

Investment Report

May 2020

Market Themes

May 2020

I. What are markets discounting? (pp. 5-9)

- Using a *nowcasting* approach we examine how soon a recovery needs to be visible in the data in order to meet market expectations. Quite quickly, is the answer.

II. What are markets *not* discounting ? (pp. 8-12).

- Credit, consumer demand, and deflationary pressures will constitute headwinds to the expected V-shaped recovery. Equity prices leave little room for such *second-round effects*. Dispersion between sectors has reached a minimum. What are the implications?

III. Hedge Assets Suspended (pp. 13-15)

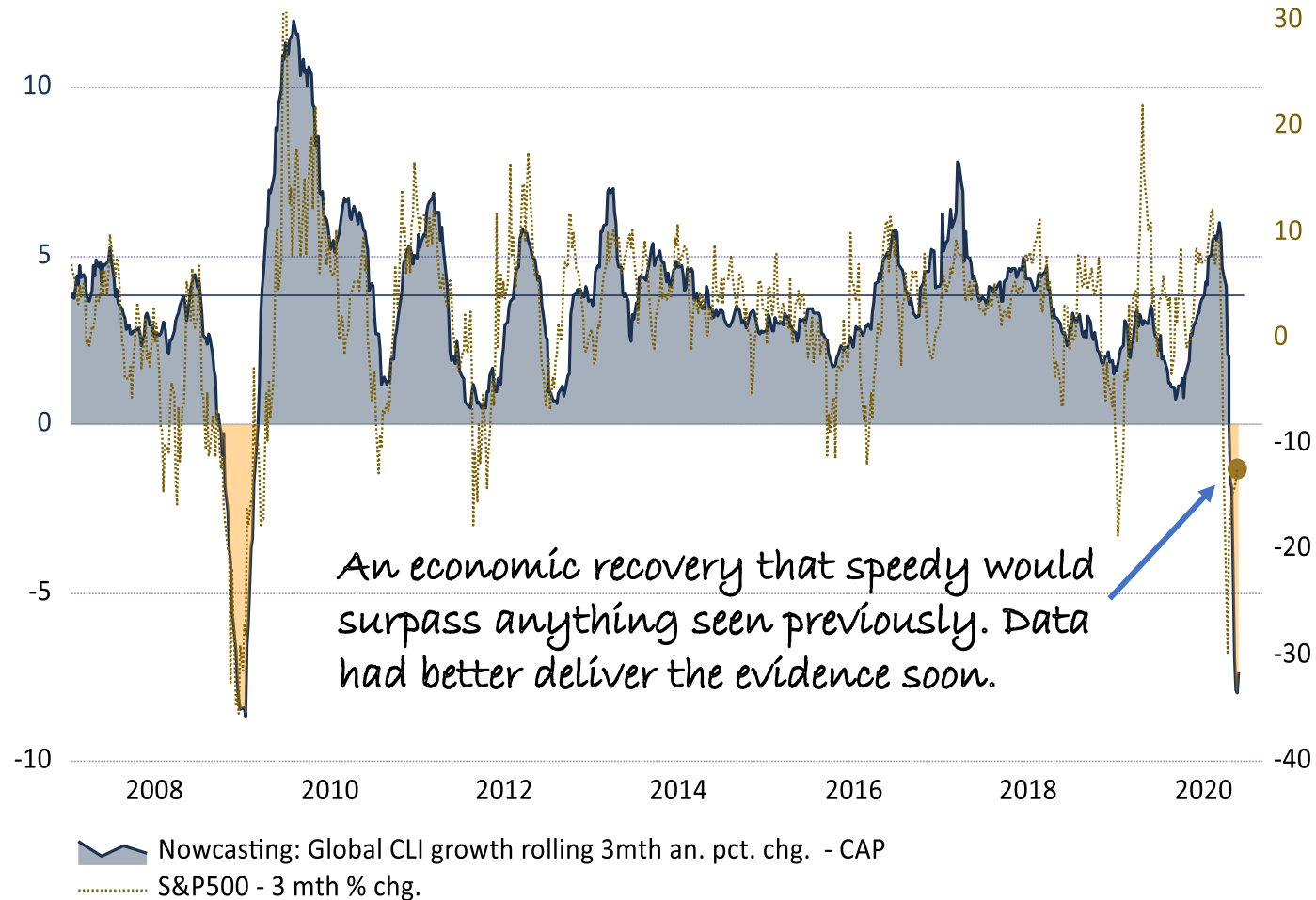
- Which hedge assets have worked in the current crisis? The answer is that the list has been reduced considerably, leaving portfolios with less protection for risk assets.

What are markets discounting? A look at our nowcasting model

Are investors over-trading the economic delta this time?

Global Growth & S&P500.

Weekly data

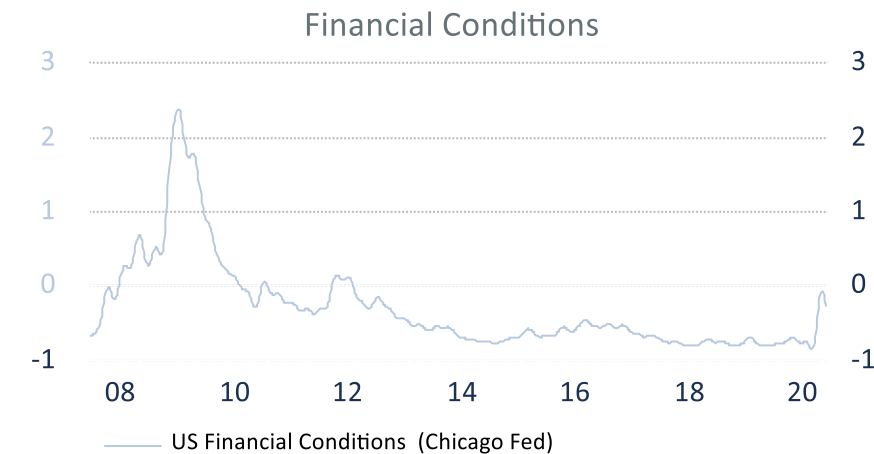
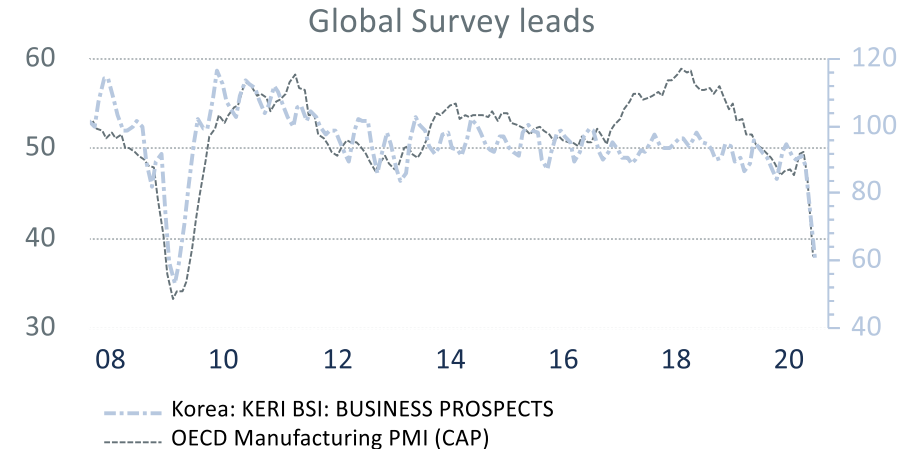
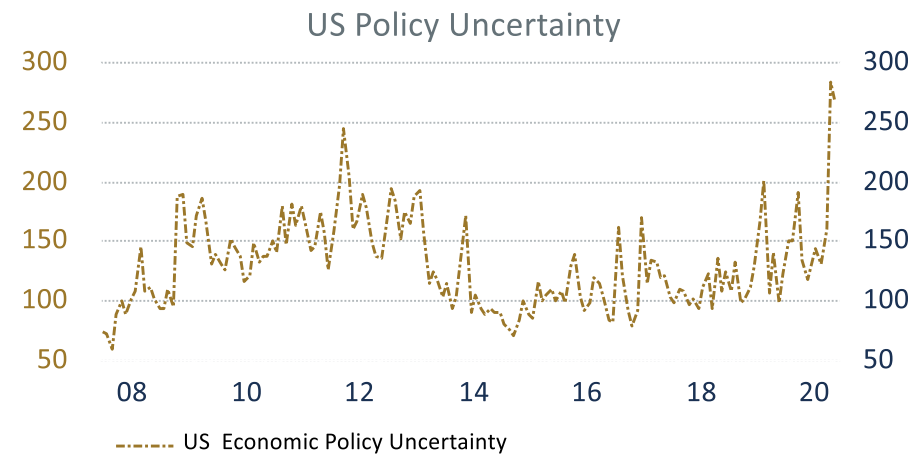
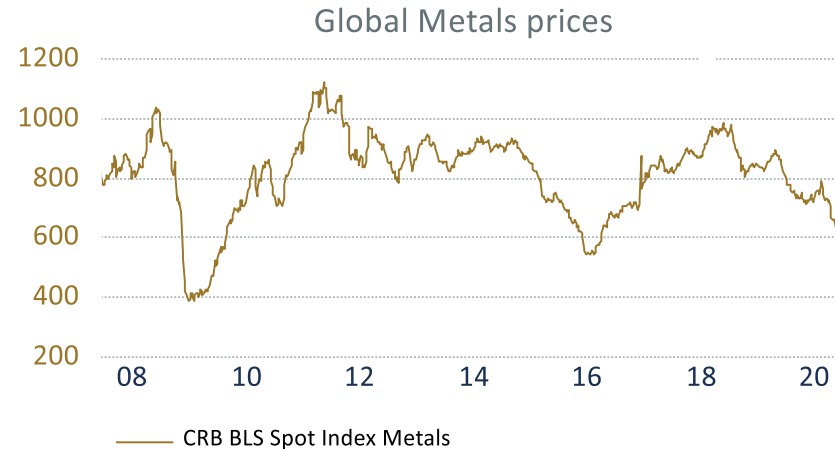


According to our nowcasting model, the 3-mth decline in the S&P 500 by late March corresponded to a drop in 3-mth quarterly annualized global GDP growth of 7.8%.

Reverse engineering this, the current 3-mth decline in the S&P500 of approx. 12% corresponds to drop in global GDP growth of only 1% over April-June.

Nowcasting

Global GDP - input variables



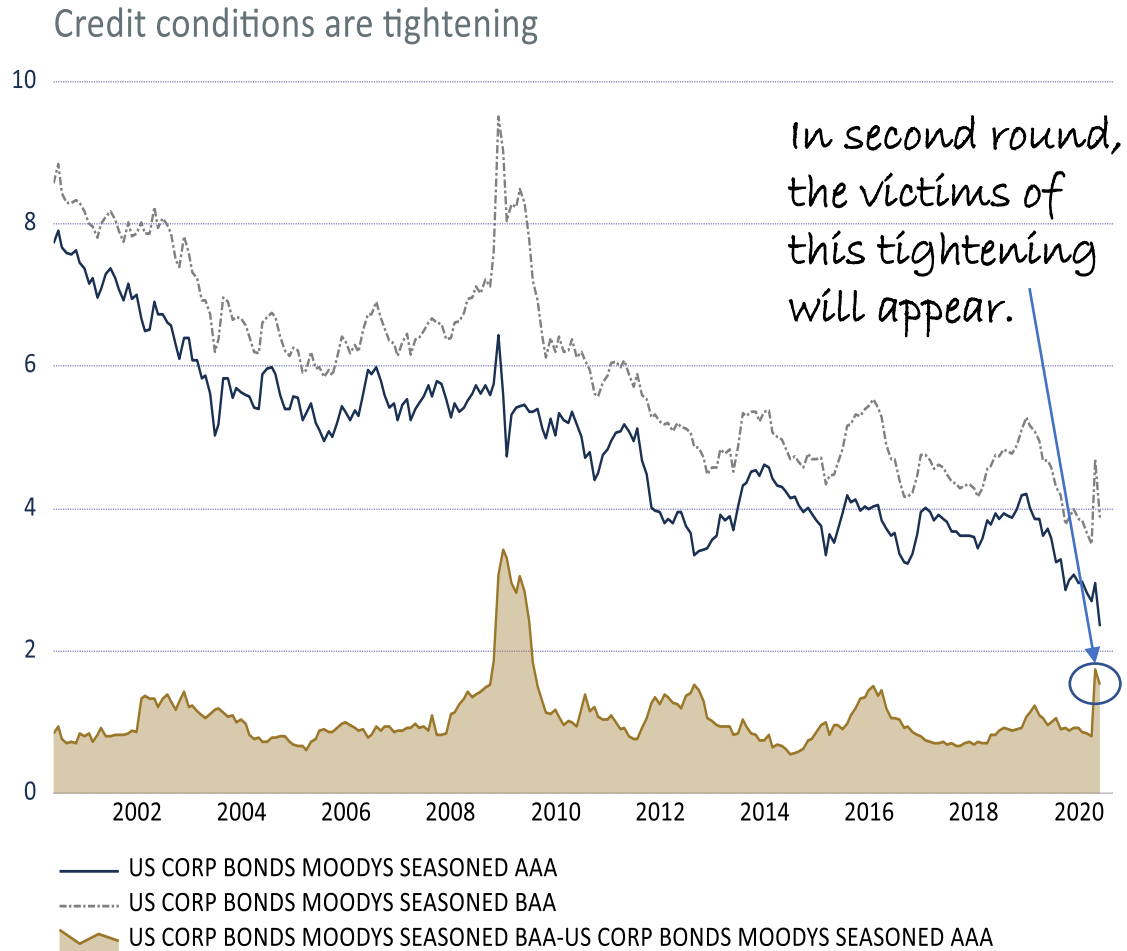
Source: Refinitiv Datastream, C.A.P

The downtrend in metals prices has so far been slow. Will it accelerate?

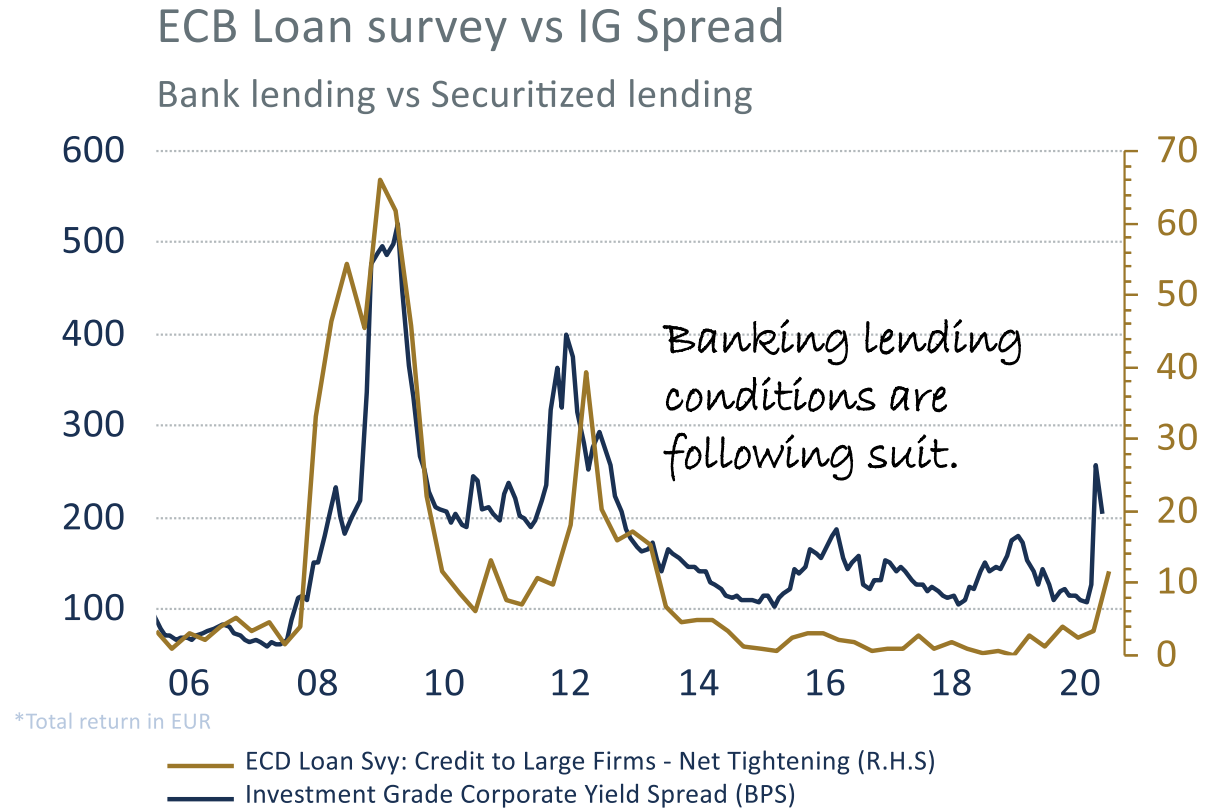
Policy uncertainty looks likely to improve, but the election year is unhelpful

Global PMIs around 38 still have room to get worse over May-June.

US Financial conditions are nowhere near the level of distress seen in the GFC. The Fed backstop has clearly worked but may have less to deliver going forward.

What are markets **not** discounting? Credit contraction

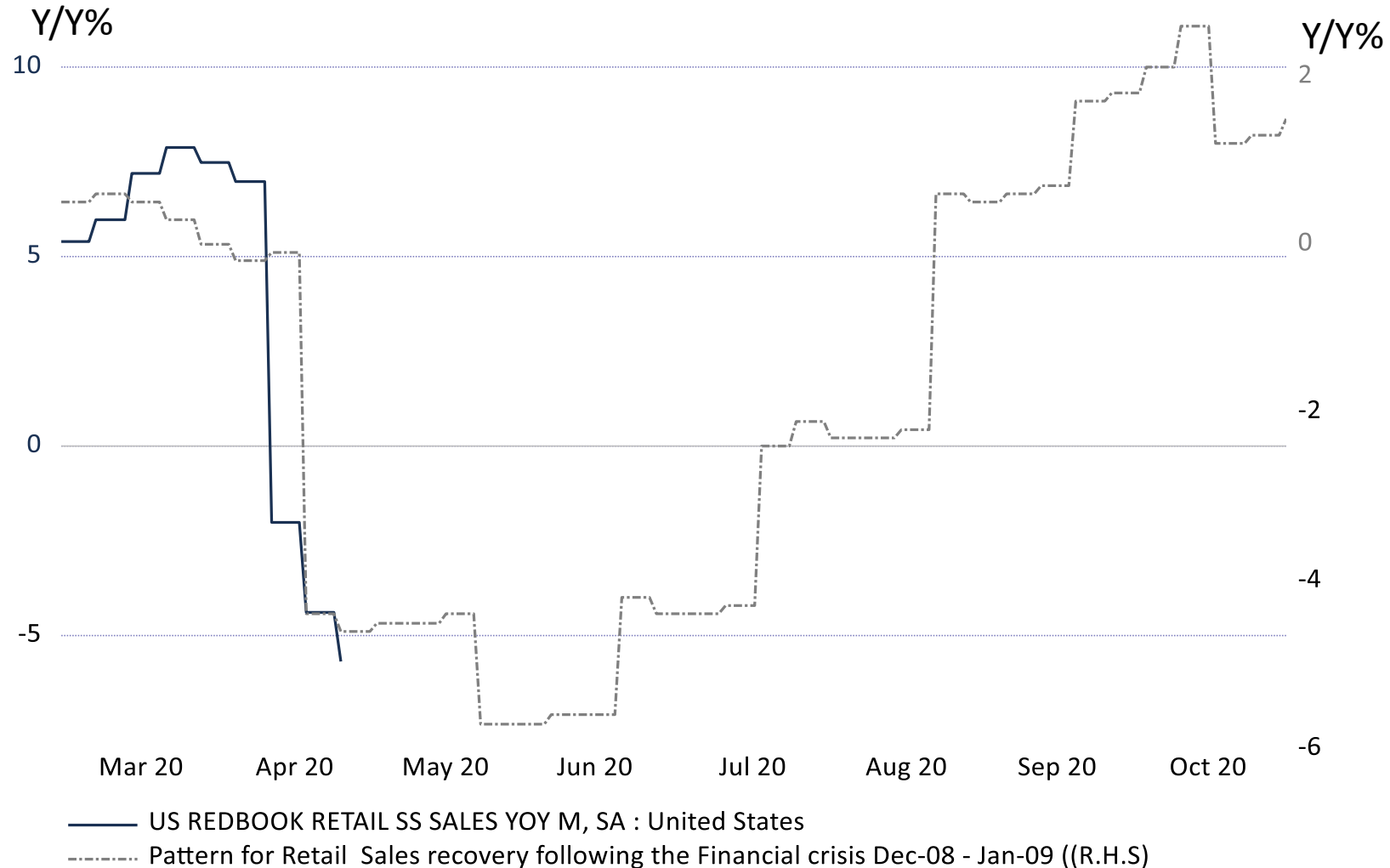
Source: Refinitiv Datastream



Source: Refinitiv Datastream, C.A.P

Even though the GFC intensified much more gradually than the present crisis, the collapse in retail sales happened at a similar speed and was concentrated on a few months in late 2008.

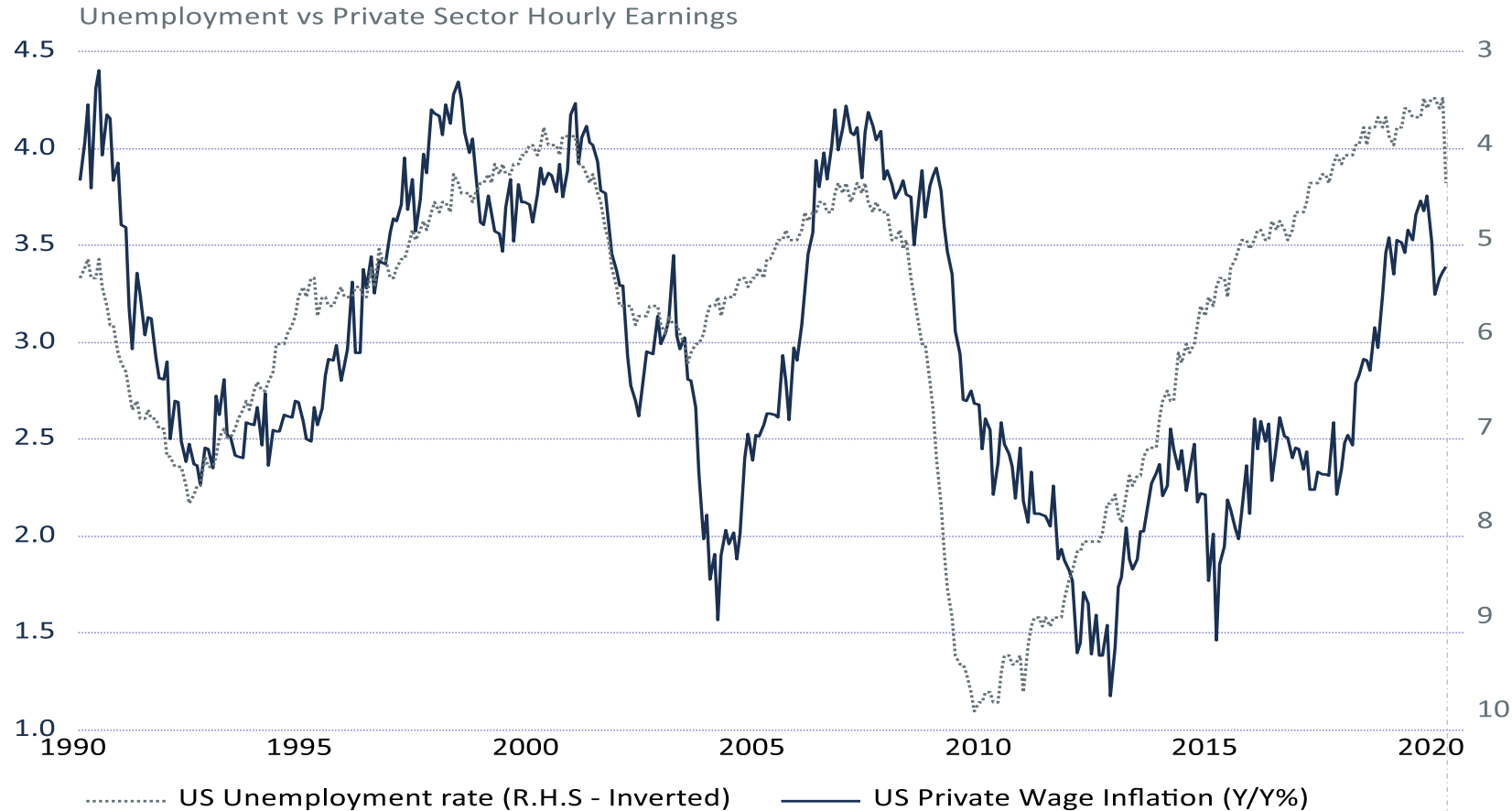
Redbook weekly retail sales tracker. Now and at the GFC



A positive second-round effect from pent-up demand kicking in is just as clear this time.

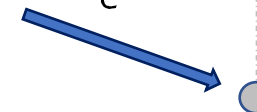
What is less obvious is why it should happen much faster than in the GFC. A recovery to the level prior to Corona might not be seen before Late Q3.

The US job market: The most deflationary force ever?



Source: Refinitiv Datastream

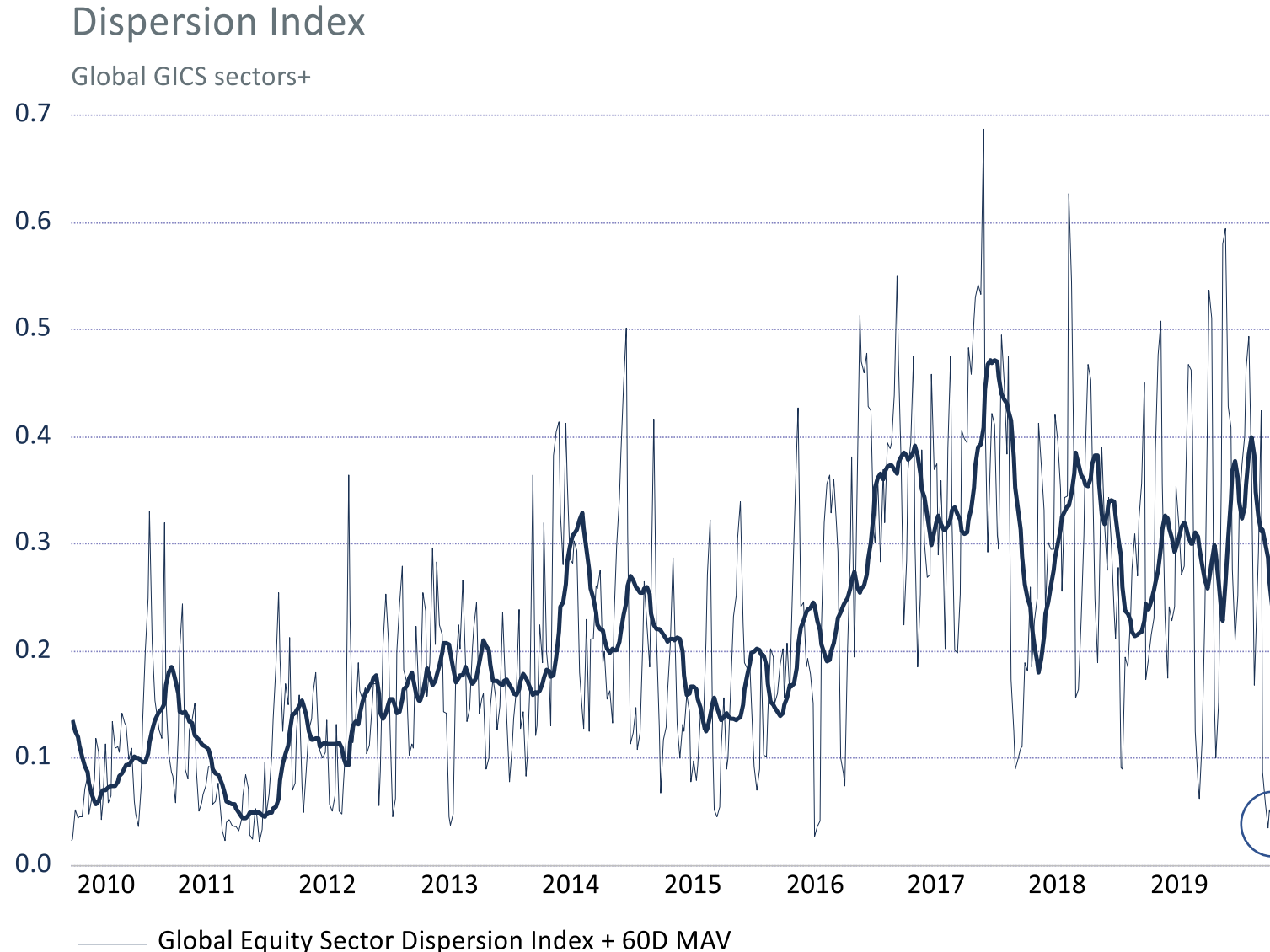
April u-rate 15%



Unemployment might fall to 10%-15% in H2-20. Beyond that further declines will likely be longer-drawn.

In the second round, wage inflation looks set to move to zero or below, which will hit both consumption and debt servicing VERY hard.

Second-round effects: from convergence to dispersion



A low dispersion of between sector returns corresponds to a high correlation of returns.

It has reached an extreme low in the present crisis as all sector became more exposed to general market beta.

In the second round, we will likely see greater performance difference between winners and losers.

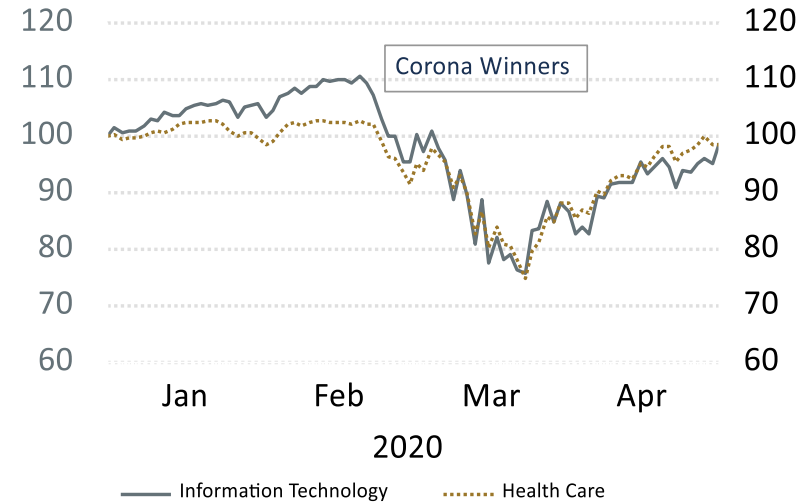
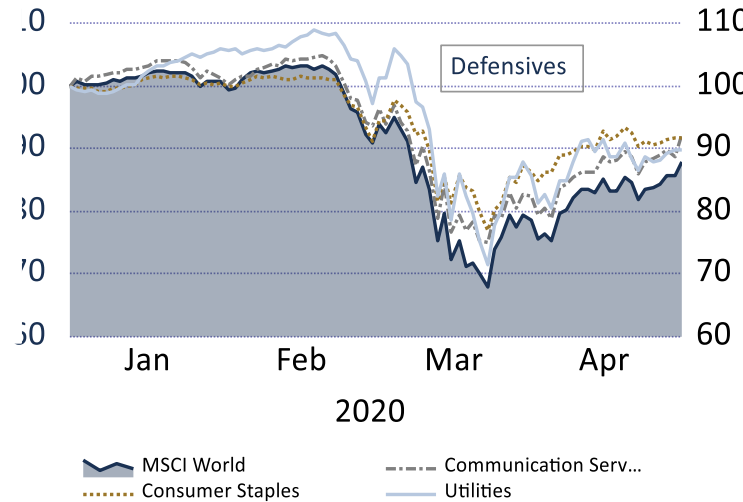
Source: Refinitiv Datastream

Second-round effects: from convergence to dispersion

Greater sector dispersion likely in second round.

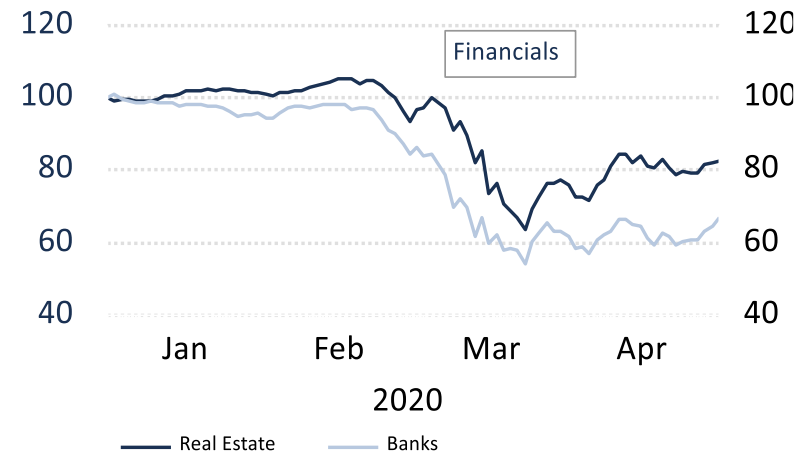
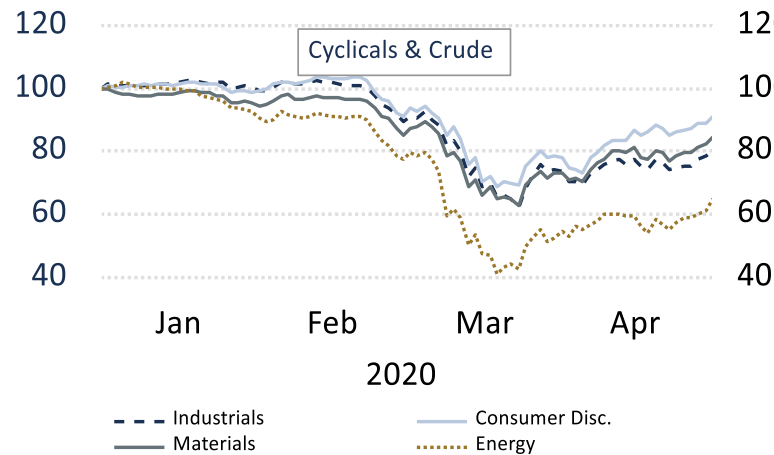
Index 100 = Jan 1, 2020

As expected, defensives as a group have done better than cyclicals and Financials.



High performance of IT & Healthcare as long as Corona is the only market theme; hardly after.

Cyclicals are candidates for underperformance in 2nd round.

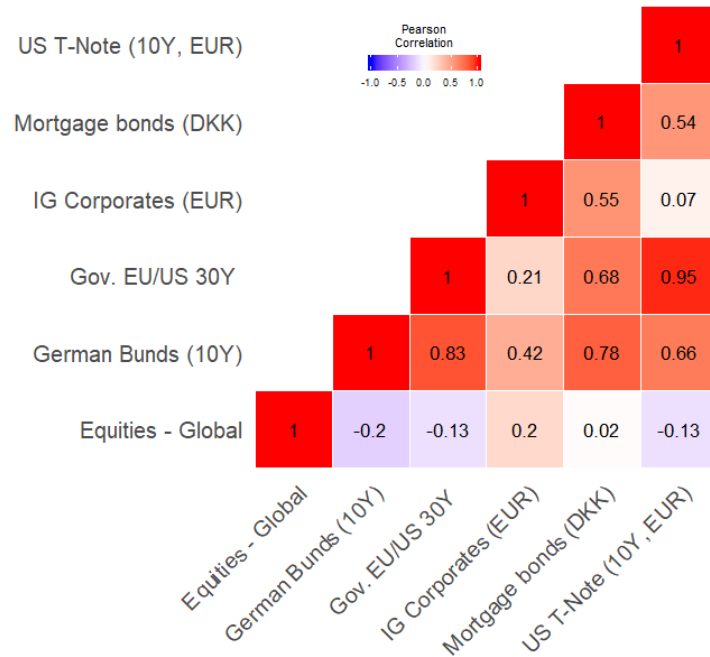


Real Estate looks like a candidate for underperformance in second round.

US Treasuries: the only game in town?

1998 – 2020

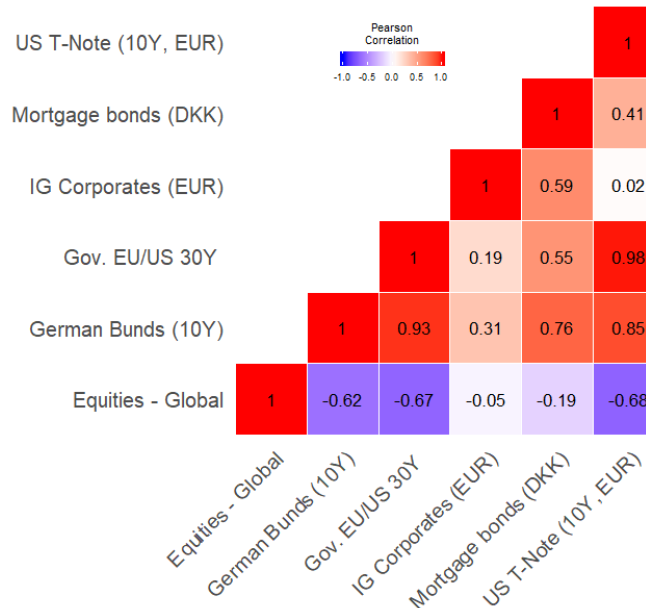
Based on total returns; weekly data



The long-term picture shows zero or slightly negative correlations between equity and bond market returns.

Aug-08 - Mar-09

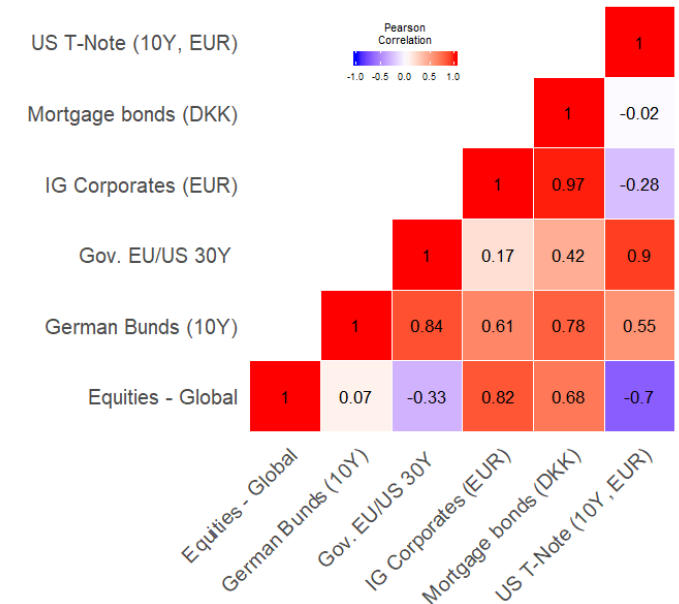
Based on total returns; weekly data



IG Corporates were uncorrelated with equities during the GFC, but both USTs and Bunds offered an attractive negative correlation to stocks, and Danish mortgage bonds did so to a lesser degree.

Dec-19 - Mar-20

Based on total returns; weekly data

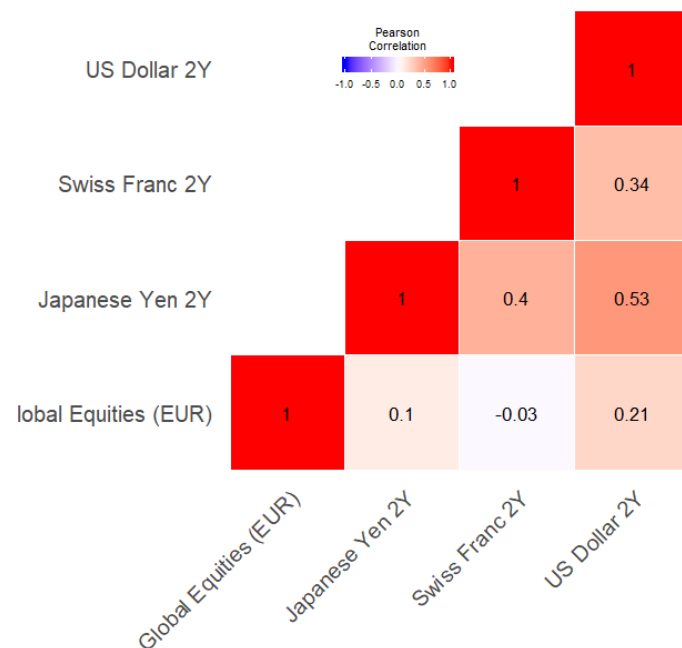


Not so this time: USTs had the same hedge capacity as in the previous crisis, but Bunds had nothing to offer and Danish mortgage bonds got dragged into the crisis.

Is JPY the only hedge currency left?

1998 – 2020

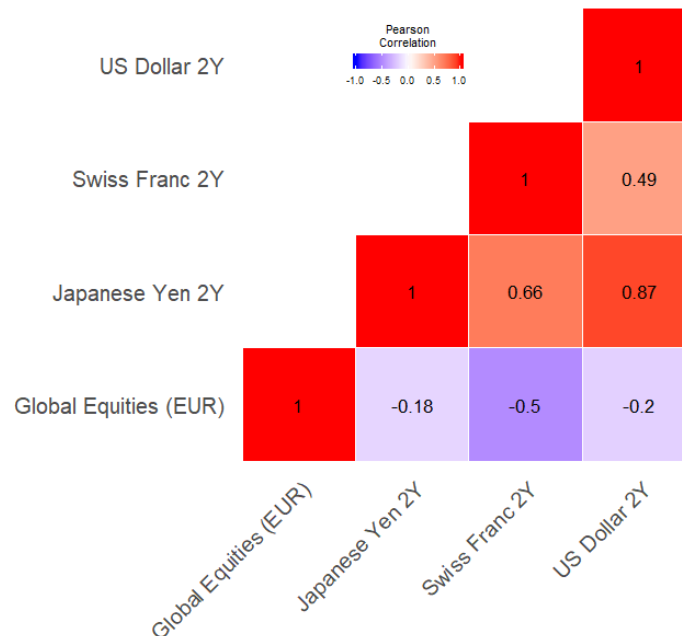
Based on total returns; weekly data



Long-term picture similar to that of stocks vs. bonds: hard currency returns from the point of view of a euro-based investor exhibit zero or slightly negative correlations to stock returns.

Aug-08 - Mar-09

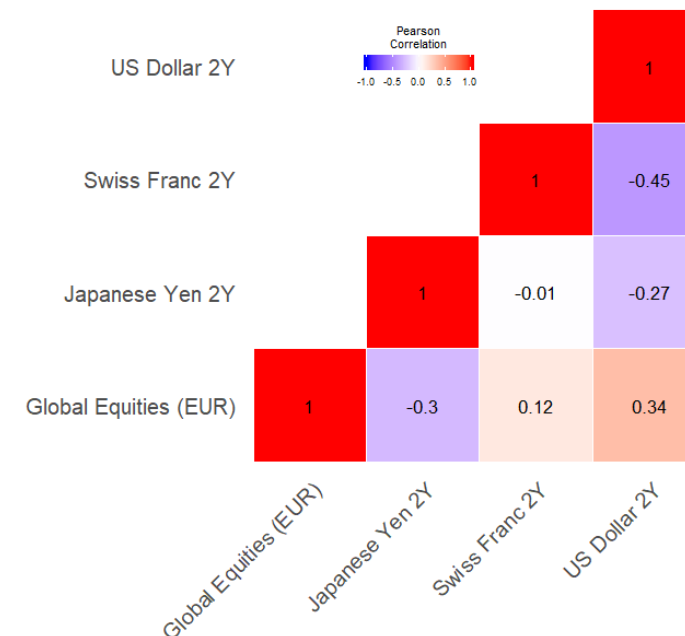
Based on total returns; weekly data



But exposure to the CHF offered a good counterweight to equity risk and less so the JPY and the USD.

Dec-19 - Mar-20

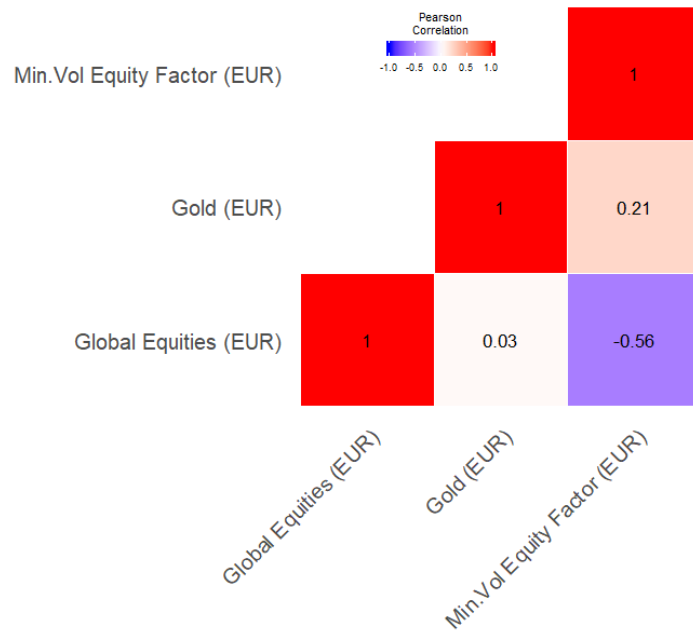
Based on total returns; weekly data



The USD has fared reasonably well against the EUR since the crisis began. But its correlation to equities has been positive. No sign of any hedge capacity on the part of the CHF in this crisis.

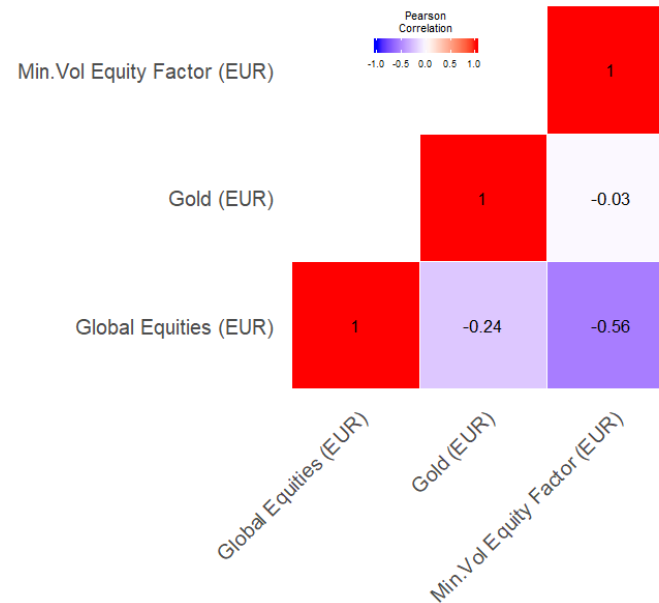
Gold and Min.Vol Factor: None of the two passed the Corona-Test

1997 - 2020



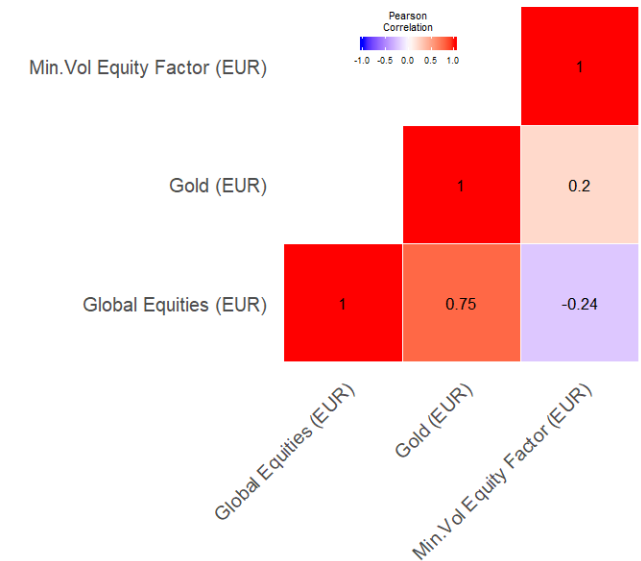
Annual returns on both gold and the Min. Vol. equity factor were in the low single digits over the past 10 years. But Min.Vol. delivered a negative correlation to equities.

Aug-08 - Mar-09



Both assets offered a good counterweight to equity risk in the previous crisis

Dec-19 - Mar-20



Gold has so far delivered a positive return since the crisis began. But its correlation to equities has been much higher than before. The Min.Vol equity factor has delivered much less hedging than its long-term performance would suggest.

Our Asset Allocation

May 2020

Summary: Our Asset Allocation

We maintain the same overall defensive positioning in risk assets from last month. Our top-down climate indicator is still very negative.

In our hedge portfolio, we overweight short duration EZ gov. bonds and hold IG bonds as an underweight.

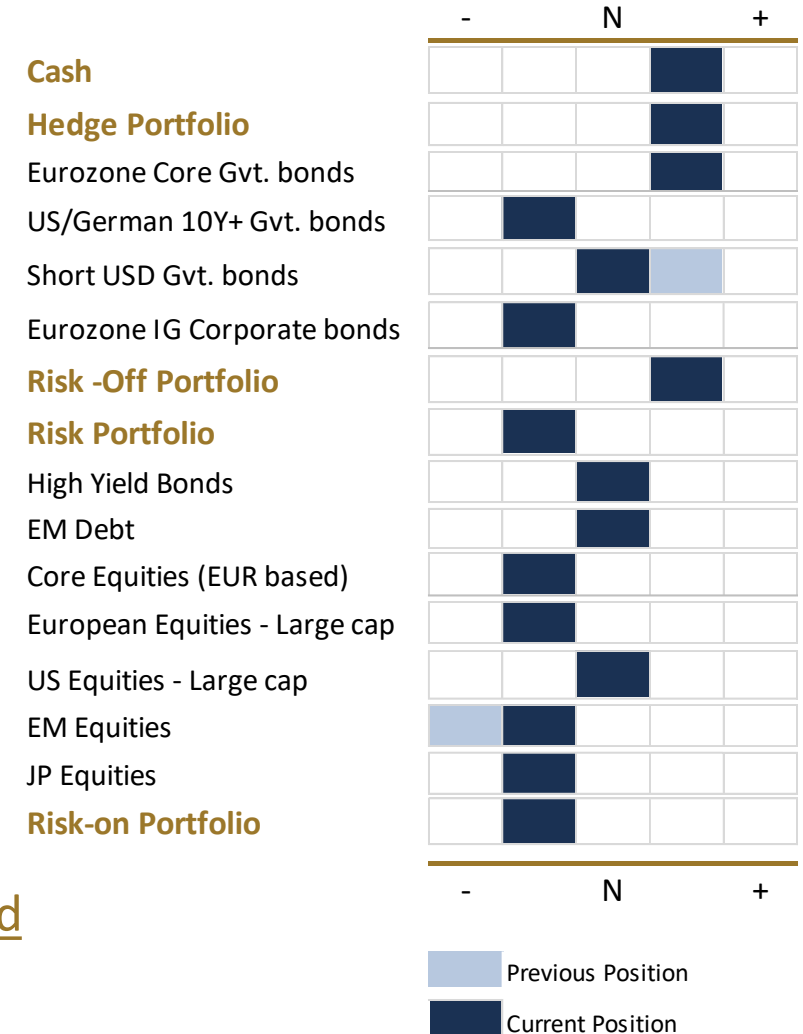
We have reduced our exposure to USD bonds.

In our Risk portfolio we stay underweight in European, EM and JP equities while holding High Risk credits and US equities in Neutral positions.

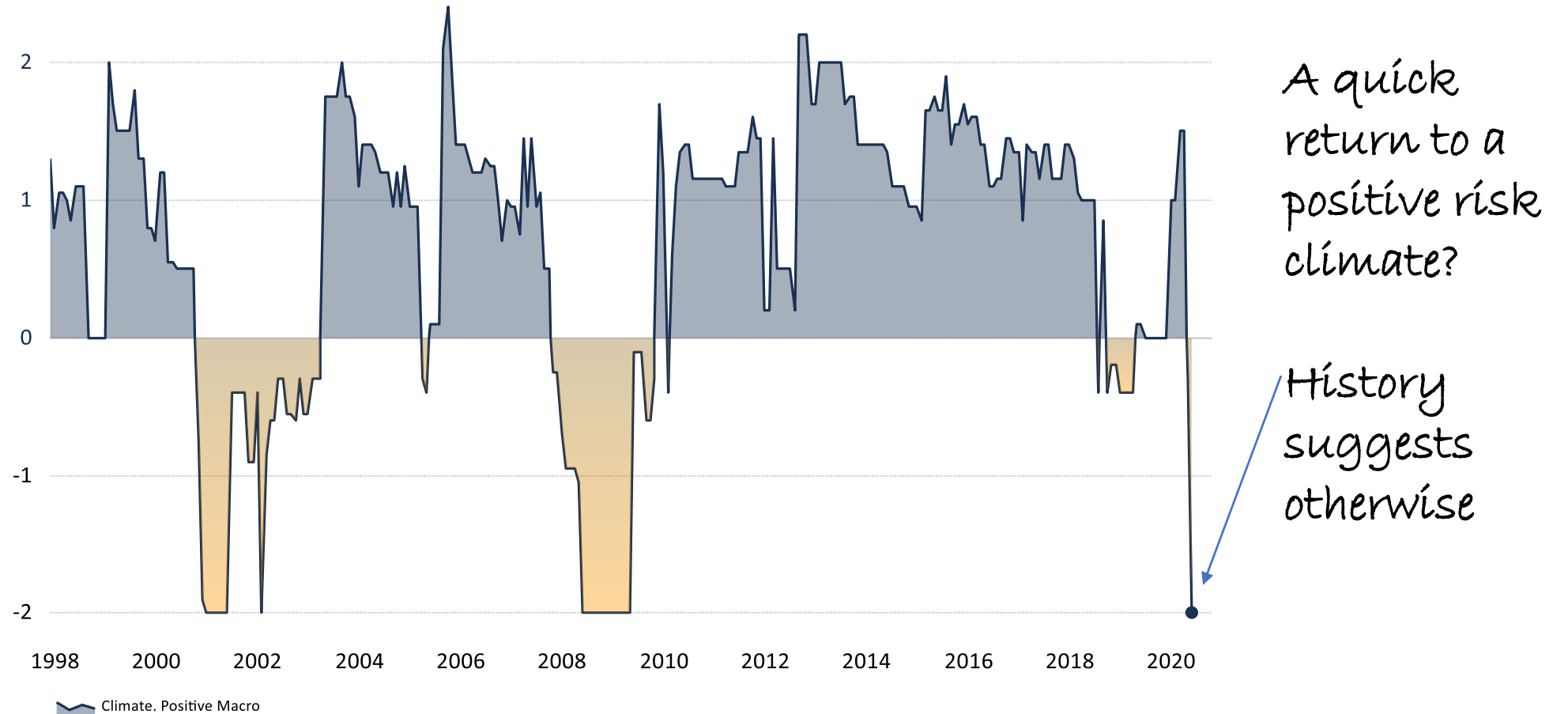
Our Cross Asset Portfolio Model is implemented in our CAP-M fund. See also: <https://c-a-p.dk/our-fund>

Our monthly in-depth allocation report
<https://c-a-p.dk/cap-scan-may-2020/>

Cross Asset Portfolio Model (CAP-M) (*)



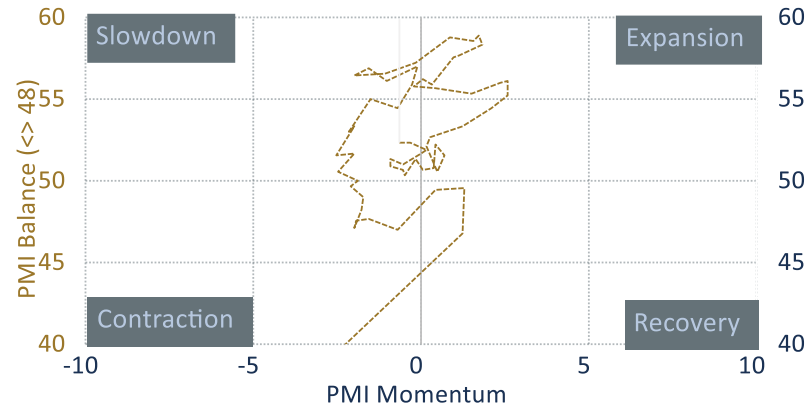
(*) (-) Underweight positions: <-25%, <-10%
 (+) Overweight positions : >+10%, >+25%
 (N) Neutral position : > -5%, < +5%



Source: Refinitiv Datastream, C.A.P

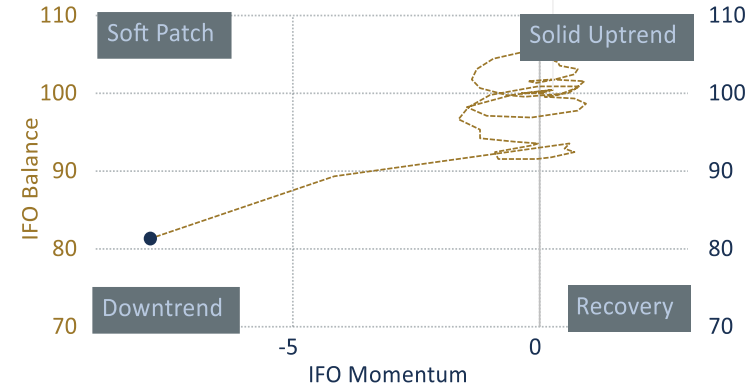
CAP Aggregate Macro Filter - Components

Macro Filter: PMI cycle



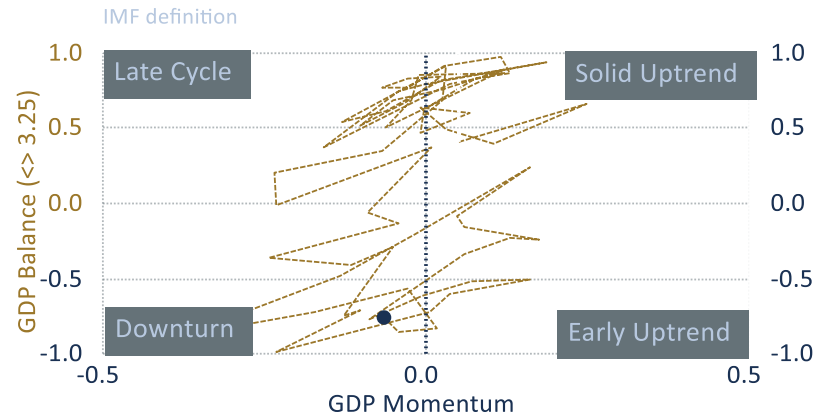
Filter scores: Recovery (2), Expansion(1), Slowdown (0), Contraction (-2)

Macro Filter: IFO cycle



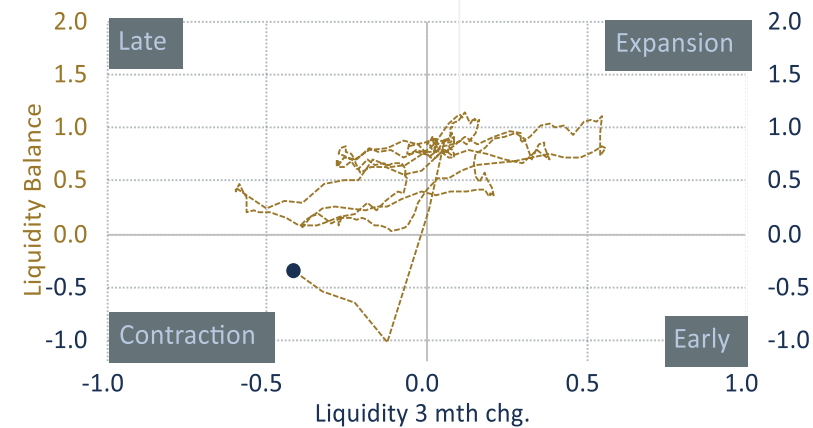
Filter scores: Recovery (2), Solid Uptrend (1), Soft Patch (0,5), Downtrend (-1)

Macro Filter: Global GDP growth



Filter scores: Early Uptrend (2), Solid Uptrend (1), Late Cycle (0.5), Downturn (-2)

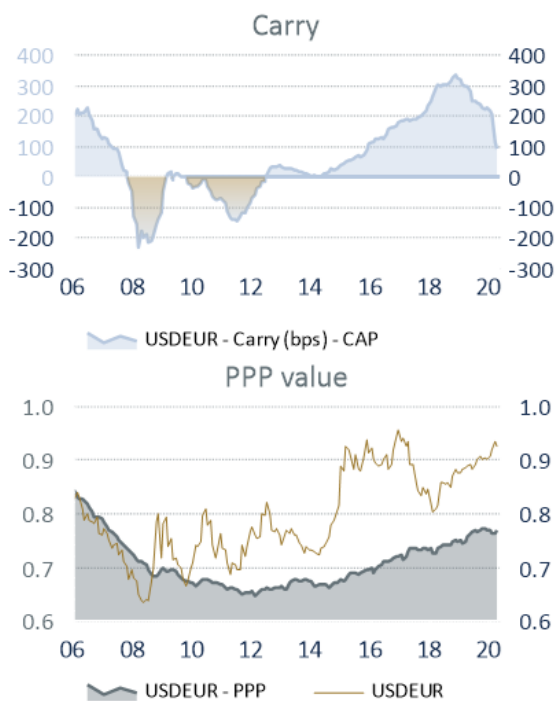
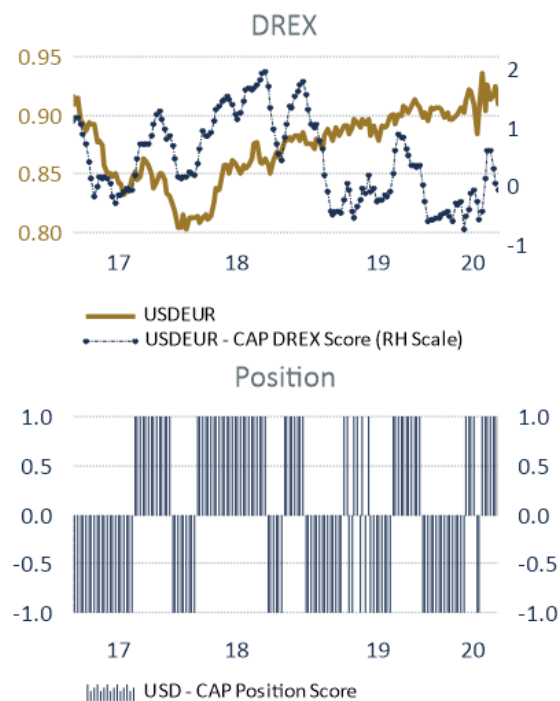
Macro Filter: Liquidity cycle



Filter scores: Early (0), Expansion(2), Late (1), Contraction(-2)

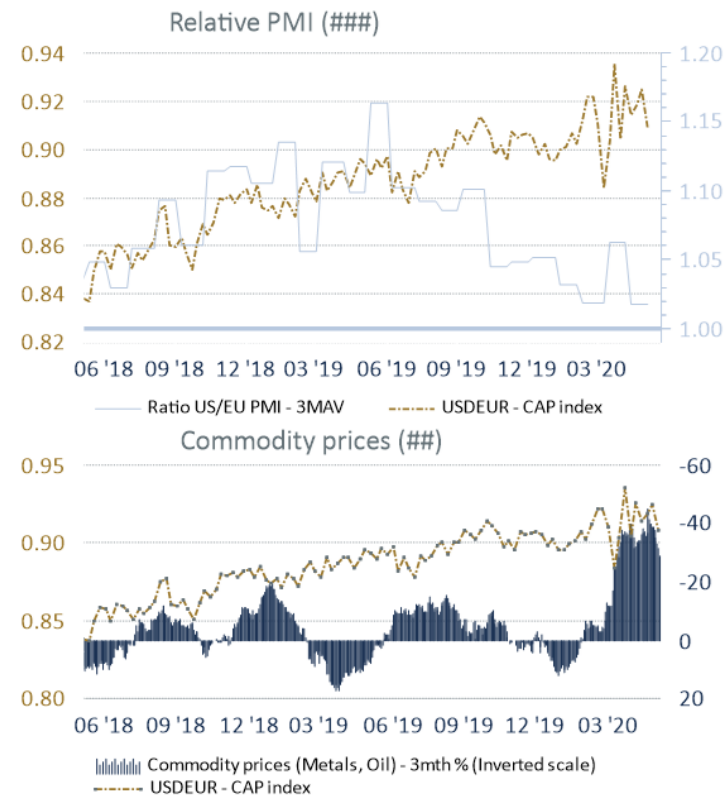
US Dollar USDEUR

DREX & factors



Source: Refinitiv Datastream, C.A.P

Short-term macro



Source: Refinitiv Datastream, C.A.P

US Equities

Asset Class Details

	11-May	-1m	-3m	-1y	ytd
Performance	Change in % / levels				
Total return	5803	14.3%	-13.4%	-1.5%	-11.5%
Trend EPS Growth	-7.2%	-1.3%	1.4%	5.2%	1.5%
Fwd EPS rev 3 mth	-18.5%	-8.1%	0.4%	1.7%	-0.6%
Valuation to Trend	95.8	94.7	109.2	92.6	92.2
DREX Score (*)	Change in points				
Macro	-1.5	-0.8	-2.4	-2.3	-2.6
Valuation	0.0	-1.0	0.0	0.0	0.0
Earnings	-1.5	0.5	-3.5	-3.5	-3.5
Position	0.0	1.0	-1.0	-1.0	-2.0
Total	-1.0	0.4	-2.3	-2.3	-2.7

(*) Dynamic Return Expectations Index. Scale: -2 to +2

European Equities

Asset Class Details

	11-May	-1m	-3m	-1Y	ytd
Performance	Change in % / levels				
Total return	222	8.9%	-17.4%	0.0%	-19.2%
Trend EPS Growth	-14.1%	-3.1%	-0.9%	5.6%	-1.5%
Fwd EPS rev 3 mth	-18.9%	-3.2%	0.0%	0.9%	-0.7%
Valuation to Trend	85.3	80.9	84.7	83.6	83.5
DREX Score (*)	Change in points				
Macro	-2.0	-2.0	-2.2	-2.8	-2.8
Valuation	0.0	-1.0	0.0	0.0	0.0
Earnings	-2.0	0.0	-2.0	-1.0	0.0
Position	0.0	0.0	1.0	0.0	-2.0
Total	-1.8	-0.4	-2.4	-2.4	-2.3

(*) Dynamic Return Expectations Input. Scale: -2 to +2

Emerging Equities

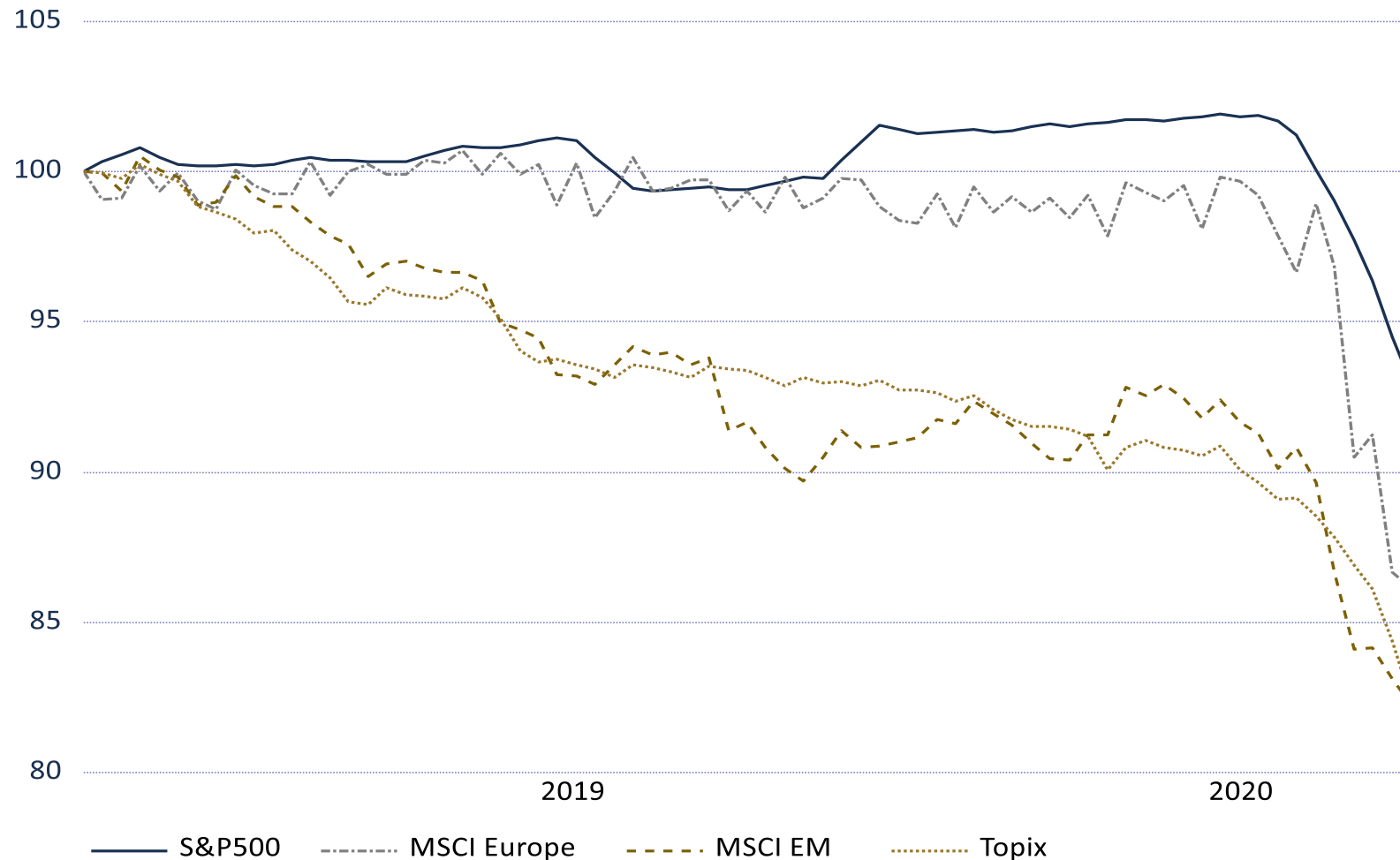
Asset Class Details

	12-May	-1m	-3m	-1y	ytd
Performance	Change in % / levels				
Total return	2127	10.4%	-15.6%	-12.7%	-17.6%
Trend EPS Growth	-15.0%	-11.2%	-6.5%	-7.0%	-9.6%
Fwd EPS rev 3 mth	-17.0%	-10.6%	1.5%	-2.2%	2.0%
Valuation to Trend	94.2	91.2	98.9	92.7	92.7
DREX Score (*)	Change in points				
Macro	-1.6	0.0	-2.9	-2.2	-3.2
Valuation	0.0	0.0	0.0	0.0	0.0
Earnings	-1.5	0.0	-3.0	-2.0	-2.0
Position	0.0	0.0	0.0	0.0	-1.0
Total	-1.6	0.0	-2.9	-2.2	-3.2

(*) Dynamic Return Expectations Input. Scale: -2 to +2

US Equities continue to shine *relative* to other regional markets

Since 2019, The US profit cycle has shown much greater resilience to the global business cycle than seen in other markets. There is no obvious reason why this should change.



Global High Yield

Asset Class Details

	11-May	-1m	-3m	-1y	ytd
Performance	Change in % / basis points				
Total return	1146	3.1%	-10.0%	-4.5%	-9.3%
Rate Avg.	8.28	-126	308	238	319
Carry	795	-69	385	373	410
Spread(bps)	8.35	-57	416	392	424
DREX Score (*)	Change in points				
Macro	-1.7	-0.4	-2.3	-3.2	-3.1
Valuation	1.0	0.0	2.0	2.0	2.0
Carry-Roll	1.0	-1.0	3.0	3.0	3.0
Position	-2.0	-1.0	-4.0	-4.0	-3.0
Total	-1.0	-0.7	-1.3	-1.7	-1.3

(*)Dynamic Return Expectations Input

Emerging Debt (Hard ccy)

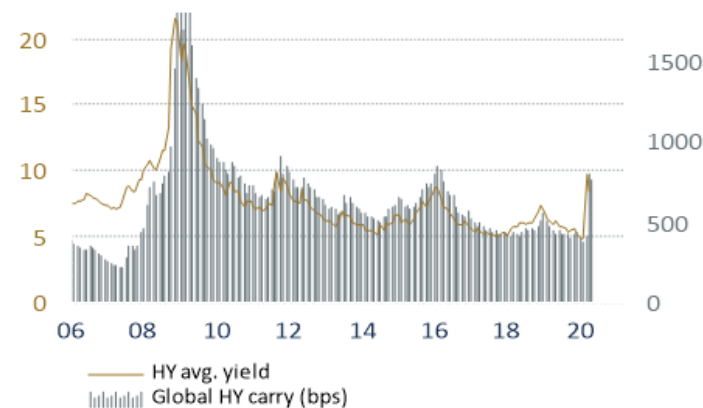
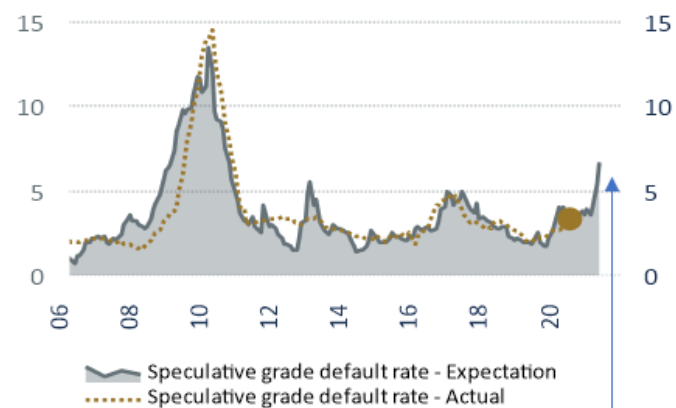
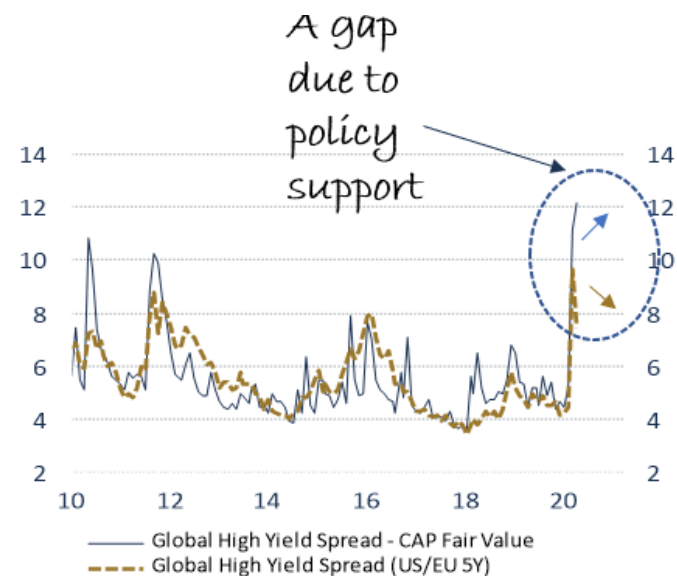
Asset Class Details

	11-May	-1m	-3m	-1y	ytd
Performance	Change in % / basis points				
Total return	412.5	1.4%	-7.4%	1.0%	-5.5%
Rate Avg.	5.64	-76	199	105	176
Carry	531.3	-19	276	241	267
Spread(bps)	2.64	-50	109	133	143
DREX Score (*)	Change in points				
Macro	0.1	0.5	-0.3	0.1	0.1
Valuation	1.0	0.0	1.0	1.0	1.0
Carry-Roll	1.0	0.0	3.0	2.0	3.0
Position	-2.0	-1.0	-3.0	-4.0	-2.0
Total	0.1	0.0	0.1	-0.2	0.6

(*)Dynamic Return Expectations Input

Low Quality Credits hold *relative* attractive risk/reward profiles

Global High Yield (USD/EUR)



Source: Refinitiv Datastream, C.A.P

Now, Default rate expectations are the highest since GFC

