Volatility arises with the end of Goldilocks

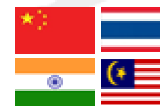
Midterms are a test for Trump
Unpopularity vs. Strenght of the Economy

The battle for world domination
Through a tit for tat trade war

Monetary stimulus to end albeit economic slowdown and risks
ECB plans to end its Asset Purchase Program at the end of the year

Brexit – end of the road to reach an agreement with the EU
An agreement should be reached by the end of the year, but divergences prevail

Selectiveness in EM
Asia: Macroeconomic fundamentals and attractive valuation support positive view
Argentina & Turkey: Strong monetary response, but risks still elevated



Government Bonds

- Inflation linked bonds attractive in US
- Opportunity in Italian debt

Corporate Bonds

- Avoid exposure to High Yield
- US IG corporates attractive as Treasuries surpass 3% yield, along with floaters

Equities

- Overweight Industrials and HealthCare in Europe
- Underweight UK due to Brexit risk
- Narrow emerging markets exposure to Asia

Commodities

- Strong correlation with emerging economies limits upside potential
- Gold and crude lack fundamental catalysts for sustained gains

Currencies

- Rise in German yields may provide a tailwind to EURUSD
- Brexit sentiment should dominate GBP fluctuations

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1. Multi Asset Allocation Views

Asset Classes	Index	Defensive	Moderate	Dynamic	Change*	Macro View
Equities		**29%**	**41%**	**58%**		
Europe	MSCI Europe Value	7%	6%	7%		Slight Overweight
Peripheral	FTSE MIB	0%	0%	0%		Underweight
HealthCare	STOXX Europe 600 Health Care	3%	5%	7%		Overweight
Consumption	STOXX Europe 600 Food & Beverages	3%	5%	5%	↓	Slight Overweight
Industrials	STOXX Europe 600 Industrials	3%	5%	8%	↑	Overweight
Media	STOXX Europe 600 Media	0%	0%	0%		Underweight
UK (Small Cap)	FTSE Small Capitalisation	0%	0%	0%	↓	Underweight
USA (momentum)	MSCI USA Momentum USD TR	8%	10%	14%		Slight Overweight
Japan	Nikkei 225 JPY	3%	5%	7%		Overweight
Emerging Markets Asia	MSCI Asia Ex-Japan Local Curr	2%	5%	10%	↑	Neutral
Government Bonds		**25%**	**25%**	**16%**		
Government Core Europe	Germany 10 Year	0%	0%	0%		Underweight
Government Peripheral Europe	Italy 10 Year	8%	5%	5%		Overweight
Government US	US 10 Year	0%	0%	0%		Neutral
Government UK	UK 10 Year	0%	0%	0%		Underweight
Government Japan	Japan 10 Year	0%	0%	0%		Underweight
Emerging Markets (Argentina)	Argentina Generic 10 Year EUR	0%	2%	3%		Overweight
Emerging Markets (Mexico)	Mexico Generic 10 Year USD	2%	3%	4%		Overweight
Low-duration	BBG Barclays Global Agg. Low Duration	10%	10%	4%		Overweight
Inflation Linked	US Govt 10Y Inflation Linked Bonds	5%	5%	0%		Overweight
Corporate Bonds		**18%**	**15%**	**13%**		
Investment Grade - Europe	BBG Barclays Pan European Corporate	0%	0%	0%		Slight Underweight
Investment Grade - US	BBG Barclays US Corporate	5%	4%	3%	↑	Overweight
Investment Grade - US Floaters	BBG Barclays Glb Agg US Corp FLoaters	5%	3%	2%	↑	Overweight
High Yield - Europe	BBG Barclays Pan-European HY	0%	0%	0%		Underweight
High Yield - US	BBG Barclays US Corporate HY	0%	0%	0%		Underweight
Convertibles	Exane European Convertible Bonds	8%	8%	8%		Overweight
Cash		**11%**	**7%**	**4%**		
EUR	EURO/US DOLLAR	3%	0%	0%		Neutral
USD	US DOLLAR/EURO	0%	0%	0%		Neutral
GBP	BRITISH POUND/EURO	3%	2%	1%		Neutral
JPY	JAPANESE YEN/EURO	5%	5%	3%		Slight Overweight
Commodities		**17%**	**12%**	**9%**		
Gold	UBS BBG Gold Euro Hedged	14%	8%	4%	↓	Slight Overweight
Commodities	Bloomberg Commodity	3%	4%	5%		Neutral
WTI Crude	WTI Cushing Crude Oil Spot Price	0%	0%	0%		Slight Underweight
Total		**100%**	**100%**	**100%**		

Currency Exposure	Defensive	Moderate	Dynamic
EUR	51%	46%	48%
USD	35%	36%	31%
GBP	4%	3%	1%
JPY	8%	10%	10%
Emerging Markets - Local Currency	2%	5%	10%

*The change is relatively to our last quarter Multi Asset Views.

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1.2. Multi Asset Performance

	3rd Quarter 2018		Since Inception (02-04-2018)	
	BiG Research	Benchmark	BiG Research	Benchmark
Defensive	0.12%	0.21%	1.95%	0.68%
Moderate	0.82%	1.04%	3.56%	2.80%
Dynamic	1.64%	1.49%	4.91%	4.94%

Source: Bloomberg, BiG Research
Performance until 28-09-2018

- In the last quarter the portfolios rose between 0.12% and 1.64%. Since inception, when compared with their respective benchmarks (which include management fee), both the defensive and moderate portfolios reached higher returns (without management fee), however the dynamic profile was below its benchmark.

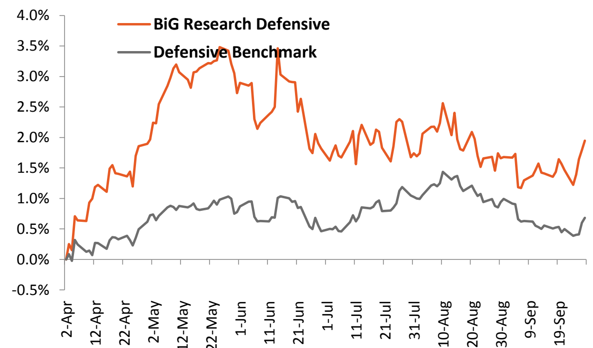
Top 3rd Quarter Returns	
MSCI US Momentum	8.30%
Nikkei 225	6.63%
STXE 600 Healthcare	5.42%
Bottom 3rd Quarter Returns	
Gold Euro Hedged	-5.70%
BBG Commodity	-2.01%
JPY/USD	-2.00%

Source: Bloomberg, BiG Research
Performance from 29-06-2018 to 28-09-2018

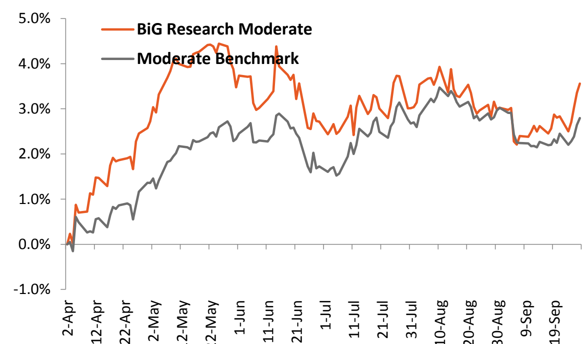
- The top contributors for the performance were equities of US Momentum, which rose 8.3%, followed by Nikkei 225 (+6.63%) and once again, the healthcare sector in Europe (+5.42%).

- As the main equity indices in the US established new record highs, our position in Gold Euro Hedged deteriorate further. The rise of yields, due to a higher deficit than expected proposed by the government to EC, negatively affected our position in Italy's debt.

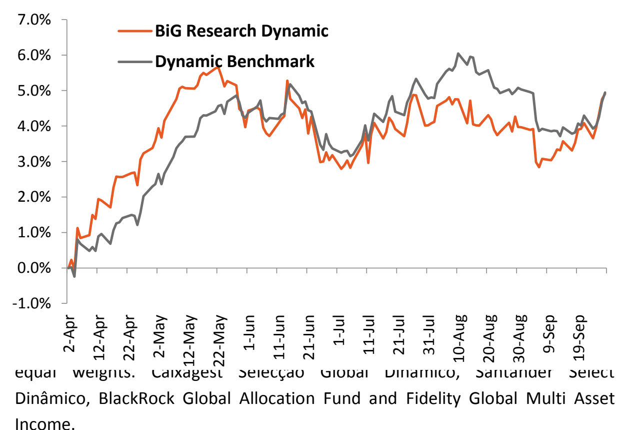
- Our gain of 2.29% in Mexican bonds was partially offset by the Argentine's bonds, which fell -1.93% as the sentiment deteriorated further.



Source: Bloomberg, BiG Research; Defensive Benchmark: Fund Portfolio with equal weights. Caixagest Selecção Global Defensivo, Santander Select Defensivo, JPMorgan Global Income Conservative Fund, BlackRock Global Multi-Asset Income Fund and Fidelity Global Multi Asset Tactical Defensive.



Source: Bloomberg, BiG Research; Moderate Benchmark: Fund Portfolio with equal weights. Caixagest Selecção Global Moderado, Santander Select Moderado, JPMorgan Global Balanced Fund, BlackRock Flexible Multi-Asset Fund and Fidelity Global Multi Asset Tactical Moderate.



equal weights. Caixagest Selecção Global Dinâmico, Santander Select Dinâmico, BlackRock Global Allocation Fund and Fidelity Global Multi Asset Income.

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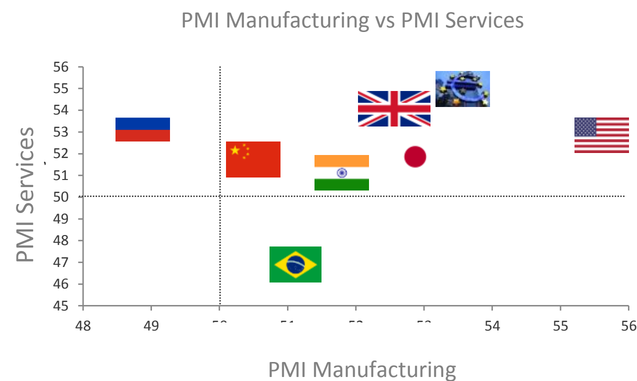
2. Global Macro Picture -Summary

- **Global**

- Entering the last quarter of the year, the Goldilocks conjuncture appears to be a pipe dream, given the global economic slowdown and the confidence crisis, whose negative effects weighed particularly on emerging economies.

- An inflation overshoot scenario remains possible, mainly in the US and China, on the back of an escalating international trade conflict between the world's two largest economies.

- A potential spill-over of the emerging markets turmoil, Brexit negotiations and Italy's political risk emerge as main key risks.



Source: Bloomberg; BiG Research;

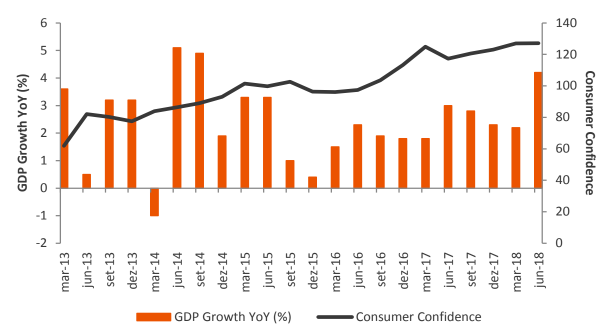
- **United States of America**

- The US economy grew at the fastest pace of the last three years in the second quarter (+4.2% YoY)

- The positive effects of Republican's fiscal reform, together with the economy in full employment and the expectation of additional stimulus from Trump's administration in 2019, makes us believe that the ongoing expansionary cycle still has room to go further.

- The quantitative tightening carried out by the Fed as a mean to contain inflation, imposes the key endogenous and exogenous risk to the current dynamics of the US economy.

GDP Growth YoY (%) vs Consumer Confidence



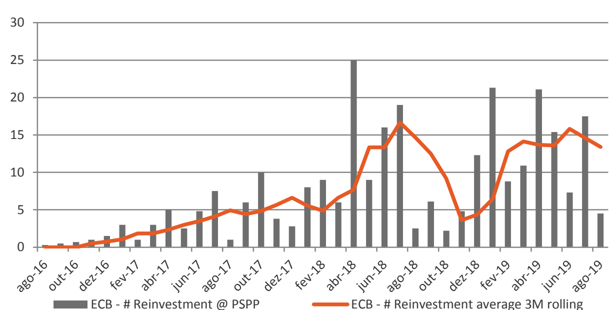
Source: Bloomberg; BiG Research;

- **Europe**

- The ECB downgraded economic growth projections for 2018, from 1.9% to 1.8%, reinforcing the persistency of inflation drivers in the medium run.

- A slowdown in exports (partly motivated by rising trade tensions) and an investment slowdown are the main catalysts for the lower economic performance, when compared to 2017.

- With Italy risk premium at relative highs, the question of how the ECB will reinvest the coupons and reimbursements of sovereign debt purchased within the scope of PSPP prevails.



Source: Bloomberg; BiG Research;

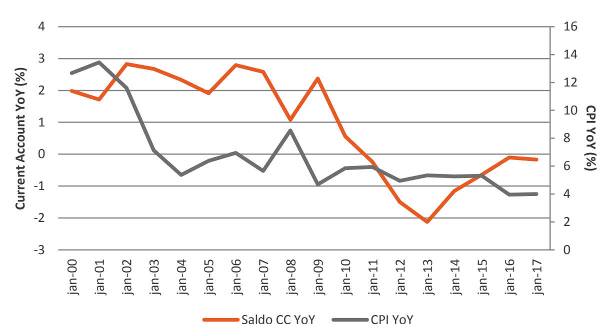
- **Emerging Markets**

- The macroeconomic and political reality of the emerging complex is heterogeneous, corroborating the vision that risks from Argentina and Turkey might remain limited.

- In general terms, emerging economies are now better prepared to cope with a liquidity crisis, given the current reasonable inflation levels as well as their balanced twin deficits.

- Facing macroeconomic (Argentina) and political (Brazil) turmoil in Latin America, we favour exposure to the Asian segment. Among others, Thailand and India display robust macro fundamentals.

CPI YoY vs Current Account YoY



Source: Bloomberg; BiG Research;

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2. Key Calls

1. **Fed quantitative tightening**

   With the US economy at full employment and going through one of the best growth dynamics since post-Lehman crisis, enhanced by the expectation of a infrastructural stimulus package in 2019 by the Trump Administration, the Fed has been keen on rising interest rates at a stronger pace. With the upper bound of the Fed Funds already at 2.25%, we believe there is little room for maneuver on the Fed to maintain the current upward path of the Refi rate, both for endogenous and exogenous reason for the US economy. We see a cap on the upward bound of the Fed Funds at 3% until 2019 YE, which is in line with the current value of US 2 Year rates (@2.80%). The recent rise of the risk free rate did not translate into higher corporate credit spreads, thereby we see relative value in Investment Grade Debt, as well as Inflation Linked Bonds and Floaters to hedge inflation risk.

   - Overweight US 10Y inflation-linked bonds
   - Overweight US Investment Grade bonds with Treasuries above 3%, as well as Linkers and Floaters

2. **Industrial Sector in Europe**

   Year to date, the industrial sector in Europe has accumulated returns of 2.98%, after achieving a revenue growth in the last quarter of 3.54% (YoY). In the next 2 years, it is expected an increase of net income in the sector of 7% and 11.2%. For this reason we decided to overweight the sector as its companies have good fundamentals and growth perspectives.

   - Overweight industrial sector in Europe

3. **Brexit – Final stretch towards an agreement with European Union**

   The time for the UK to reach an agreement with the EU is running out, with the last theoretical opportunity, before the consummation of Brexit, occurring at the last annual meeting of the European Council (December 13th and 14th). There are ever more supporters of a second referendum on EU membership and the possibility of an UK departure without a deal has motivated catastrophic forecasting, namely by BoE's governor Mark Carney. Theresa May faces clear domestic hurdles, including within the Conservative Party, and several European leaders are increasingly impatient with the lack of progress on key issues, such as the Irish border.

   - Underweight stocks deeply connected to the British economy
   - Underweight pound sterling

4. **Asian Market is best in class among smoothening of Emerging Market risks**

   The steep interest rate hikes committed by the Central Banks of Argentina (60%) and Turkey (24%) could begin to mark a gradual, but slow, recovery of the economy on both countries, besides promoting a certain stabilization on the USD vs emerging currencies. The contained inflation levels and a balanced Current Account on aggregate and historical levels are key factors that support our positive view on Emerging Markets. Asian countries are best in class on valuation and macroeconomic fundamentals.

   - Overweight Emerging Market Asian Equities

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3. In-depth Analysis

A. US Midterms – The end of the game for Trump?

On the 6th of November the US goes to midterm elections. On that day, each State will vote to elect the representatives for the 435 seats in the House of Representatives and 35 of the 100 members of the Senate – the House of Representatives and the Senate compose the US Congress. The midterms, by occurring in the middle of the president's mandate, show the electorate view about the president. Historically, this view is negative – the president's party loses representation in the midterm elections (it occurred in five of the six past midterm elections). Thus, and considering how unpopular Donald Trump is, one of the main questions of this midterm election is: can the democrats win the control of the House of Representatives and the Senate? According to the current pools, the democrats will win the majority of the House of Representatives, but not the Senate – in fact the predictive models point towards a probability between 77% and 66% of democrat control in the House of Representatives, but in the Senate due to the higher number of democrat senators up for reelection it is harder for the party to defend the places it currently controls in the Senate and invert the current minority of 49:51. However, and regardless of how the US government will be composed after the elections, on the basis of past data it is possible to expect two trends from the equity markets – ii) volatility in the elections year until they occur; ii) a positive performance from the markets in the twelve months after the midterms (between 1950 and 2014 S&P gained, on average, 15% in the period). The gains in the stock market occur regardless of how the government is composed, but vary in magnitude depending on the composition of it – the current framework of republican control in the House of Representatives, Senate and Presidency generates the highest gains (+15%), while a backdrop of democrat control in Congress with a Republican president generates the less positive outcome for the market (+5%). The outcome that the pools are predicting, with a democrat majority in the House of Representatives, a Senate with a republican majority and a President of the Republican party is, on average, characterised by an annual gain of 10.8% in the S&P 500.

Average S&P 500 performance depending on the Government Composition (1933-2016)

Source: Wells Fargo Investment Institute; Strategas; BiG Research
Note: Data until 20 th of April of 2018

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B. Floaters – Introduction

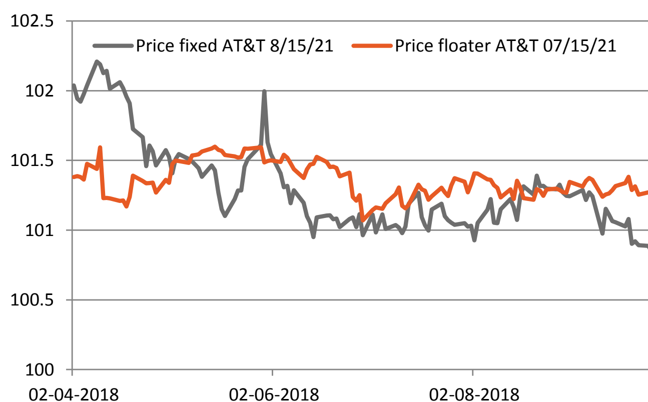
A "Floater" is a bond with interest payments that adjust accordingly to an interest rate benchmark such as T-Bills or LIBOR (London Interbank Offered Rate). The coupon paid will then be this interest rate plus a fixed spread. The spread is based on numerous factors, such as credit quality of the issuer and the time to maturity. It is common that the initial coupon of a Floater is lower than that of a fixed-rate bond with the same maturity, as short term interest rates are usually lower.

Caps and floors:

Many Floaters have caps or floors. A cap is the maximum interest rate the issuer will be able to pay, regardless of how high the benchmark interest rate goes. The floor on the other hand defines the minimum coupon that will be paid, protecting the investor.

Benefits:

As floaters' coupon rate changes when interest rates move, its price will fluctuate less than fixed-rate bonds with the same maturity. Fixed rate bonds tend to decrease in price as interest rates rise. This fact may be seen in the graph below in which we compare the price between a floating and a fixed bond of the same issuer (AT&T) and with very close maturities.



Source: Bloomberg

If an investor believes interest rates will rise, he may prefer to hold until the movement is done and then invest in higher longer term rates. However, while waiting, it is usually more advantageous to invest in floaters that pay short term rates plus a spread than in short term bonds. Using the same two bonds of AT&T, the 1-year return of the floating is 3.35% while the fixed was only 0.21%.

Risks:

The market value of a floating bond may be less volatile than a fixed bond, however if interest rate expectations do not materialize, total return may fall behind what the investor estimated.

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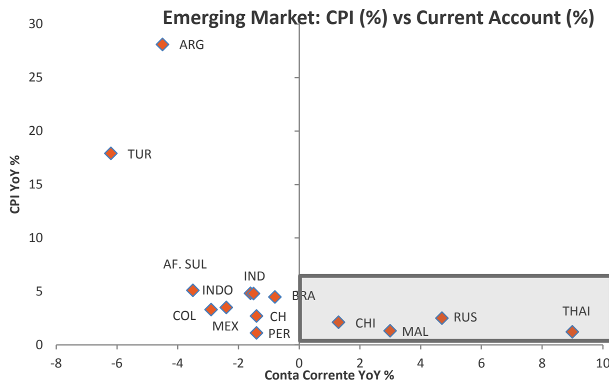
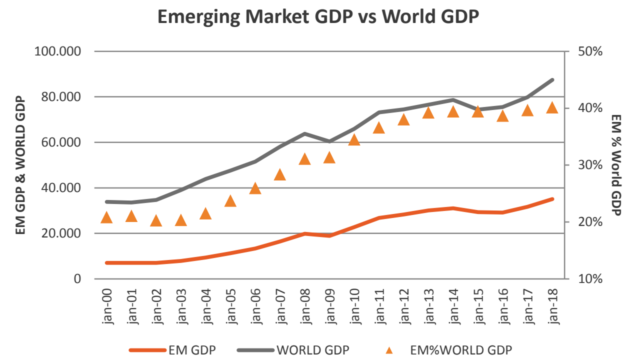
C. Emerging Market weakness – Framework and forward view

Turkey is the last victim of global quantitative tightening, resulting from higher interest rates, strengthening of the USD and liquidity constraints. Twin deficits, out of control inflation and lack of monetary and political credibility undermined the depth of the crisis in Turkey. From a macroeconomic standpoint, the negative similarities with Argentina are evident, despite most countries in the emerging world reveal a much better fundamental and structural position.

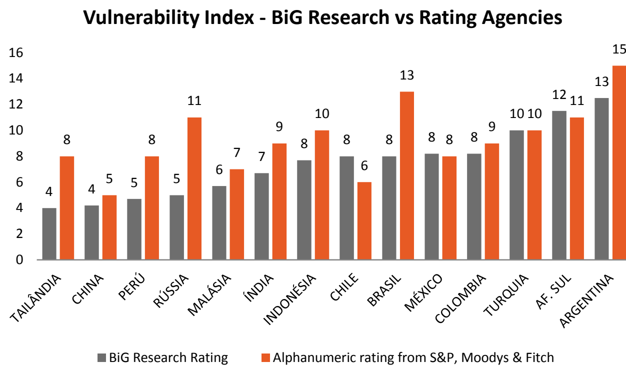


Source: Bloomberg; BiG Research;

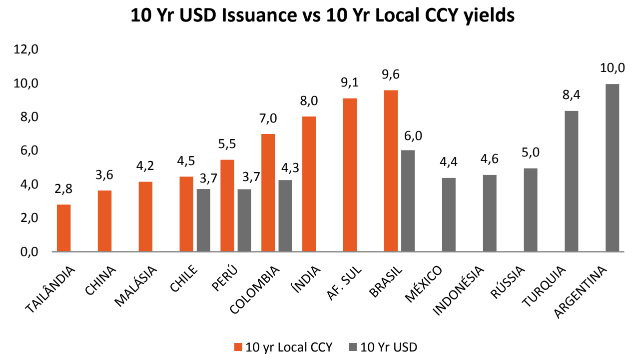


Source: Bloomberg; BiG Research;

Below, we constructed a Proprietary Index regarding Emerging Market vulnerability, obtained from a combined analysis of fundamental metrics (CPI, GDP growth, Foreign Reserves, External Debt, Fiscal and Current Account Budget), which compares to a weighted alphanumeric rating derived from the top 3 Rating Agencies – global score ranges from 1 (best) to 16 (worst). Interesting to recognize the difference between (BiG Research and Rating Agencies) on the assessment of fundamentals in countries like Thailand, Russia and Brazil. On a quality basis, we highlight the Asia region – despite underlying China ongoing risks – as the most attractive investment play, reinforced by the economic (Argentina) and political (Brazil) turmoil that is weighting on Latin America.



Source: Bloomberg; BiG Research;



Source: Bloomberg; BiG Research;

Globally, we consider that the spillover risks from Argentina and Turkey economic meltdown has materialized aggressively over most emerging economies, while the vast majority of them do not reveal the same underlying structural weaknesses. The aggregate inflation levels are very much under control in the emerging world and the Current Account reveals a balanced budget – reinforced by positive developments in recent years. We believe in two distinct scenarios forwards: a) gradual recovery from the Emerging Market assets due to depressed valuation levels and very negative sentiment; b) if this recovery fails to materialize, we believe there will be a knock-on effect over the developed economies (US and Europe in particular). Scenario b) reflects mainly the steep rising growth weight of the emerging economies relative to World GDP (already at 40% vs 20% at early 2000).

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D. Is the ECB getting its tapering timing right?

Despite a substantially longer, three-staged, Quantitative Easing (QE) in the United States of America than in Europe, as well as a different tapering approach by the European Central Bank – gradual reduction of monthly purchases accompanied by extensions in the longevity of the monetary stimulus package – a comparison between the two programs is worthwhile to analyse one of the most striking themes of this year's last quarter: the end of ECB's quantitative easing.

The table below clearly establishes that the US Federal Reserve executed its necessary tapering with an extremely pertinent timing. Since the moment the market started anticipating the withdrawal of the Fed's unprecedented monetary aid, until its conclusion, the economy and financial markets evolved in a truly healthy fashion. In fact, at the time tapering ended in the US (October 2014) a quadruple positive effect of the decision to remove non-conventional monetary stimulus was easily observable: economy-wise, growth, inflation, manufacturing and services activity had all accelerated, unemployment preserved its downward trend and consumer and investor sentiments recorded favourable improvements; on the financial markets front, the US dollar appreciated not only against the euro, but also *vis-à-vis* other main currencies, the yield on the 10-year Treasury note dropped meaningfully and the stock market kept accumulating gains.

In Europe, with only three months left until ECB's tapering conclusion, it is manifest that the apex of the European economic recovery already belongs to the past (second half of 2017). Actually, the ECB is preparing to terminate its expanded asset purchase programme with the Euro Zone economy slowing down, core inflation still hovering 1% (harmonised inflation is close to central bank's goal [2%], mainly as a result of higher prices in the energy component), economic activity PMI indicators are far from their maximum levels of this business cycle, consumer and investor sentiments are deteriorating and the European stock market looks relatively fragile, accumulating year-to-date losses. On top of this arguably sufficient environment to end the extraordinarily expansionist monetary support, Europe has to cope with (1) an elevated political risk, with populism already taking hostage the third largest economy of the Euro Zone, (2) Trump's growing protectionist effort, bearing disruptive effects for international trade and (3) the weakness of the emerging economies bloc, to which Europe has exposure, namely through its financial sector.

Under such circumstances, we expect that, contrasting with the US Federal Reserve success, the – possibly premature – end of the stimulus programme by the ECB may give a substantial contribution to the deceleration of the European economy, with the lack of monetary support incrementing uncertainty and its adverse repercussions on the financial markets. Facing interest rates between zero and negative values, if the expanded asset purchase programme really comes to an end, the main foreseeable tool the ECB will be left with is creating flexibility for its reinvestment policy of coupons and debt reimbursements, on which, up until now, the central Bank, with a balance sheet amounting to EUR 4.6 billion, has not provided any material clues.

United States of America Federal Reserve	GDP Growth (2-quarter average) YoY %	Inflation - Core PCE (6-month average) YoY %	Unemploy-ment rate %	ISM PMI Composite (6-month average)	Consumer confidence (6-month average) 49,9 @ the beginning of QE	State Street Investor Confidence (6-month average)	EURUSD	US 10-Year Treasury Note (Yield %)	Stock market S&P500 level (% YTD)
Market starts antecipating tapering (05/2013)	1,5	1,5	7,7	54,7	66,4	94,4	1,2906	1,93	1.669 (16,1%)
Tapering begins (12/2013)	2,3	1,6	7,1	54,5	77,5	99,7	1,3685	2,89	1.810 (27,0%)
End of tapering (10/2014)	2,9	1,7	6,1	57,0	89,2	110,1	1,2613	2,31	1.995 (8,9%)
12 months after the end of QE(12/2015)	2,2	1,3	5,2	56,7	98,1	128,8	1,1006	2,14	2.079 (1,0%)
Euro Zone European Central Bank	**GDP Growth (2-quarter average) YoY %**	**HICP/Core CPI (6-month average) YoY %**	**Unemploy-ment rate %**	**Markit PMI Composite (6-month average)**	**Consumer confidence (6-month average) -3,6 @ the beginning of QE**	**State Street Investor Confidence (6-month average)**	**EURUSD**	**10-Year German Bund (Yield %)**	**Stock Market Stoxx 600 level (% YTD)**
Market starts antecipating tapering (10/2016)	1,9	0,2 / 0,8	9,8	53,0	-7,9	91,8	1,1204	-0,054	346 (-5,4%)
Tapering begins, with extension of programme's longevity (12/2016)	1,8	0,5 / 0,8	9,6	53,4	-7,4	90,0	1,0615	0,382	352 (-3,8%)
Last programme extension (06/2018)	2,6	1,4 / 1,0	8,2	56,4	0,4	104,3	1,1568	0,426	393 (+1,0%)
Present (3 months until the end of QE)	2,3	1,8 / 1,0	8	54,7	-0,4	99,4	1,1690	0,458	378 (-2,8%)

Source: Bloomberg; BiG Research;

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  - Accumulate, expected absolute return between +5% and +15%;
  - Keep/Neutral, expected absolute return between -5% and +5%;
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PSI20 Notes in the last 12 months as of 30th of September of 2018:

	Number of Recomendations	%
Accumulate/Buy	3	75.0%
Keep/Neutral	0	0.0%
Reduce/Sell	1	25.0%
Total	4	100.0%

Trading Ideas in the last 12 months as of 30th of September of 2018:

	Number of Recomendations	%
Profit Taking	11	61.1%
Stop Loss	6	33.3%
In Place	1	5.6%
Total	18	100.0%

Pair Trades in the last 12 months as of 30th of September of 2018:

	Number of Recomendations	%
Profit Taking	0	0%
Stop Loss	0	0%
In Place	0	0%
Total	0	0%

Source: BiG Research

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