook, Inc. Class A (US) in USD as of 24/01/20



Source: FactSet

Wall Street at 18.6x 2020… and at 22.7 for IT

Data as of 24/01/20	Weight vs S&P 500	Perf 2020	Perf 2019	Weighted P/E 2020	Weighted P/E 2019	% Wted EPS Chge 2021	% Wted EPS Chge 2020	% Wted EPS Chge 2019	Div Yield 2 020	Revision vs M-2% Fiscal 20	Revision vs M-2% Fiscal 19
S&P 500	100.0%	2.0%	28.8%	18.6 x	20.2 x	10.0%	8.3%	1.4%	1.91%	0.1%	0.8%
S&P 500 ex Energy	96.1%	2.3%	30.0%	18.7 x	20.1 x	10.1%	7.5%	3.4%	1.81%	0.2%	1.0%
Consumer Discr.	10.1%	0.5%	26.2%	22.2 x	24.7 x	11.3%	10.9%	1.5%	1.35%	-0.1%	1.4%
Consumer Staples	7.8%	1.0%	24.0%	20.3 x	21.6 x	6.9%	6.3%	1.7%	2.79%	0.4%	0.3%
Energy	3.9%	-5.9%	7.6%	16.6 x	21.0 x	7.7%	26.4%	-31.2%	4.33%	0.1%	-4.9%
Financials	12.1%	-1.5%	29.1%	13.0 x	13.4 x	7.9%	3.5%	8.4%	2.26%	1.1%	1.5%
Health Care	13.8%	0.4%	18.4%	16.1 x	17.3 x	9.8%	7.6%	9.4%	1.76%	-0.4%	0.4%
Industrials	9.1%	2.4%	26.6%	17.7 x	19.8 x	12.9%	11.9%	-2.8%	1.93%	-3.9%	-0.1%
IT	23.8%	6.2%	48.1%	22.7 x	24.6 x	12.6%	8.3%	2.4%	1.31%	1.4%	1.9%
Materials	2.5%	-2.7%	22.5%	18.0 x	19.8 x	13.4%	9.9%	-17.5%	2.13%	-2.3%	1.0%
Real Estate	2.9%	3.2%	24.8%	45.3 x	43.2 x	6.8%	-4.7%	-7.3%	3.17%	0.5%	-4.2%
Comm Services	10.6%	3.9%	30.4%	19.4 x	21.9 x	11.1%	12.8%	1.9%	1.26%	0.1%	-1.1%
Utilities	3.3%	5.8%	22.9%	20.9 x	21.0 x	4.2%	0.4%	4.7%	3.06%	0.5%	4.3%

Benchmarks source iShares ETF - Data as of 24/01/2020

The table above shows that several sectors are trading at PERs over 20: IT, cyclicals (dominated by Amazon) and defensives. IT and financials are benefiting from upward revisions, while downward revisions are concentrated among industrials such as Boeing. We would not be surprised to see energy earnings being revised down as well.

Market valuations

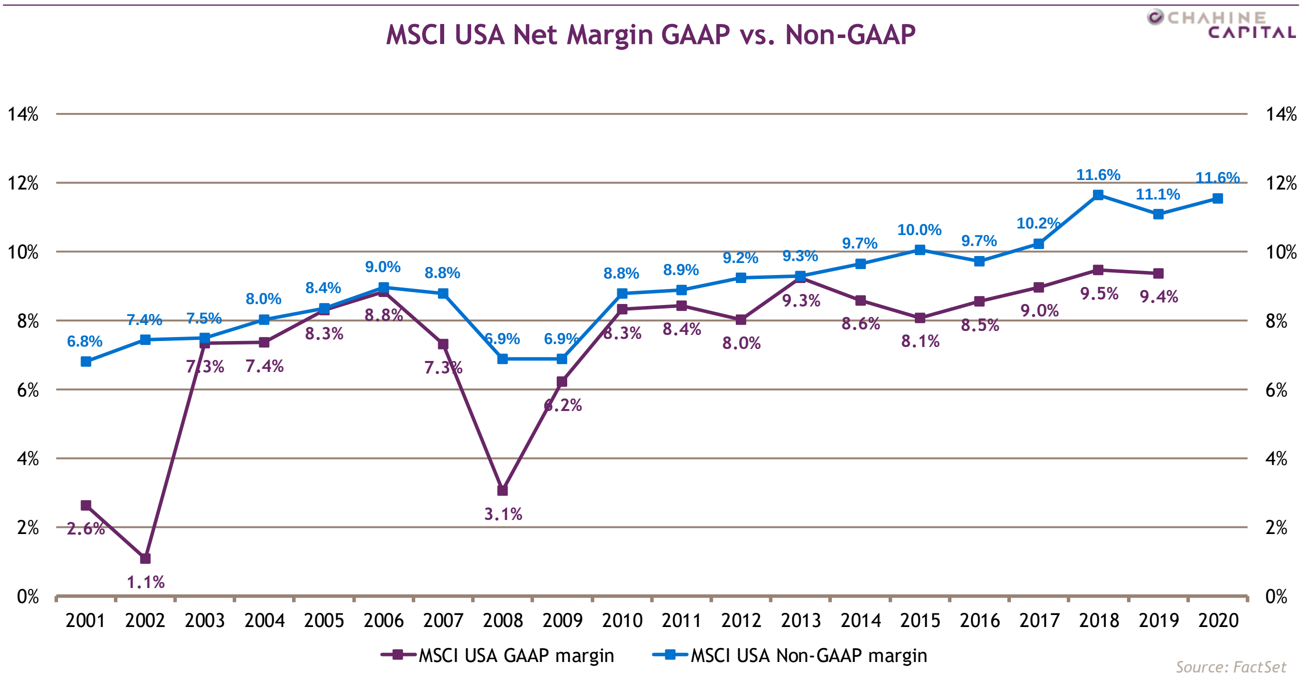
Given the hypotheses we are using, our valuation model for the US market is still negative for 2020 despite an uptick in its theoretical objective from 2,897 to 3,051 points. This revision follows the drop in the 30-year rate from 2.32% to 2.18% as well as the switch to the New Year, which by shifting slower profits growth one year further out lifts the CAGR from 2.1% to 2.7%. The equilibrium CAGR that would justify current price levels is 3.8% (1.8% growth plus 2% inflation, for example); while this looks plausible in normal conditions, it may be a stretch when we are already at a cycle high. Our model implies a recession or serious slowdown at some point in the coming 8 years. The 30-year yield had dropped from 2.18% at last Friday's close to 2.05% at the time of writing, lifting the model's objective to 3,200 points. We are sticking with our 2020 profits growth rate of 8% and 7% for 2021, compared with a 10% consensus view. Profit margins at all-time highs pretty much rule out further growth at a rate higher than the economy as a whole.

Despite a correction, Wall Street is still overpriced

S&P 500 - Valuation end 2020 except implied scenario

CAGR Compounded Annual Growth Rate from 2019	30 Years Gvt bonds				
	1.75%	2.00%	**2.18%**	2.50%	2.75%
Mild recession: -2.7% in 2020, 4.5% in 2021 - CAGR 0.5%	**2 867**	**2 697**	2 585	2 405	2 279
Implied Scenario CAGR 3.8% over 8 years	3 690	3 470	**3 326**	3 091	2 928
Base scenario: 8.0% in 2020, 7% in 2021 - CAGR 2.7%	3 386	**3 184**	**3 051**	**2 837**	2 687
Current Index S&P 500			**3 243**		

Margins at historical highs



Source: FactSet

As we have already pointed out, the market's correction stems from a totally unexpected event – the coronavirus outbreak – and its presumed impact on the Chinese economy. We have as yet no idea of the human cost, let alone the economic implications. The market's strong reaction suggests that it was at a level that was already too high for comfort. We are maintaining our underweight equities position relative to our benchmark (35% versus 40%, although the 35% had crept up to 37-38%). We have no intention of joining the general panic, as we see our stance as essentially long-term. We have continually recommended keeping cash in dollars rather than at negative interest rates in euros, and that has paid off even with lower dollar rates and currency appreciation.

Our price objective for the euro zone has risen for the same reasons as those for the S&P 500: lower interest rates and the switch to 2020. Our objective for the MSCI EMU at year-end is 142 points, up from 127 points, to which we should add a generous 3.5% dividend yield to offset negative ECB rates. The market closed last week at 133 points.

The eurozone economic growth rate is expected to be a weak 1% this year. EPS growth was zero last year and we would cautiously estimate a 5% rebound this year.

European equities look more attractive than Americans

MSCI EMU - Valuation end 2020 except implied scenario

CAGR Compounded Annual Growth Rate from 2019	30 Years Gvt bonds				
	0.25%	0.50%	**0.70%**	1.00%	1.25%
Depression scenario: 0% in 2019, -5% in 2020, 2% in 2021 - CAGR -8.2%	**127**	**118**	112	103	97
Implied Scenario: CAGR -6.5% over 8 years	151	140	**133**	123	115
Base scenario: 5% in 2020, 5% in 2021 - CAGR -5.3%	162	150	**142**	**131**	**123**
Current Index MSCI EMU			**133**		

Conclusions

Following all that champagne at the end of a remarkable 2019, equity markets carried on partying into January. The immediate cause was the so-called Phase 1 US-China trade deal, but volatility was so low that it looked as though investors would be untroubled by anything coming their way. The new coronavirus outbreak is a stark reminder of the unpredictable and has raised fears of a slowdown in Chinese activity to mark the New Year. US stock market volatility has climbed from 12% to 18% at the time of writing, and after an historic 31.6% progression last year plus a peak of another 3% so far in 2020, the MSCI US has fallen back to its 2019 close.

The Phase 1 agreement certainly favours the USA, but will it be respected? It is supposed to enforce intellectual property rights, end forced technology transfer, remove administrative barriers to farm exports, open financial markets, rule out currency market manipulation and will require China to import $200 billion-worth of goods over two years, of which $32 billion in farm products. The problem is that there is no neutral dispute resolution mechanism and either side can walk away from the agreement at its own risk. This is why Donald Trump has made only the smallest gesture by cancelling recent tariff hikes.

While the legal part of Brexit is finally over this week, it marks only the start of more – and probably more difficult – negotiations. The British would like the free flow of goods to continue, but without tying themselves to the EU rulebook and at the same time opening up new trade agreements with mainly English-speaking countries elsewhere. Fishing rights are a serious bone of contention and the end-year deadline for a trade agreement is far too tight. In the meantime, the UK's attractiveness as an investment platform with access to the Continent is bound to wane. European financial institutions are already migrating back to base and some industrial firms are doing the same. The big international risks this year will be Iran and the Middle East, with a serious risk of interruptions to oil supplies. The North Korean missile threat has not gone away, either.

America is providing a steady trickle of upbeat macroeconomic news to counteract a generally sluggish global picture. Its construction sector has gone from strength to strength on the back of low interest rates, consumer confidence is at its highs, employment remains buoyant and the services ISM index has rebounded. But the composite leading indicators index is down, indicating a slowdown in the future, and that echoes a drop in 2020 GDP growth forecasts from 2% to 1.8%. US inflation is showing no sign of acceleration and the Fed is on hold. It may even lower rates as a result of the coronavirus: the markets think so, as the curve has inverted out to 3 years and the 30 year is down to 2.12%. In contrast, the ECB has no scope left to lower rates and it may yet resort to helicopter money in 2020. Food prices have been rising faster than overall inflation over the past 15 years in China and India, and apart from kindling fears of a world crisis, renewed pressure now could cause inflation rates to spike in both countries. The implied consensus growth rate for world GDP this year is down to 2.62%, with many revisions stemming from Asia. French GDP is expected to increase 1.5% this year, above the European average.

S&P 500 profits will have been unchanged in 2019 and we expect an 8% gain this year. That estimate could fade if the coronavirus ends up hitting international activity. Our valuation model has raised our year-end objective for the S&P 500 from 2,897 to 3,051 points, and to 3,200 points using current long rates. The index multiple of 18.7x 2020 is still high. The theoretical objective for the MSCI EMU index 142 points, compared with last week's close of 133 points, and a very generous 3.5% dividend yield can be added to that. We are maintaining our equities underweight relative to our benchmark (35% vs. 40%), and have no intention of being swept up in the prevailing panic as this is a long-term allocation. We have consistently argued in favour of keeping cash in dollars rather than at negative interest rates in euros; this strategy has proved its worth for a very long time, notwithstanding dollar appreciation and Fed easing.

Jacques Chahine

Main ratios for markets and sectors as of 27/01/2020 (in local currency)

Data as of	Weight vs	Perf		Weighted P/E		% Wted EPS Chge			Div Yield	Revision vs M-2%	
27/01/20	MSCI World	2019	2018	2020	2019	2020	2019	2018	2020	Fiscal 20	Fiscal 19
MSCI The World Index	**100.0%**	**25.3%**	**-10.2%**	**17.1 x**	**18.2 x**	**6.3%**	**0.8%**	**12.3%**	**2.43%**	**-1.1%**	**0.5%**
MSCI USA	62.1%	29.2%	-6.4%	18.9 x	20.4 x	8.0%	-0.4%	22.5%	1.89%	-1.2%	-0.1%
MSCI Japan	8.2%	15.7%	-15.8%	14.0 x	14.7 x	5.1%	-8.8%	1.2%	2.58%	-0.5%	-1.5%
MSCI EMU	13.5%	21.8%	-14.5%	14.3 x	15.3 x	7.2%	1.4%	0.4%	3.48%	-1.6%	-0.6%
MSCI Europe	24.6%	22.2%	-13.1%	14.6 x	15.5 x	6.2%	4.5%	5.3%	3.68%	-0.8%	0.0%
MSCI Europe ex Energy	23.1%	23.8%	-13.7%	15.0 x	15.7 x	5.1%	6.6%	2.0%	3.49%	-0.8%	0.4%
MSCI Austria	0.1%	13.4%	-26.7%	9.7 x	10.6 x	9.4%	-20.2%	10.2%	4.48%	-3.1%	-6.7%
MSCI Belgium	0.5%	19.4%	-24.9%	15.5 x	15.3 x	-1.4%	14.9%	-0.4%	3.46%	-0.1%	0.1%
MSCI Denmark	0.8%	29.0%	-12.4%	22.6 x	24.2 x	7.2%	-2.2%	-0.9%	2.01%	-1.6%	0.8%
MSCI Finland	0.4%	8.3%	-1.5%	17.1 x	18.6 x	8.7%	-5.2%	2.4%	4.02%	-0.4%	2.0%
MSCI France	5.0%	26.1%	-9.7%	14.9 x	16.3 x	9.7%	4.1%	6.4%	3.33%	-0.9%	-0.7%
MSCI Germany	3.5%	20.1%	-20.3%	14.0 x	15.1 x	7.9%	-1.3%	-9.5%	3.11%	-1.5%	-0.5%
MSCI Great-Britain	5.4%	11.3%	-12.7%	13.2 x	13.9 x	4.6%	-3.2%	9.7%	4.64%	-1.7%	-1.8%
MSCI Ireland	0.1%	25.6%	-23.5%	16.8 x	17.6 x	4.5%	-9.3%		2.10%	-0.7%	0.1%
MSCI Italy	1.0%	25.5%	-15.5%	11.2 x	11.6 x	3.3%	5.8%	14.4%	4.67%	-1.6%	-0.6%
MSCI Netherlands	1.5%	26.8%	-10.9%	17.4 x	18.0 x	3.4%	-3.7%	6.0%	2.86%	-4.8%	0.7%
MSCI Norway	0.4%	8.3%	-6.0%	13.6 x	16.2 x	18.7%	-11.6%	20.0%	5.09%	-2.5%	-2.8%
MSCI Spain	1.2%	9.8%	-15.0%	11.9 x	12.7 x	6.9%	2.8%	-5.0%	4.84%	-1.3%	-1.3%
MSCI Sweden	1.0%	24.5%	-8.1%	16.0 x	13.6 x	-15.3%	57.0%	-7.3%	3.67%	-0.6%	17.5%
MSCI Switzerland	3.3%	27.2%	-10.1%	17.8 x	19.5 x	10.0%	8.7%	24.7%	3.03%	-1.0%	-1.9%
MSCI Europe Consumer Discretionary	3.1%	30.0%	-17.6%	14.2 x	14.9 x	4.9%	-0.2%	-7.4%	2.93%	-1.4%	0.3%
MSCI Europe Consumer Staples	3.5%	22.4%	-11.3%	18.2 x	19.4 x	6.5%	11.3%	7.5%	3.09%	-0.2%	-0.1%
MSCI Europe Energy	1.5%	3.5%	-5.0%	11.0 x	13.0 x	19.1%	-15.1%	50.2%	6.42%	-0.8%	-4.4%
MSCI Europe Financials	4.1%	17.5%	-21.8%	10.1 x	10.2 x	0.9%	12.5%	6.2%	5.33%	0.1%	2.7%
MSCI Europe Health Care	3.2%	28.4%	-2.5%	17.4 x	18.6 x	6.8%	9.5%	4.6%	2.78%	-0.1%	0.4%
MSCI Europe Industrials	3.4%	32.1%	-15.0%	17.6 x	19.0 x	8.1%	6.8%	2.9%	2.68%	-0.9%	-0.4%
MSCI Europe Information Technology	1.4%	35.8%	-8.2%	22.2 x	26.3 x	18.7%	3.6%	12.4%	1.35%	-1.4%	-4.8%
MSCI Europe Materials	1.6%	21.4%	-16.4%	14.9 x	15.9 x	6.7%	-6.4%	2.5%	3.82%	-3.8%	-2.5%
MSCI Europe Real Estate	0.3%	18.9%	-17.5%	16.8 x	15.1 x	-10.3%	-16.9%	11.3%	4.46%	2.3%	1.7%
MSCI Europe Communication Services	1.2%	0.6%	-10.8%	14.5 x	15.4 x	6.6%	-1.2%	-9.5%	4.52%	-4.0%	-1.3%
MSCI Europe Utilities	1.3%	24.3%	-1.6%	16.4 x	17.6 x	7.8%	19.2%	-14.7%	4.52%	0.1%	0.0%

Benchmarks source iShares ETF - Data as of 27/01/2020

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