Alpha Beta PARTNERS

Manager's Quarterly Review

Q4 2019

	Q4 2019	Return	Level
Equity	MSCI AW Index	8.56%	565
	S&P 500 Index	8.53%	3,231
	MSCI EM Index	11.35%	1,115
	MSCI CH Index	13.95%	86
	FTSE 100 Index	1.81%	7,542
Debt	BBARC GA Index	0.49%	512
	US G2Y Index*	0.14%	1.61%
	US G10Y Index*	-3.95%	1.86%
	US G30Y Index*	-1.45%	2.30%
Infrastructure	S&P GI Index	4.29%	2,789

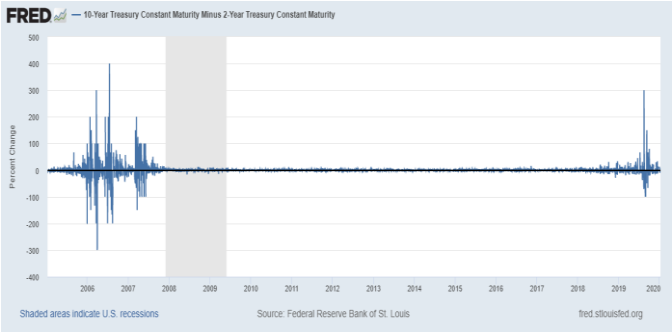
*Total Returns are calculated using active Futures

(Source: Bloomberg)

The final quarter of 2019 saw a strong recovery in equity markets and some small losses in bond markets (rise in yields) at the longer end of the yield curve, principally driven by an unexpected renewed bout of monetary policy (effective QE) support from the Fed and investor focus on risk assets.

At the end of Q3, we took some risk off the table, having chalked-up some decent outperformance against our IA Sector benchmarks in the past few years, primarily due to the fact that equity market valuations were looking stretched, GDP forecasts were underwhelming and we still had to navigate the Brexit vote and the China-US trade deal negotiations. What we underestimated, was the Fed's resolve to provide liquidity in the form of an additional $60bn per month expansion of its balance sheet to principally support the Treasury bill market, which helped propel the US equity market to new highs. However, we did the right thing by lowering risk and protecting gains for investors at a time when a combination of events and ensuing stock market volatility could have damaged returns markedly.

It is interesting to note that in 2019 we briefly saw an inverted yield curve, which, historically points to recession in the following 12-15 months. At the same time, however, we saw tightening in High Yield spreads and lowering cost of Corporate Debt, suggesting little strain, for now, in the corporate sector.



(Source: Federal Reserve Bank)

The longer end of swap rate curve, however, remains below the yield curve, signalling further downward expectations. Whilst we expect the Fed to remain on the side-lines for 2020, it can step-in to provide further support if equity markets falter significantly from here. Let's not forget that this a Presidential Election year and keeping the markets afloat and hanging onto the gains will clearly be on President Trumps agenda.

As argued above, the Q4 risk-on mood was certainly triggered by the support provided by central banks and loose monetary policy helped increase valuations, but investor behaviour played a major part especially where there was no notable increase in EPS data [earnings per share]. In part the market now believes that central banks will always step-in to support whenever there is a hint of weakness. As we questioned in our Q3 review, is this a new paradigm? If this is true, then all assets should keep rising - but to what level? At some point ahead, with a hint of real inflation and a shift to more hawkish language and behaviour there will come a time when this new paradigm ends. We remain focused to identify any significant catalysts to change.

Leading economic activity data such as PMIs inched higher across most of the developed markets towards the end of 2019. In the UK, activity was held back by Brexit uncertainty but with the Conservatives winning a significant majority, business sentiment is improving, and the scene looks set for a modest rebound in activity through Q1.

The potential signing of the phase one US-China trade deal is also boosting sentiment and while it will provide a

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modest boost to both US and Chinese data, the phase one trade deal is classed as "hiatus" and nothing exceptional.

Rate of Change	12/31/19	11/30/19	10/31/19
China	-1.1%	2.3%	0.2%
United Kingdom	0.0%	-1.4%	1.4%
United States	1.3%	2.2%	-0.2%

(Source: Markit, Bloomberg)

Fundamental indicators now point to a fully priced US market. After hitting a recent new high, the S&P500 forward multiple is at an 18-year high of 18.4 and CAPE reading 31. Low interest rates have certainly helped the US equity market and provide good support but there is little room for disappointment through the Q4 earnings reporting season. Bulls argue that the current Earnings Yield of S&P 500 is 4 times the 3-month Treasury Bill, which means there is no alternative but to buy equities.

By contrast, both the UK and European markets, would appear to offer better value on both an absolute and relative valuation ground.

European economic data is subdued mainly due to a manufacturing downturn in Germany. However recent PMI data for Germany and France show some positive signs and we expect European indices to show some modest improvement in 2020.

Emerging Markets have been faring relatively better when it comes to the monetary policy tools compared to the developed markets. Q4 saw a double digit return from Emerging and Chinese market indices despite the ongoing geopolitical and trade issues.

Under the "Phase one" trade deal both the US and China are expected to increase exports to each other. This means Chinese export volume will be restored to levels higher than pre trade war. This should increase the activity level in China and provide a modest boost to GDP in the US. This should play out well in 2020, provided there are no other geopolitical risks.

Having taken a cautious position to cover ourselves against downside risk in Q4 2019, we have re-evaluated our position for 2020.

We believe world equity markets still have some upside left in this cycle. As such, we are ready to deploy cash as the next pullback emerges, primarily into Emerging Markets and the UK at the relative expense of the US, where we have had great success over the last few years.

Performance %	Year to Date	Quarter to Date	Month to Date
AB1	10.20	-0.35	0.11
AB2	13.92	-0.40	0.18
AB3	15.68	-0.36	0.31
AB4	17.79	-0.04	0.51
AB5	18.00	0.33	0.78
AB6	17.32	0.83	1.21

(Source: ABP and Morningstar, for Indexed funds solution, Data as at 31/12/2019)

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