Research Redux: Snapshot: Q2 2016
Deltec Quarterly Global Strategy Outlook:
Bigger Data

Please note this Deltec Investment Research is a Research Redux – a research note that we are reiterating due to its importance or recent investment market activity. The original research note was published on 11 April 2016.

Key Trades and updated Investment Positioning are provided within this document, however for comprehensive charts, data and commentary, please refer to full presentation, distributed upon request only.

Should you wish to receive a copy of the Q2 2016 Deltec Quarterly Global Strategy Outlook: Bigger Data, please contact your Deltec representative or click here.
Bigger Data

At present, concern amongst consensus regarding the potential for a derailment of the global economic expansion, the failure of policymakers and a broad based decline in asset prices remains elevated. We take the contrarian view, underwritten by the ideology that data dependency is as important for market participants as it is for policymakers.

Leading indicator data is consistent with a significant improvement in global growth momentum, still supportive liquidity conditions, and rising asset prices. Outright global economic expansion remains intact, led by Developed Markets, where growth is broadening across sectors. Emerging Market economies will improve in the near term, although continue to lag as the cycle progresses, facing impending deleveraging spirals, idiosyncratic in their degree, although identical in their genesis of a reliance on USD liquidity. From a cyclical perspective, an improvement in both the growth and liquidity data sees a positive outlook for economies and markets broadly. However, this is juxtaposed with the secular perspective, where liquidity shortages and deleveraging can only be countered by capital investment and intelligent ideas, which sees a more distinctive outlook for economies and markets alike.

This data is likely to engender an improvement in investment markets, which will remain volatile, and greater idiosyncrasy within asset classes, which will become uncorrelated. This environment will present substantial challenges, however also significant opportunities, both long and short. In the coming period many risky assets are likely to rise, however as the cycle progresses and secular trends reaffirm, growth sensitive assets will outperform liquidity sensitive assets. The greatest risk to markets is not an end to the economic expansion, but rather Developed Market policy and Emerging Market deleveraging, with the financial system the likely transmission mechanism.

In the coming periods, both markets and policymaker credibility will be challenged by the participants, the populace and above all, the data. This disparity between reality of data and the perception of markets advocates misunderstanding and engenders significant risks, which manifest as mispriced assets and tremendous investment opportunities. The instability of capital is juxtaposed with the capriciousness of market sentiment, however ultimately, there is only one factor that will drive markets through the cycle – Bigger Data.
Key Trades

Global

- **Refer to Pages 16-31**
- **Investment Conclusion:** Data is consistent with an improvement in growth momentum and a continued Developed Market led economic expansion. However, this will not be without further turbulence, especially as policymaker credibility is tested and liquidity conditions change again, by late 2016. This environment delays, but does not deny, the further deleveraging due across carry trade assets. Many risky assets will benefit initially, however through the cycle Selected Developed Market Equities are likely to provide the most attractive risk adjusted returns, whilst Emerging Markets will remain selectively challenged across all asset classes. FX markets remain the automatic stabilizer, pre-empting the next phase of deleveraging.

Emerging Markets

- **Refer to Pages 32-52**
- **Investment Conclusion:** Data is consistent with an improvement in markets in the short term, however over the coming year Emerging Markets must still contend with slowing USD liquidity growth and undergo structural change, all whilst negotiating an environment of weak domestic growth and rising inflation. A deleveraging spiral is likely to take hold as the crisis continues. Relative opportunities exist in the short term, however outright short positions in EMFX, Emerging Market Equities and Emerging Market Debt are preferred in the medium term.
- **Positives:** Relatively India; Mexico
- **Negatives:** Primarily Brazil; Turkey; Malaysia

United States

- **Refer to Pages 53-77**
- **Investment Conclusion:** Data is strong across the majority of the economy, consistent with a still positive cyclical outlook. Growth momentum is rising, USD liquidity growth is stable and global risks are diminishing, all supportive of investment markets in the near term, with the productivity driven secular outlook essential to support valuations. Global conditions will be supportive of cash flow generative exposures and rising earnings will be supportive of growth sensitive sectors, whilst rising interest rates will negatively impact liquidity sensitive sectors.
- **Positives:** Housing Exposures; Consumer Discretionary; Technology; Selected Financials; Selected Industrials
- **Negatives:** Utilities; REITs
Europe

- Refer to Pages 78-95
- **Investment Conclusion:** The tentative improvement in economic data is not enough to drive a robust exit from the multi-year economic malaise, and fostering the recovery is key for policymakers, as exogenous risks, primarily from Emerging Markets, have the potential to derail the still nascent expansion. Rising growth momentum should generate upside to undervalued markets, with improving outright economic growth and loose monetary conditions supporting earnings upgrades. Externally focused sectors remain the key beneficiaries, whilst Emerging Markets and contagion to credit conditions the potential area of derailment, particularly for selected Financials. The Euro carries only limited downside risk from the current point.
  - **Positives:** Technology; Industrials; Capital Goods; Consumer Discretionary; REITs; Utilities; Selected Financials
  - **Negatives:** Consumer Staples; Selected Financials

Japan

- Refer to Pages 96-104
- **Investment Conclusion:** Deteriorating domestic data and policy errors are likely to be overshadowed by rising global growth momentum and a stabilization in China, courtesy of the leverage Japan has to both stronger global growth and lower oil prices. On balance, markets are likely to selectively recover, however a lower JPY is essential for a durable earnings and asset price recovery. Sectors exposed to areas of US growth and the USD, including Technology, are likely to benefit in volume and value terms, whilst those sectors exposed to the domestic economy are likely to be pressured. The Yen carries short term and medium term downside risk.
  - **Positives:** USD Exposures; Technology; Industrials
  - **Negatives:** Consumer Discretionary; Industrials

China

- Refer to Pages 105-130
- **Investment Conclusion:** Recent data indicates a troughing in growth momentum and a tentative cyclical recovery, as the economy undergoes the risky transition to an alternative model of growth. Markets are likely to rise in the short term, however downside risk remains given the weak cyclical and secular backdrop. In the short term, sectors exposed to fixed asset investment and trade are likely to rise. In the medium term short opportunities remain in derivatives of China, including Commodities, Commodity Economies and Commodity Currencies. The CNY carries short term and medium term downside risk.
  - **Positives:** Defensive Sectors
  - **Negatives:** Financials
Commodities

- Refer to Pages 131-151
- Investment Conclusion: The short term outlook for commodities is more positive, however can turn asymmetrically with the USD. Cyclical downside to commodities is acute, as slowing USD liquidity growth compounds structural shifts within Emerging Markets. As importantly, secular downside remains, as the last commodities boom is over, and, for selected commodities, the next remains a generation away. Tactical opportunities within commodities and across the capital structure exist as the bubble deflates, at present within Energy.
  - Positives: Selected Energy
  - Negatives: Gold

Currencies

- Refer to Pages 152-169
- Investment Conclusion: Data, both from the economic outcomes and data dependent central banks, is supportive of a pause in USD appreciation in the coming period. However, the factors that are contributing to the cyclical and secular strong USD outlook remain – relative economic growth, divergent monetary policy, shifts in trade and slowing USD liquidity growth – all contributing to USD shortages. In the short term, GBP, EUR, CAD, AUD and even EMFX have the potential to rise against the USD and JPY, however the medium term order of preference remains USD, GBP, EUR, JPY, CAD, AUD and EMFX.
  - Positives: GBP; EUR; EMFX; CAD; AUD
  - Negatives: JPY

Credit

- Refer to Pages 170-185
- Investment Conclusion: Data is supportive of riskier credit in the near term, both from a global growth and liquidity perspective. However, the reprieve for selected credit will be temporary, as slowing USD liquidity growth by late 2016 becomes the catalyst for another unwind. Outperformance in credit markets will oscillate significantly from Sovereign to High Yield Credit, however through the cycle, Investment Grade will benefit in risk adjusted terms. From a duration perspective, floating rate notes and longer dated issues will benefit over the medium term, whilst the belly of the curve is at significant risk.
  - Positives: Selected Investment Grade; Floating Rate Notes; Long Duration
  - Negatives: Emerging Market Sovereigns; High Yield; Short Duration
Market Valuations

- Refer to Pages 186-213
- Investment Conclusion: Improved growth data favors Equities, however increased stimulus data will also continue to support Fixed Income and Real Assets, delaying the coming multi-decade rotation. Stronger global growth momentum and looser liquidity conditions will support many risky assets irrespective of valuations, however can only delay the deleveraging risks across Emerging Markets and High Yield Credit. Developed Equities remain attractive, as the economic expansion will ultimately effect more attractive absolute and relative valuations.
- Positives: Equities; Long Duration Assets; Cash & Liquids
- Negatives: Selected Emerging Market Equities; Emerging Market Fixed Income

Market Momentum

- Refer to Pages 214-225
- Investment Conclusion: Current market momentum is lackluster given the impending rise in global growth momentum, still supportive liquidity conditions and more broadly, a global economic expansion that remains on track. Significant risks remain, particularly for carry trade sensitive assets including Emerging Markets, Commodities and High Yield Credit, as USD liquidity growth slows by late 2016, however for the coming period, buying opportunities exist, with growth sensitive assets preferred to liquidity sensitive assets through the cycle.
- Positives: Risk Assets; Equities
- Negatives: European Equities Volatility; FX Volatility

For further details on Key Trades please contact your Deltec representative.
Investment Positioning

Core Portfolios (Long Term)

Preference for Equities over Cash & Liquids, Fixed Income and Real Assets to capitalize on the continued global economic expansion, against a backdrop of peaking liquidity growth.

- **Equities**: Preference for Developed Markets over Emerging Markets. Within Developed Markets, the US and Europe are preferred, whilst Japan is contending with policy credibility and Commodity Economies are to be avoided as the secular decline continues. In Emerging Markets, only selected opportunities exist, where structural issues are being addressed.

- **Cash & Liquids**: Preference for selected Investment Grade Corporates over Financials and both over Governments, as corporate balance sheets are robust and free cash flows stable.

- **Fixed Income**: Preference for Investment Grade Corporates over Governments and both over selected High Yield, as corporate balance sheets are strong and economic growth is broadly improving, however liquidity growth is peaking.

- **Alternatives**: Preference for Macro Strategies as global liquidity dynamics undergo a multi-year shift, and Event Driven Strategies, as corporate activity is likely to remain a prominent feature of markets.

Tactical Portfolios (Short – Medium Term)

Preference for selected Equities and Cash & Liquids over Fixed Income, during the current period of rising global growth momentum and improving liquidity conditions, all within an economic expansion that is still on track. Given the potential for further bouts of slowing USD liquidity growth by late 2016, many risky assets will rise in the near term. However, the preference for Equities is highly selective, with cash flow generative and growth sensitive assets preferred to liquidity sensitive assets as the cycle progresses, as slowing USD liquidity growth will ultimately negatively impact carry trade sensitive assets, including Emerging Markets, High Yield Credit, Commodities.

- **Equities**: Preference for selected Developed Markets over Emerging Markets. Within Developed Markets, we have a preference for the US, given the relative growth profile from a short and medium term perspective and; Europe, given the recovery is turning to expansion, with still supportive liquidity conditions. We see short opportunities in selected Emerging Markets given the impending deleveraging cycle, and only see long opportunities in those Emerging Markets that are structurally sound and less reliant on capital inflows. We also see short opportunities in Commodity Economies, which are still to experience a deleveraging cycle.

- **Cash & Liquids**: Preference for Corporates over selected Financials and both over Governments, as corporate balance sheets are robust and free cash flows stable.

- **Fixed Income**: Preference for Floating Rate Securities and longer duration Government and Investment Grade exposures over selected High Yield Credit, as the latter remains highly susceptible to slowing USD liquidity growth and its ancillary impacts as the cycle progresses.
Currencies: Preference for USD over the GBP, EUR, JPY, AUD, CAD and EMFX. Data, both from the economic outcomes and data dependent central banks, is supportive of a pause in USD appreciation in the coming period. However, the factors that are contributing to the cyclical and secular strong USD outlook remain – relative economic growth, divergent monetary policy, shifts in trade and slowing USD liquidity growth – all contributing to USD shortages. In the short term, GBP, EUR, CAD, AUD and even EMFX have the potential to rise against the USD and JPY, however the medium term order of preference remains USD, GBP, EUR, JPY, CAD, AUD and EMFX.

Opportunistic Portfolios (Direct Investments)

Preference for selected Developed Market assets in only selected regions and sectors, and those positioned for the continued yield premium in direct investments over public markets, and the potential for greater capital upside given the current point in the economic and investment market cycle.

- In absolute terms, most asset classes are expensive when using public valuation metrics, emboldening the case for non-public or direct investments, particularly so debt, where private firms are still facing issues regarding the availability of credit, but also in equity, where both leveraged and unleveraged valuations are low. Where investors are willing to trade the liquidity premium paid in public markets for the valuation discount received in direct investments, there is a clear case for direct investments at present.

- Preference for defensive Developed Market assets that offer capital stability, stable ongoing yields and the potential for equity upside. Within this, we have a preference for USD denominated investments with stable cash flows, and investments that generate productivity growth.

For further details on Investment Positioning please contact your Deltec representative.
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