J. SAFRA SARASIN

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CIO Update

Investment Committee Bank J. Safra Sarasin
7 November 2019

Editorial

Dear reader

Jerome Powell, President of the US Federal Reserve Bank (Fed), pointed out on numerous occasions in recent months that the US economy was «in a good place». After the Fed's latest interest rate cut, another US central banker said that monetary policy was «in a good place». I believe our investment portfolios are «in a good place». We have taken a balanced approach to risk with a slightly underweight position on equities and an overweight stance on other risk assets. By investing in high-yield and emerging market bonds, our portfolios can profit from the rising level of risk appetite among investors. In the event of a resurgence of geopolitical tensions, we also are perfectly positioned with our gold diversification.

Yours faithfully
Philipp E. Bärtschi, CFA
Chief Investment Officer

Focus

«In a Good Place»

Review: Risks decline

After a turbulent third-quarter period in which the spectre of recession made an appearance many times, the environment saw a substantial improvement in October. Aside from economic indicators showing signs of stabilization, this was primarily driven by positive trade policy developments and optimism about an amicable Brexit compromise between the UK and the European Union. The calmer geopolitical situation also prompted investors to gradually leave safe havens. Yields subsequently increased sharply as well.

Decline in risks = rising bond yields

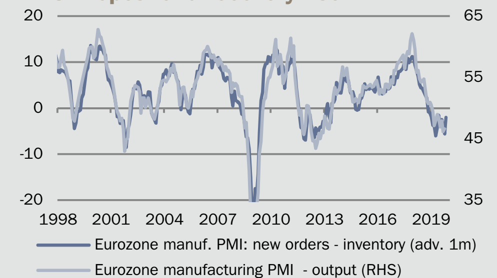
Source: Datastream, J. Safra Sarasin, 07.11.2019

While many equity indices have scaled highs, long-term interest rates are much lower than where they were at the start of the year.

Macro outlook: Hope sprouts

The risks associated with the global economic development certainly remain high. However, purchasing managers' indices (PMIs), which have looked worryingly weak in recent months, showed initial signs of stabilization in October. More specifically, the latest Eurozone data reveals a consolidation, albeit at a low level.

EMU: Hopes for a recovery rise



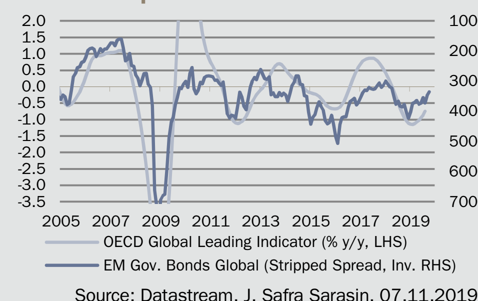
Source: Datastream, J. Safra Sarasin, 07.11.2019

The US economy appeared fairly immune to trade policy developments in the past. Lately, however, the negative ramifications are increasingly reflected in the weaker economic data, which are attributable to the investment-inhibiting uncertainty of the ongoing trade war between the USA and China.

Looking at the entire macroeconomic dataset, we notice a marked divergence between the sometimes very weak soft data – the PMIs for example – and the continuing robust hard data, such as retail sales or, most recently, the higher-than-expected US GDP growth rate. This situation is hardly surprising. The continual back and forth in the US-China trade dispute, as well as the seemingly never-ending Brexit saga, mean that companies cannot make long-term invest-

ment decisions or be optimistic about the future. Clarity on these issues is therefore essential. The US presidential election next year will be a determining factor. Despite the lack of a coherent, integrated geopolitical and trade-policy strategy, US President Donald Trump could always rely on the strong economy in the first years of his presidency. But now this foundation is at risk of crumbling and, in domestic developments, President Trump has come under increasing pressure from a formal impeachment inquiry. The determination to reach a trade deal with China and reduce this latent source of uncertainty (and secure a win in domestic politics) should steadily increase in the months leading up to the US presidential election, and ultimately also lead to an improvement in the investment environment.

EM: Credit spreads could fall



Source: Datastream, J. Safra Sarasin, 07.11.2019

Emerging market bonds favoured

Against this backdrop, the US Fed cut interest rates in October for a third time this year and at the same time indicated a rate cut pause. The other central banks are not expected to provide any stimulus in the coming months either. It remains to be seen whether the signs of recovery will be confirmed. A lack of monetary stimulus also raises the risk of further interest rate increases. As a result, we continue to clearly underweight government bonds. In addition to high-yield bonds, emerging market debt should directly profit from a cyclical upturn. Emerging market local-currency bonds, which have seen a resurgence of demand from investors in recent weeks, look particularly attractive. This asset class should also receive support in future from a range-bound US dollar and monetary policy measures implemented in several key emerging market regions.

Equities set new records

The present combination of central banks' liquidity boosting operations, geopolitical easing and the first signs of an improvement in global macroeconomic data presents a positive picture of the equity market. The new highs in equity prices therefore come as no surprise. Nonetheless, given the latest increase, upside potential at an index level is effectively exhausted. If interest rates climb further, an increasing rotation out of defensive areas and into cyclical sectors and regions looks more likely.

Global equity markets are energized

Source: Datastream, J. Safra Sarasin, 07.11.2019

In equity markets, the earnings season is in full swing. So far, corporate results are in line with analysts' very conservative estimates. But (once again) there are very clear regional differences. Earnings growth of around 4% in the USA has come in substantially ahead of expectations and is also much higher than in Europe. Earnings in the Eurozone have declined on average by about 6%. It is worth noting that of the companies that have reported earnings so far, most of the firms that posted strong results are from defensive sectors. Cyclical companies, on the other hand, while not suffering a slide in profits, have reported much weaker figures. This is mainly attributed to the high degree of uncertainty associated with the US-China trade dispute and Brexit. Companies have taken a very positive view in this respect. If the cyclical recovery continues, as we expect it will, these companies stand to benefit the most. In regional terms, we currently favour European equities, including the UK because several stocks here still have catch-up potential. The latest trend of rotating out of growth names and into value stocks should continue for a while.

Asset allocation: Balanced portfolio

We have focused on achieving a balanced asset allocation in our mixed portfolios. Given the sharp reversal in investor sentiment since the low point in August, setbacks at the geopolitical level are possible at any time. We retain our slight underweight to equities, but have made our stock selection more cyclical in anticipation of growth acceleration. In bonds, we continue to clearly underweight government and investment-grade bonds because they remain susceptible to price declines given the historically low yield level. We continue to favour high-yield and emerging market bonds based on the credit spread and the coupon, which at least provides some buffering against risk. Alternative assets including gold ensure the portfolio remains well diversified and will also ensure that our portfolios are «in a good place» at the end of the year.

Contact
Philipp E. Bärtschi, CFA
Chief Investment Officer
+41 58 317 3572
Email: philipp.baertschi@jsafrasarasin.com

Attractiveness of individual investments

Asset class	Weighting	Relative attractiveness within the categories			
Equities	=/–	Industrial countries =/–	Emerging markets =/+	Large caps =	Small caps =
Bonds	–	Government bonds –	Corporate bonds =	High-yield bonds =	Emerging markets +
Alternative assets	+	Money market =	Convertible bonds =	Other alternatives +	Commodities/Gold =/+

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Bank J. Safra Sarasin Ltd
General Guisan-Quai 26
P.O. Box
CH-8022 Zürich
T: +41 (0)58 317 33 33
F: +41 (0)58 317 33 00
www.jsafrasarasin.com