Alpha Beta PARTNERS

Manager's Quarterly Review

Q2 2019

Tempering Valour with Caution

Looking Back:

	Q2 2019 Stats	Return	Level
Equity	MSCI AW Index	1.77%	523
	S&P 500 Index	2.60%	2,942
	MSCI EM Index	-1.42%	1,055
	MSCI CH Index	-6.90%	79
	FTSE 100 Index	1.48%	7,426
Debt	BBARC GA Index	3.62%	505.58
	US 2Yr TR*	0.92%	1.75%
	US 10Yr TR*	3.34%	2.01%
	US 30Yr TR*	5.42%	2.53%
Infrastructure	S&P GI Index	3.42%	2,681

*Total Returns are calculated using active Futures

(Source: Bloomberg)

Q2 2019 saw an extension of the Q1 rally in both the bond and equity markets. The catalyst remained the dovish stance by the Federal Reserve and hints on loose monetary policies across the US and Europe. US economic data remained intact during this period with signs of slow down only showing in the Purchasing Manager's Index.

It was interesting to note that despite increasing signs of slow down in the near term indicated by the inverted yield curve and PMIs, risky assets continued to do better during the quarter. This can be attributed to the markets expecting another round of quantitative easing fuelling an unlimited supply of free cash. Accordingly, fixed income markets rallied hard with a drop of 50 basis points in the USG2YR and a drop of spreads in high yield bonds.

PMI Rate of Change	6/30/19	5/31/19	4/30/19
China	-1.7%	-2.3%	-0.4%
United Kingdom	-2.4%	0.0%	1.8%
United States	1.2%	-4.0%	-2.9%
Developed Markets	0.4%	-1.7%	-1.3%

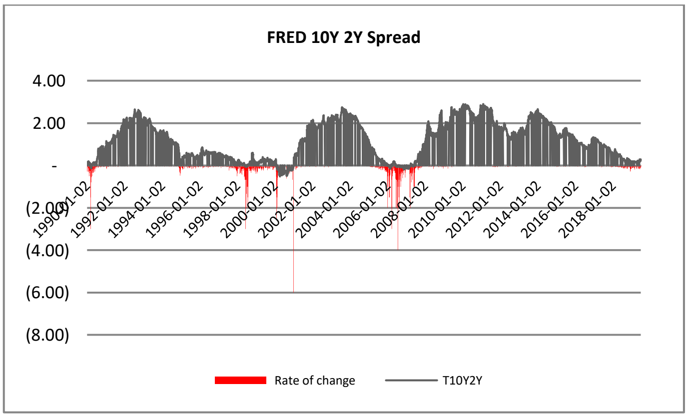
(Source: Markit, Bloomberg)

High yield bond and Corporate bond spreads, which are seen, historically, as an early indicator of market fracture, tightened, signalling more demand.

The US Treasury Yield Curve remained inverted at the shorter end compared to the ten-year point, whilst the swap rate curve pointed to lower rates and a shift down soon. Market implied rates also pointed to the market discounting a high probability of a rate cut after recent Fed comments.

Our expectations are that the Fed will retain its dovish stance for the rest of the year and that we may see some more flattening of the shorter end of the curve.

All this points to an unpredictable behaviour of the markets, whereby all types of assets continue to rally, the US economy generally posting healthy numbers with the Fed bracing for a slow down and moving into an expansionary mode. Let's not forget; however, that the Fed Balance sheet still sits at $21tr+ with another $1tr expected to be added to plug the fiscal deficit this year, thanks to President Trump's tax cuts.
The current spread between 2-Year and 10-Year Treasury stands at 26 basis points.



(Source: Federal Reserve Bank)

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Looking Ahead:

Cyclically Adjusted Price to Earnings ratios remain in the 25+ area, and historically these levels have led to a correction. We remain increasingly cautious of the price levels in US equities.

UK equity returns lagged those of the US and Emerging Markets counterparts. Brexit remains a major limiting factor and now the UK has another political drama being played out. Boris Johnson is leading the race to become the next Prime Minister of the UK, and with that the chance of a no-deal Brexit has already spiked.

What does this mean for our portfolios? Brexit, one way or the other, will remove the uncertainty that has plagued the UK equities for two years. Once this political uncertainty is removed and the UK has a clear path, we expect UK equities to retrace previous highs and break through the consolidation pattern its been holding over 2 years.

The Woodford scandal came to light during the period. It has put a spotlight on the fund industry in general and funds dealing in less liquid assets. Our investment process is designed to consider multiple risks including the concentration and liquidity risks before funds are added to our Buy List. Our investment philosophy dictates that our exposures are to overall markets using highly liquid instruments, ensuring there is no idiosyncratic risk in our core portfolios and risk is well-diversified across our satellite positions.

We expect increased regulatory pressure in the UK funds space, for which we are well prepared.

Latest official Chinese GDP numbers show the impact of tariff war on the economy, shaving 0.2% off the growth forecast for the year. Latest PMI reading stands at 50.6, which is marginally above the contraction level at 50.

The rate of change in PMI has been negative for most part of the H1 depicting a broader slowdown in China. However, the Fixed Investment gauge and electricity production increased during the quarter. Electricity production gauge is often used to measure the level of industrial activity and demand. Despite slower exports and PMI readings being soft, China's trade surplus with the US remains at a record high.

PBOC remains committed to an expansionary monetary policy. The Required Reserve Ratio (RRR) and SHIBOR have fallen significantly during the year to encourage lending. Expansionary monetary policy is likely to put a floor under the slowing economy and encourage infrastructure spending.

Our approach to de-risking in Q4 2018 has delivered its dividends through the correction period in the markets, resulting in a healthy return this year. Given our views of H2 2019, we will only slightly reduce the risk in our portfolios and remain on guard, tempering valour with caution.

Performance %	Year to Date	Quarter to Date	Month to Date
AB1	7.56	2.79	2.03
AB2	10.01	3.63	2.72
AB3	11.88	4.31	3.32
AB4	13.69	5.09	4.04
AB5	14.41	5.59	4.60
AB6	14.48	5.70	4.86

(Source: Morningstar, Data as at 30/06/2019)

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