Market Update & 2020 Outlook

January 2020

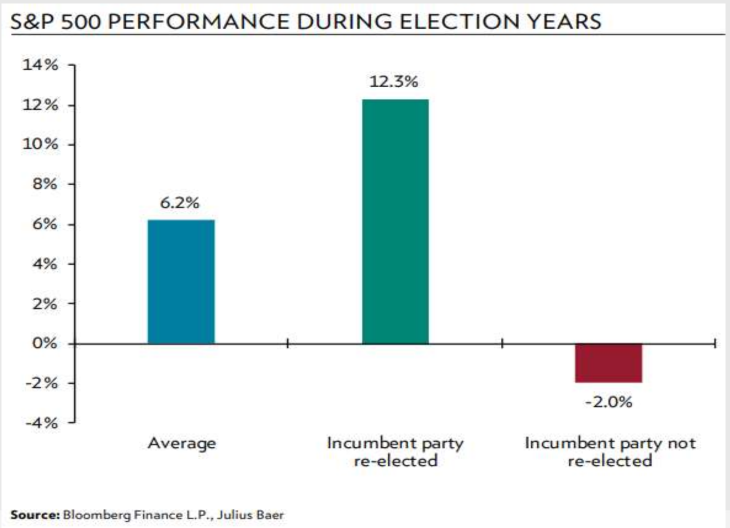
Market Update

2019 Market Performance: Stellar returns and record highs

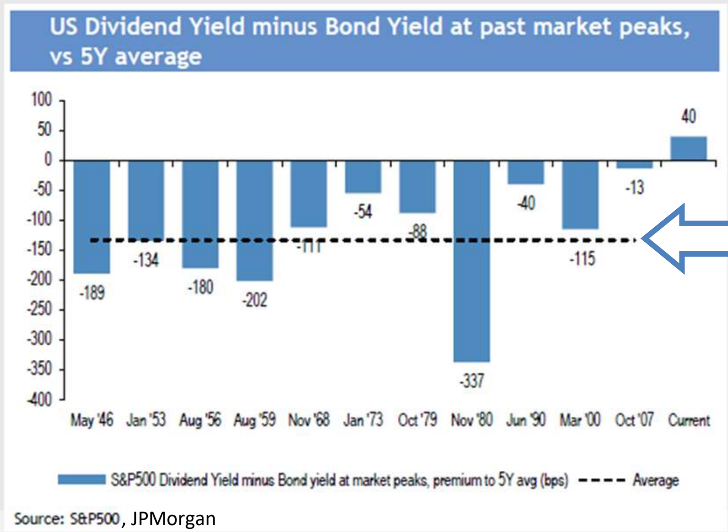
- 2019 market performance was stellar, with equities reaching record highs (S&P 500 delivered over +31% in total return) and bonds also performing strongly (USD investment grade bonds recorded a return of over +17%).

2020 Market Outlook: bouts of volatility expected but positive overall

- **US elections likely to provide market support:** S&P 500 returns tend to be solid during elections years, particularly when the incumbent party gets re-elected. Historically (since 1928), the average return in those years was +12.3% (see chart below).
- **Valuations not particularly expensive:** S&P 500 is trading on a c.18.5x earnings multiple which is within 10% of its historical average, so equity valuations are still quite undemanding. US dividend yields are also higher than bond yields, suggesting we are not nearing a market peak yet (see below).
- **Geopolitical instability could lead to volatility:** There is currently a risk that the Iran-US tensions escalate and lead to a risk-off move. However historically, these incidents have had a limited market impact and if there was any, it tended to be relatively short-lived in nature.
- **Overall: We remain sanguine on markets in 2020, expect another move higher and do not anticipate a US recession ahead of the US elections.**



Source: Bloomberg Finance L.P., Julius Baer



Source: S&P500, JPMorgan

Less than 120 bps means fair valuation

VAR Capital Positioning - Conservative stance to withstand volatility

- **Bond strategy – lower duration and higher quality:**
  - Most developed market yields declined significantly in the first 8 months of 2019 (US 10 year dropped from over 2.6% in January 2019 to the low of c.1.5% by September 2019) but recovered towards the end of the year (to c.1.9%) on the back of a central bank policy action and signs of the global economy improving.
  - Going forward, we do not expect major moves lower, unless persistent recession worries start looming again. This is in our opinion unlikely ahead of the US presidential election and also in the light of the global macro picture stabilising (global manufacturing PMIs bottoming out, unemployment falling, US household leverage low etc).
  - We prefer to structure our bond portfolio relatively conservatively and keep duration low (c.3-4 years), as well as limit our exposure to high yield and risky EM credits.

- **Equity strategy – defensive outlook; overweight thematic (value/ FTSE midcap) and EM equities**
  - Despite the strong equity market performance in 2019, we remain cautiously optimistic in 2020. Election years tend to be beneficial for equities (see previous page), valuations are not too demanding, PMIs seem to be bottoming and positioning is also supportive.
  - Given the most recent geopolitical issues between the US and Iran and ongoing global trade negotiations, we do however acknowledge that some volatility may be on the cards. We therefore continue to focus on high quality and more defensive companies and sectors, which should hold better than the general market. Event and thematic names still form a large part of the equity portfolio as their returns tend to be less correlated to the market.
  - We continue to maintain the Value Factor ETF and FTSE 250/MSCI UK Small Caps as our key equity themes for 2020 and we are increasing our exposure to Emerging Markets.

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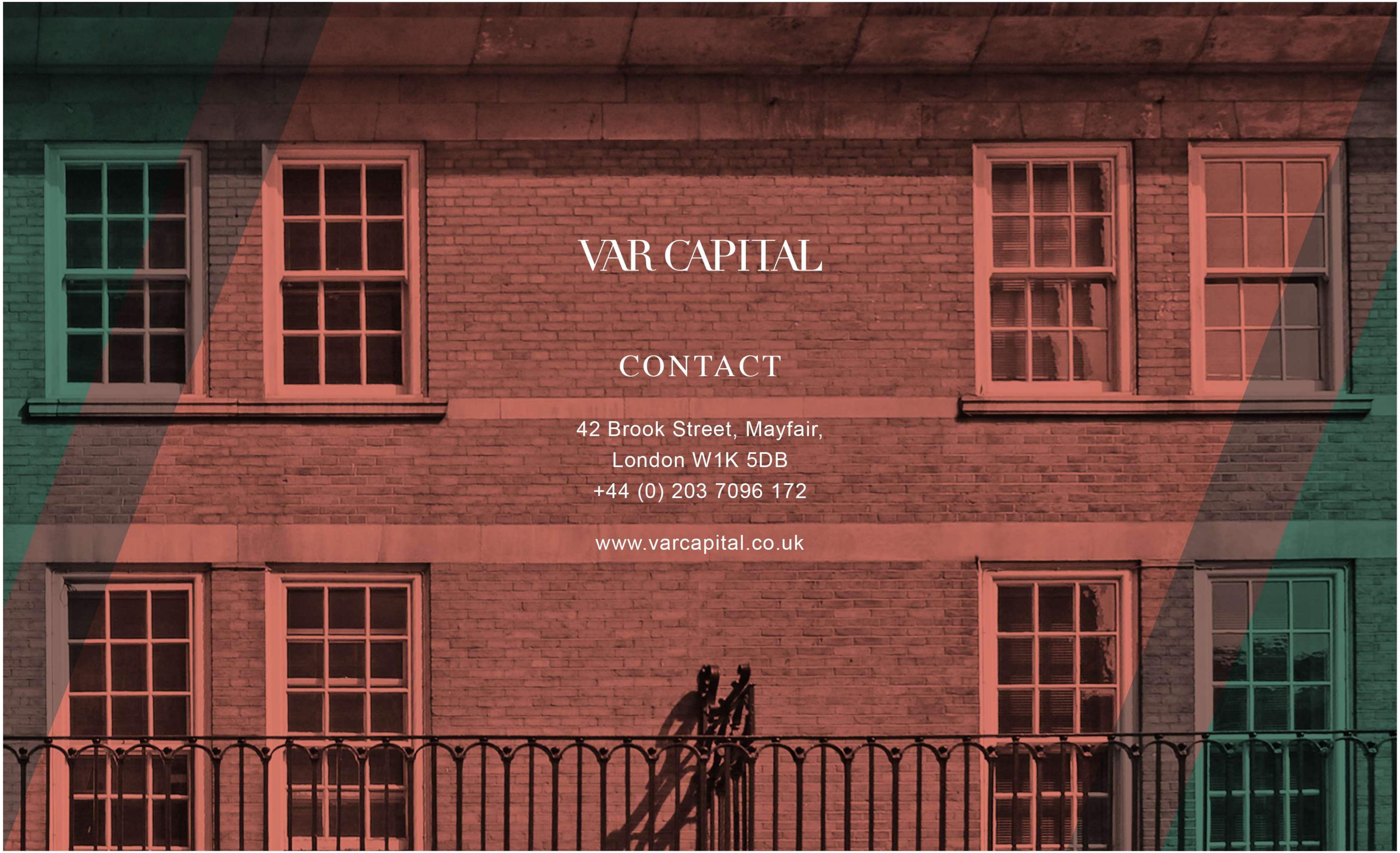
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