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Hunt for yield

Low interest rates lead to higher risk tolerance

July 2019

- 10-year government bond yields and high yield spreads remain at low levels
- Fed funds rate still above 10-year U.S. government bond yield
- PMI data remains below 50 with the U.S. being the only exception
- Defensive positioning of investors

In line with the Federal Reserve's forward guidance, Chairman Powell prepared investors for a possible interest rate cut, scheduled to be announced at the end of July. The current market environment makes it increasingly difficult for investors to achieve a positive return without accepting higher risks. While risk is now inadequately compensated in the fixed income space, equities still offer considerable earnings yield as well as, to some extent, an attractive dividend yield. In fact, the "final phase" of a stock boom is often characterized by shares being bought by the "wrong investors" with the "wrong argument". Investors are therefore increasingly likely to focus on equities in their "hunt for yield". In anticipation of this trend, we used the already elevated and slightly increased risk premium as an argument to upgrade this indicator from + to ++. On the other hand, we have reduced our assessment of macroeconomic leading indicators from + to 0. The other indicators remain unchanged.

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Valuation Bonds: -

	low		**Yields**		high
	- -	-	0	+	+ +
New		X			
Old		X			

	low		**Spreads**		high
	- -	-	0	+	+ +
New		X			
Old		X			

Valuation Equities: +

	expensive		**Shiller PE**		cheap
	- -	-	0	+	+ +
New	X				
Old	X				

	low		**Risk Premium**		high
	- -	-	0	+	+ +
New					X
Old				X	

	Contraction		**Macro Leading Indicators**		Expansion
	- -	-	0	+	+ +
New			X		
Old				X	

	Euphoria		**Risk-Index**		Panic
	- -	-	0	+	+ +
New				X	
Old				X	

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The evaluation derived from our Navigator leads to the following decisions:

Assessment of asset classes remains unchanged: liquidity underweighted; fixed income neutral weighted; equities slightly overweighted.

Shifts within the asset classes:
European equities slightly overweighted at the expense of Japan, which is now slightly underweighted. Cat bonds newly underweighted.

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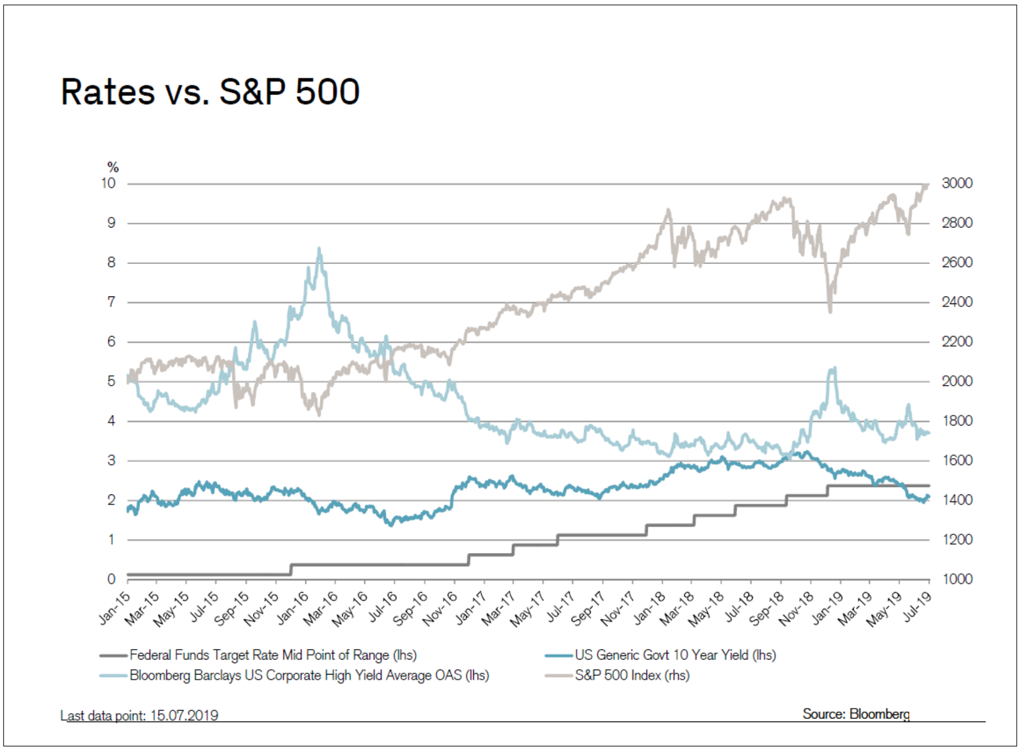
Interest rate level (assessment indicator -) / Spreads (assessment indicator -)

Assessment unchanged / Assessment unchanged

Interest rates on 10-year government bonds and the risk premium on high yield corporate bonds remain at low levels. In the fixed income investment universe, investors are inadequately compensated for the risk they accept.



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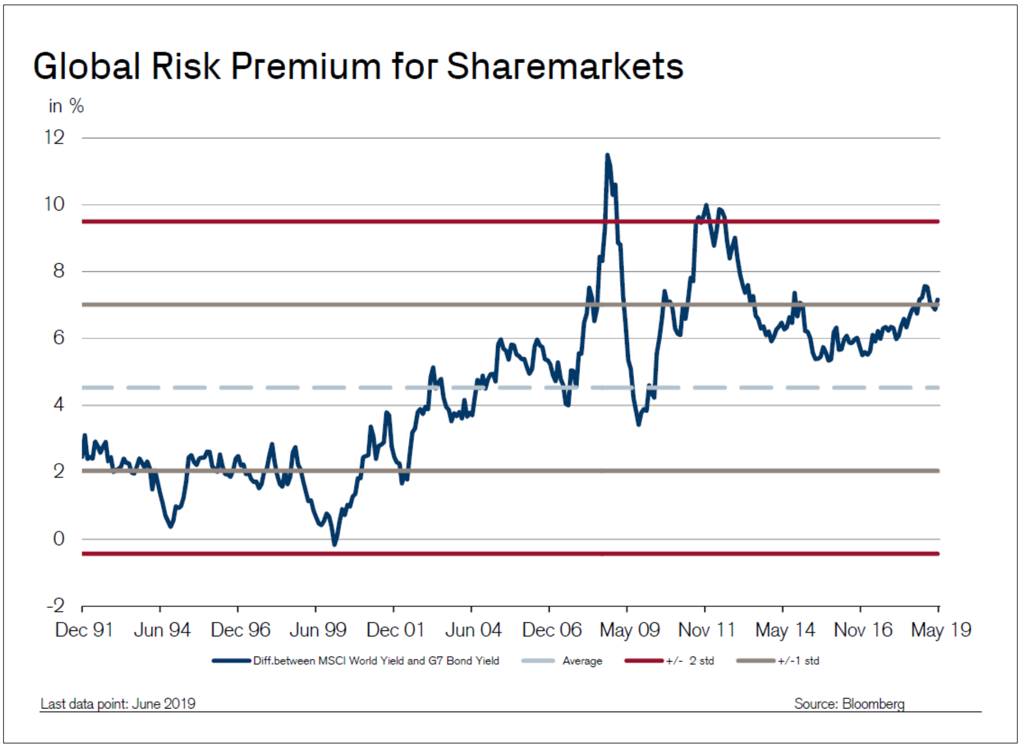
Shiller P/E (assessment indicator --) / risk premium (assessment indicator ++)

Assessment unchanged / Assessment changed from + to ++

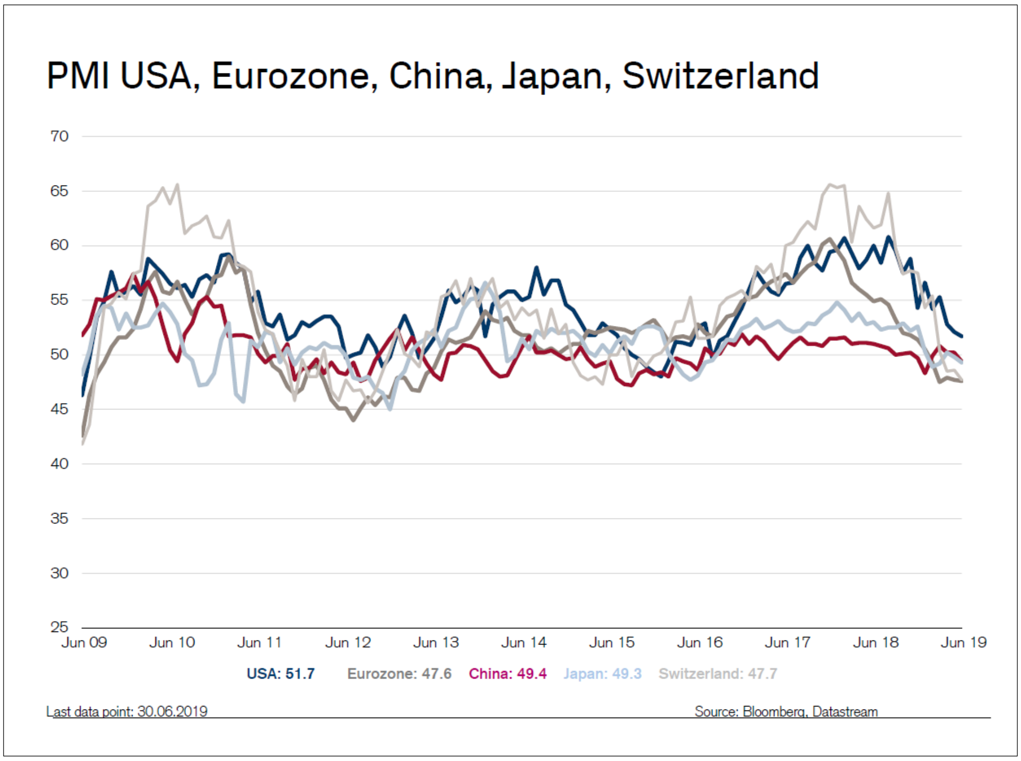
The absolute valuation of the U.S. stock market as measured by the Shiller P/E ratio remains unattractive. By contrast, the relative valuation of equities against government bonds remains attractive and even exhibits an upward trend (driven by falling yields on U.S. government bonds). This should increasingly become the main argument in favour of equities, rather than the naive TINA (there-is-no-alternative) paradigm.



Macro leading indicators (assessment indicator 0)

Assessment changed from + to 0

The U.S. remains the only expanding economy in our data table. Hence, we are downgrading our assessment of macro leading indicators from + to 0. However, we continue to expect that a forward-looking Fed and a U.S. president eager for re-election will make a recession unlikely (for the time being).



Risk index (assessment indicator +)

Assessment unchanged

The risk indicator continues to positively affect our overall assessment due to the persistence of an extremely negative sentiment regarding risk assets as well as a continuously defensive positioning of investors.