CHAHINE CAPITAL
Performance Engineering

1/6/2019

STRATEGY OVERVIEW

Helicopter money to tackle the next recession?

Summary

Each time the equity markets wobble and the yield curve inverts, investors start worrying about the next slowdown or recession – and here we are again. Our 27 April letter turned out to have been bang on: we pointed out that Wall Street was 9% overvalued, according to our models, and the S&P 500 was at 2,940 points at the time. It closed at 2,752 points last Friday. It took another twist in America's trade war with China to focus investors on the reality of the situation, and the war of words between the two has only worsened since. Instead of joining forces with Europe, which has also been sucked into China's game, Donald Trump is looking to attack it. On equity markets, specialist retailers hit by higher tariffs have been notable casualties, while IT firms are looking at lower exports because of the embargo and weaker demand. Amid fears of slower growth and net sales of equities, long rates have slumped again in America and Europe. German yields are negative out to 15 years! The US 30-year is down to 2.58%, the curve is inverted out to 3 years and the market appears to be ordering the Fed to ease swiftly even though the state of the economy suggests the opposite.

The eurozone economy has never really bounced back from the financial crisis, even though the ECB's balance sheet has ballooned to €4.7 trillion (61% of eurozone GDP) and its interest rates are negative. The ECB says that it has enough in its toolbox to cope with a significant deceleration or recession: could that be so-called helicopter money, given that it has described the idea as 'interesting'?

Simply handing out €50 per month to each adult in the eurozone would cost €160 billion per year, compared with the ECB's sterile €4.7 trillion and could boost growth by over 1%. It would also generate tax revenue. The poorer the country, the more this windfall would be appreciated, and this sort of imaginative intervention could help reconcile EU citizens with an institution that comes in for heavy criticism. Unlike qualitative easing, which parks money among banks before it seeps out to the already rich, direct subsidies to households would boost consumption and inflation expectations. In the USA, QE has raised the prices of financial assets: equities have gained an average 12% per year over the past decade on Wall Street and Mr Trump's tax reforms have only accelerated the process. America's inequalities have widened still further. The gap between remuneration on capital and that on actual work is hitting such high levels that the law of the market is bound to correct it.

Macroeconomic indicators are very stable, giving us an unchanged world growth figure for this year of 2.9%. America's ISM series, which measures expectations for activity in manufacturing and services, is the only indicator showing a marked decline, although nervousness over demand has cut oil prices 19% from their recent highs. France's 'yellow jacket' protesters will be pleased about that. Earnings estimates are also largely unchanged, with S&P 500 profits expected to rise 2.1% this year. The drop in share prices has cut the index's PERs to 16.6x 2019 and 15.1x 2020.

Lower interest rates have boosted our S&P 500 valuation to 2,993 points for the end of 2019. It would be back down to 2,785 points with a 30-year yield of 3% in a trade war ceasefire scenario. In the event of modest recession with long rates easing to 2.5%, our instantaneous index objective would be 2,666 points, some 100 points below Friday's close. We suggest re-entering the market at this level, although only partially as it could exaggerate to the downside. We are sticking with our decision to underweight our equities benchmark (an allocation of 35% rather than 40%, in our case). European equities look attractive with such low interest rates but continue to track Wall Street.

Jacques Chahine

Trade wars a stumbling block for equities

Each time the equity markets wobble and the yield curve inverts, investors start worrying about the next slowdown or recession – and here we are again. Our 27 April letter turned out to have been bang on: we pointed out that Wall Street was 9% overvalued, according to our models, and the S&P 500 was at 2,940 points at the time. It climbed to a high at 2,946 points before correcting 6.5% in May to close at 2,752 points last Friday.

Our model had also identified a high when we wrote on 29 September 2018 that the market was closing on bubble territory. We said that Wall Street was 11% overvalued at the time, when the S&P 500 was at 2,914 points.

It took another twist in America's trade war with China to focus investors on the reality of the situation and make them realise that the conflict is not about to end anytime soon. Quite the opposite, in fact: Mr Trump has just raised the stakes again by switching to a pretty defenceless Mexico. The Chinese are proving a hard nut to crack, though. Apart from declaring a possible embargo on rare-earth elements, they are threatening to blacklist US firms in response to the Huawei affair. The Americans have been naïve in believing that their demands on intellectual property, forced technology transfer and hidden subsidies would be accepted without demur. For the Chinese, it has been a bit like de Funès in *Rabbi Jacob*, when he says "Promise me everything and I'll give you nothing". China is still hoping to get away once again with vague verbal assurances. It worked with the EU, which recently signed an agreement on technology transfer without any means of ensuring its implementation. In the same vein, an agreement on protected geographical indications (Champagne, for example, or Parma ham) that was supposed to come into force in October 2018 has been delayed until the end of 2019.

At the end of the day, the West agrees with Mr Trump that it is high time that China plays by the rules and should open up its domestic markets if it wants to export its own goods and services. The alternative is the prospect of China becoming the world's biggest economic power with 1.3 billion people.

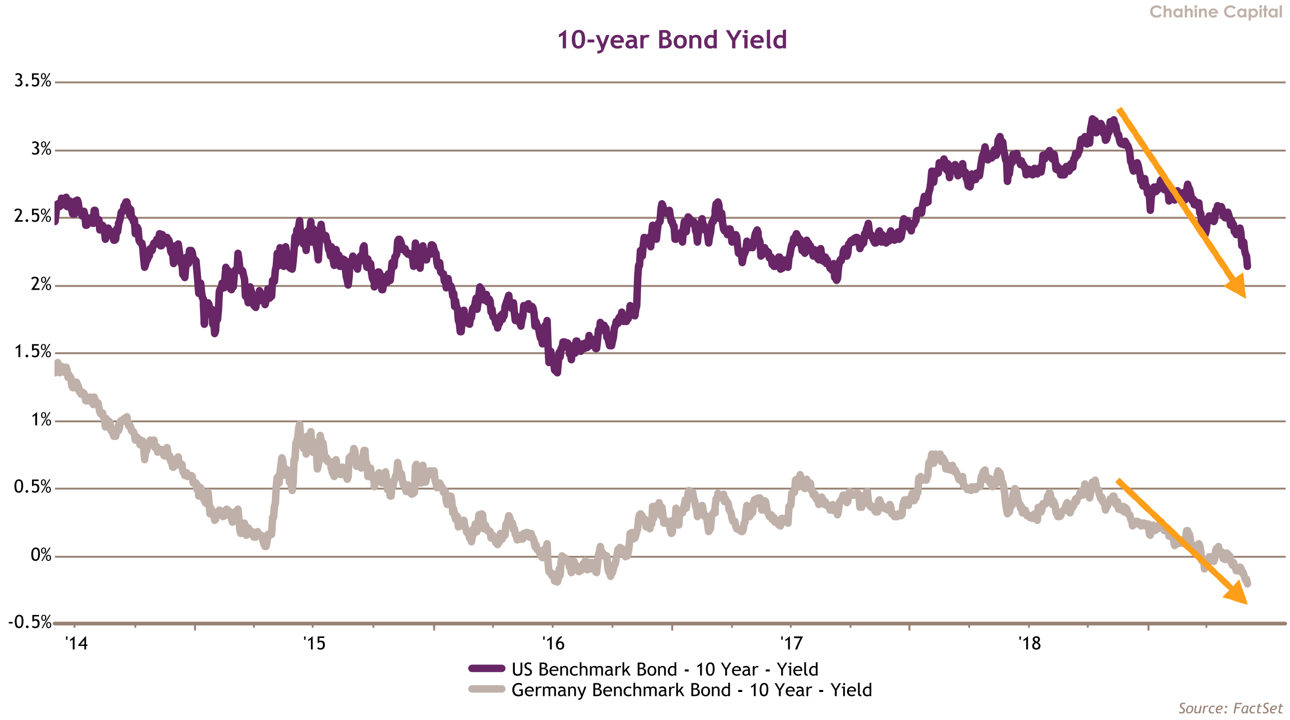
Equities are taking the short-term consequences of these developments. More and more sectors are affected, particularly department stores and specialist retailers paying a 25% tariff on the products they import. On the export side, IT firms are reporting lower sales to China because of the embargo and weaker demand. Mr Trump's problem is that he has picked trade fights with the whole planet when he would have done better to forge a united front against the Chinese. The EU would have been the ideal ally in the circumstances, as it is affected even more by China's lawlessness, but he is busy attacking the Europeans on cars and Airbus instead.

Investors have shed most of their illusions on the chances of a quick settlement with China and assume that the economy will be affected, even though there is as yet no real sign of slowing growth overall. The present 6-7% correction will worsen if tempers fray further between the two main protagonists – and that looks likely.

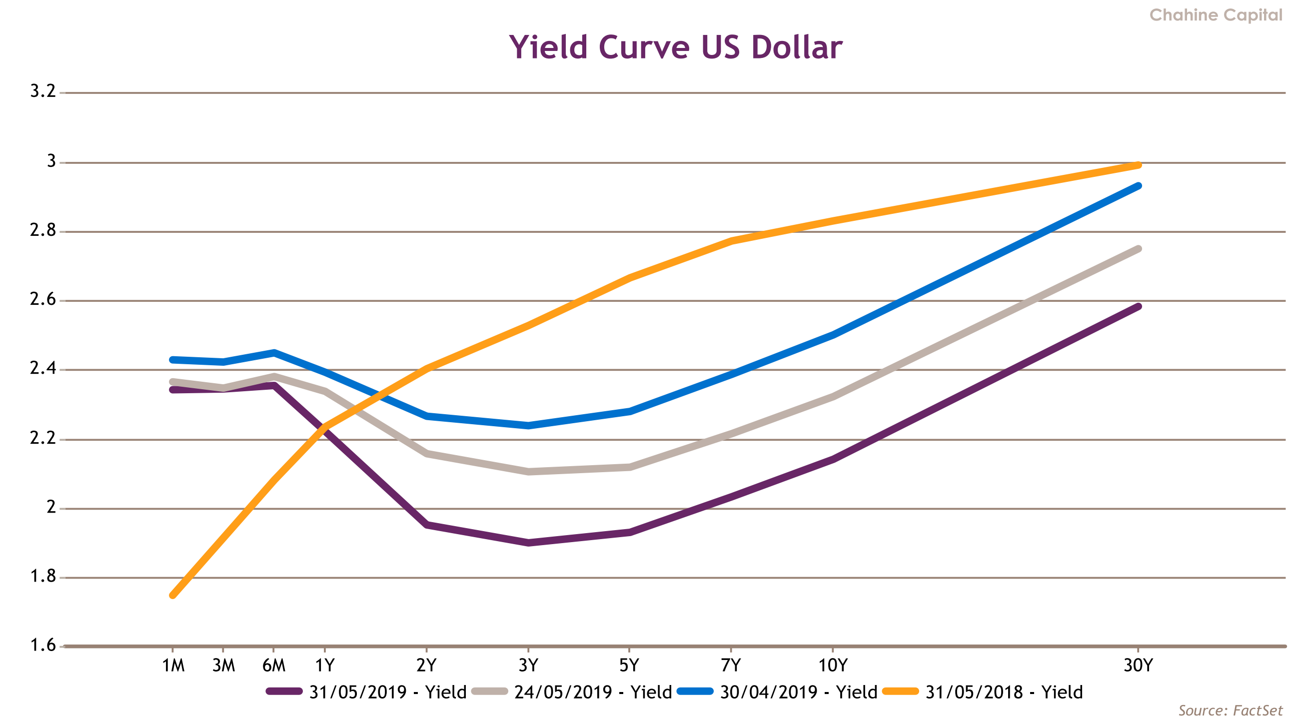
A slump in long rates

Fears of slower growth have pulled long rates lower. The US curve is now inverted out to 3 years and the 10-year is down to 2.14%. The yield on the German Bund – the ultimate safe haven – is down to -0.2%. The 30-year US Treasury yield, which plays a dominant role in our risk premium model, has fallen from 3% a year ago to 2.58%. The market is effectively ordering the Federal Reserve to cut its own interest rates swiftly, although the vigour of the US economy suggests that it should be doing the opposite. Given that the inflation rate is 2.1%, investments in Treasuries offer little in the way of a real return.

Long rates fall again



A more inverted yield curve



The situation is even more extreme in Europe, where government bond yields are negative out to 15 years. The ECB has called a halt to QE because of a lack of quality paper left to buy, leaving its balance sheet at a whopping €4.7 trillion, or 61% of eurozone GDP. Even with this monster injection of liquidity, Europe's recovery has been so sluggish that we have to ask what the authorities would do in the event of a recession.

Helicopter money: the next weapon?

In March 2016, Mario Draghi described the 'helicopter money' idea as very interesting. When the ECB refers to the tools left in its box, it includes that one. While there are many variations on the theme, we refer here to the distribution of a sum of money to eurozone citizens without anything in return. The allocation could be a one-off or recurrent, say €50 per month to each adult, adding up to €1,200 per year per couple. That would represent an injection of €30 billion into France, for example, or 1.3% of GDP. This windfall would be appreciated more in the poorer EU countries, such as Portugal, than at the richer end of the euro zone. The windfall would not be means tested. At the level suggested above, it would add €160 billion per year to household purchasing power, which although substantial is nothing like the size of the ECB's QE programme.

At a time when EU citizens are far from convinced of the eurozone's usefulness, this sort of imaginative intervention could help reconcile them with it in a very concrete way.

Unlike qualitative easing, which parks money among banks, direct subsidies to households would boost consumption and inflation expectations. Part of these subsidies would find its way back into government coffers via the impact of higher spending on VAT, income tax and corporation tax receipts. In the meantime, the term structure of interest rates could start to normalise with renewed growth and inflation.

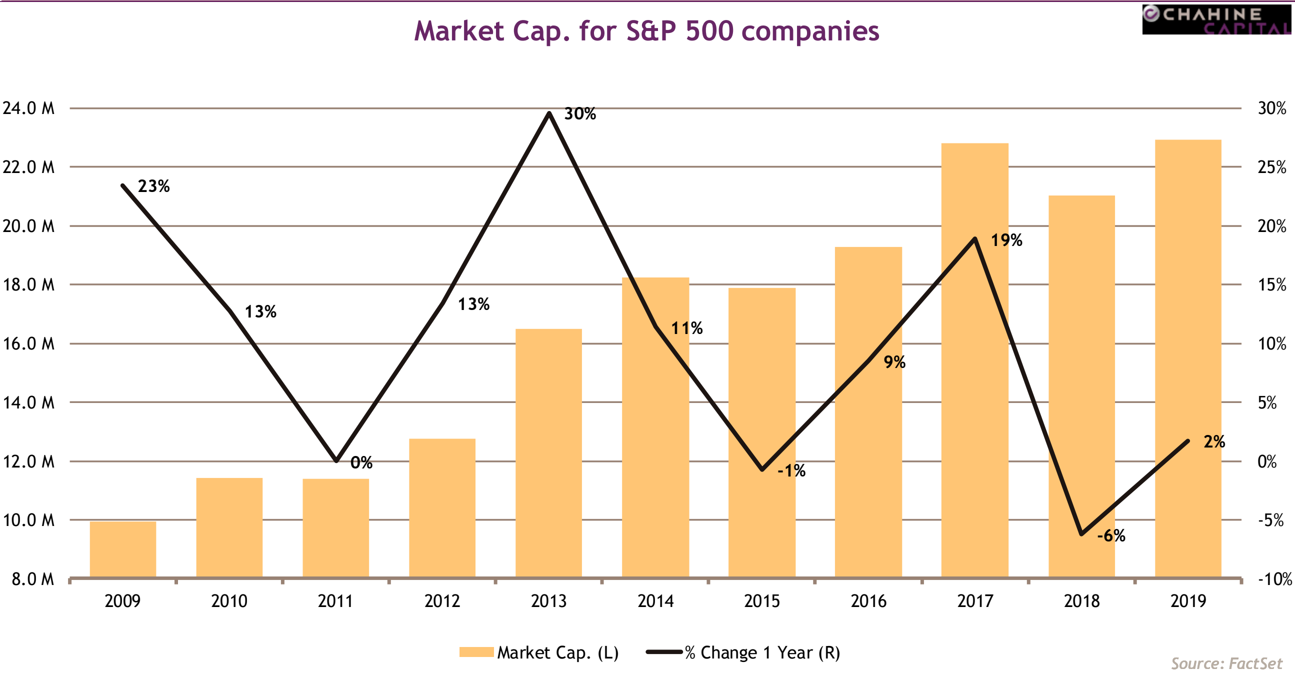
There would be plenty of opposition to this sort of initiative, particularly in a Germany very watchful over inflation. The move could also be expected to raise imports, thereby widening trade deficits in countries unable to meet higher demand domestically, and windfalls will serve only to raise savings if confidence does not return. Last but not least, the strategy has never really been tried before, and to that extent would be a leap into the unknown.

QE has had little impact on the real economy…

As a complement to monetary policy instruments that had run up against their limits, QE certainly helped the world economy during the 2008 subprime crisis. The US economy was struggling to recover even with interest rates at 0%, and the Fed's QE programme was copied in other major economies. It has since ended in the USA and its effectiveness in the eurozone has been questionable. The fact is that QE has never really filtered through the real economy to consumers; the money has all gone to the already rich, partly through cheap borrowing and partly through asset reflation on equity and real estate markets.

The S&P 500's market capitalisation has surged from $10 trillion to $23 trillion over the past decade, thanks to annual average performance worth 12.4% including dividends. In contrast, average hourly wages in the USA have increased by an annual 2.4% over the period, barely enough to cover inflation. The $13 trillion in additional wealth is 'only paper'; its fortunate owners appear to be bent on increasing it still further. The wealth of S&P 500 shareholders rose by $3.2 trillion in 2017 alone, thanks to Mr Trump's tax reform. Capital in the major S&P 500 companies – and especially the new economy – is still concentrated mainly among a few very rich individuals, such as Bezos, Bill Gates and Mark Zuckerberg.

$13,000 billion additional wealth in a decade



The low interest-rate policy that has done so much for equities has bolstered the prices of all other assets that generate recurrent cash flows. Real estate is a good example. If we take prime office space available for rent in one of our city centres, for example, we would expect a sale price of 3-3.2% its cap rate. That means that a building generating €1 million in annual cash flow would change hands at 1m/3.2% = $31 million. The same building may have been purchased at a 5% cap rate six years ago, i.e. for €20 million. Even at €31 million, an insurer would obtain a return good enough to produce a decent yield on life insurance policies. High-quality investors can borrow over long periods at 1-1.2% per year. Assuming 50% leverage, their rate of return would be 5.2%. What it all comes down to is that the money injected into banks by the ECB ends up as a bubble in the prices of financial assets. Unlike helicopter money, it does not buoy the real economy.

Our analysis suggests that the asset price bubble fuelled by low and negative interest rates could burst in the event of a downturn in economic growth. Those offices rented out for a million per year could find themselves empty and the investors that borrowed to buy them could prove incapable of servicing their debts, putting the bank itself in danger.

… and has worsened inequalities

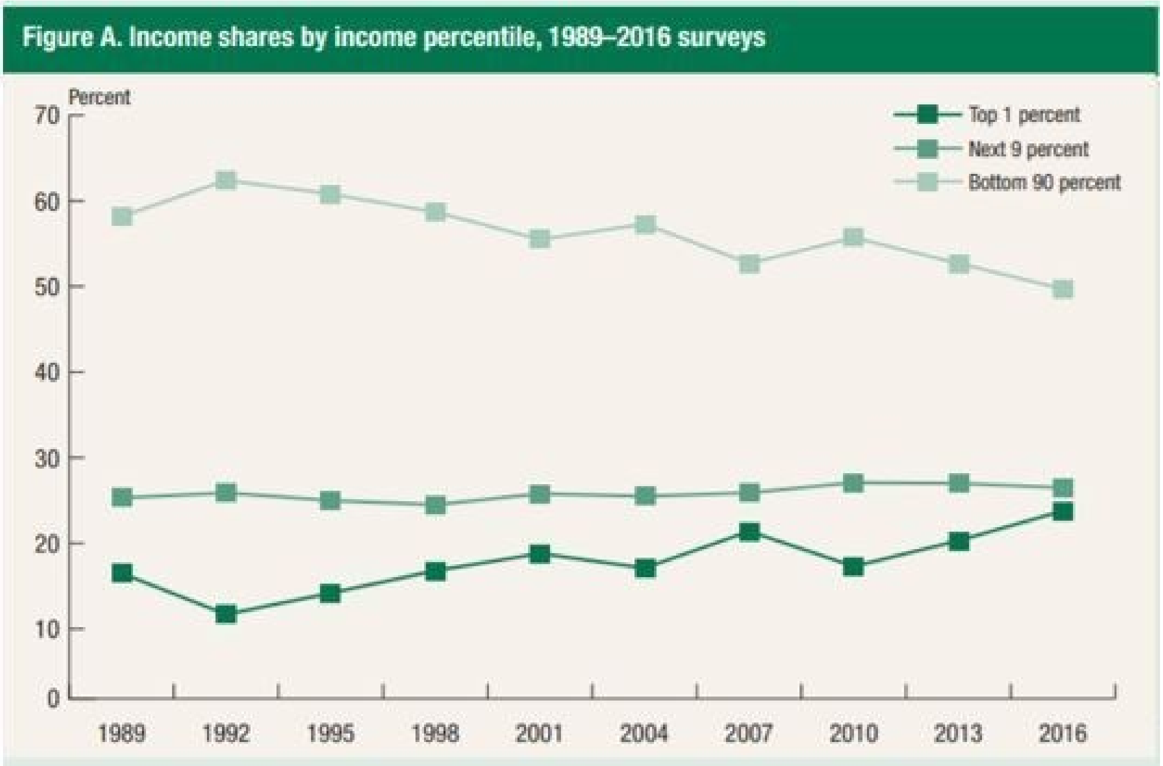
The unending pursuit of increasingly accommodating monetary policies can be compared to the injection of higher and higher doses of morphine to an addict. The logical conclusion of the current shift of money supply towards relatively few super-rich individuals is their possession of all assets. The curve below shows the increasing concentration of wealth in the USA to 2016, and of course that trend has accelerated since as a result of tax cuts and the subsequent jump in share prices. The richest 1% of American households account for 37% of the country’s wealth, and as much as the following 9%. Within the 1%, the top 0.01% own more than the 0.09%, and most own financial securities and (sometimes) real estate. The 90% below the top decile own just 22% of total wealth.

The continuing concentration of US wealth

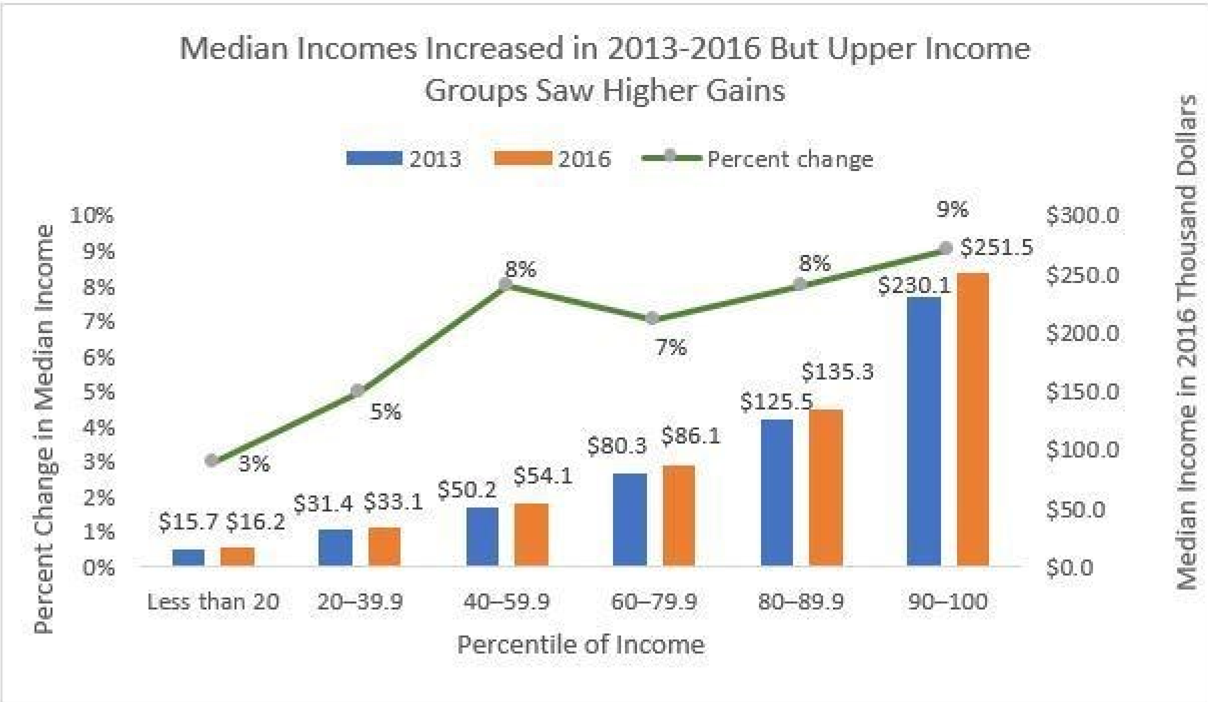
Income inequalities have worsened as well. The 10% best-paid US households own as much as the remaining 90%, with half the total each. In the 1990s, the 90% earned 60% of the total. The new economy has undermined the blue-collar middle class by substituting machines for the people that used to do repetitive tasks. At the same time, the IT sector can pay millions per year to individuals, especially through stock options. The top 10% of households in terms of income have securities portfolios, while the 90% do not. The chart below also shows that the 1% best-paid make as much together as the following 9%, pointing to the scarcity of top-level talents and managers.

The higher the salary, the faster it increases. Low-income workers earning less than $20,000 per year are seeing wage growth of less than 3% per year, in line with hourly wages. The best-paid are enjoying far greater annual increases, not just through salary but also stock options and investment income.

Rapid increases in pay for the top end



The higher you start, the greater the gain

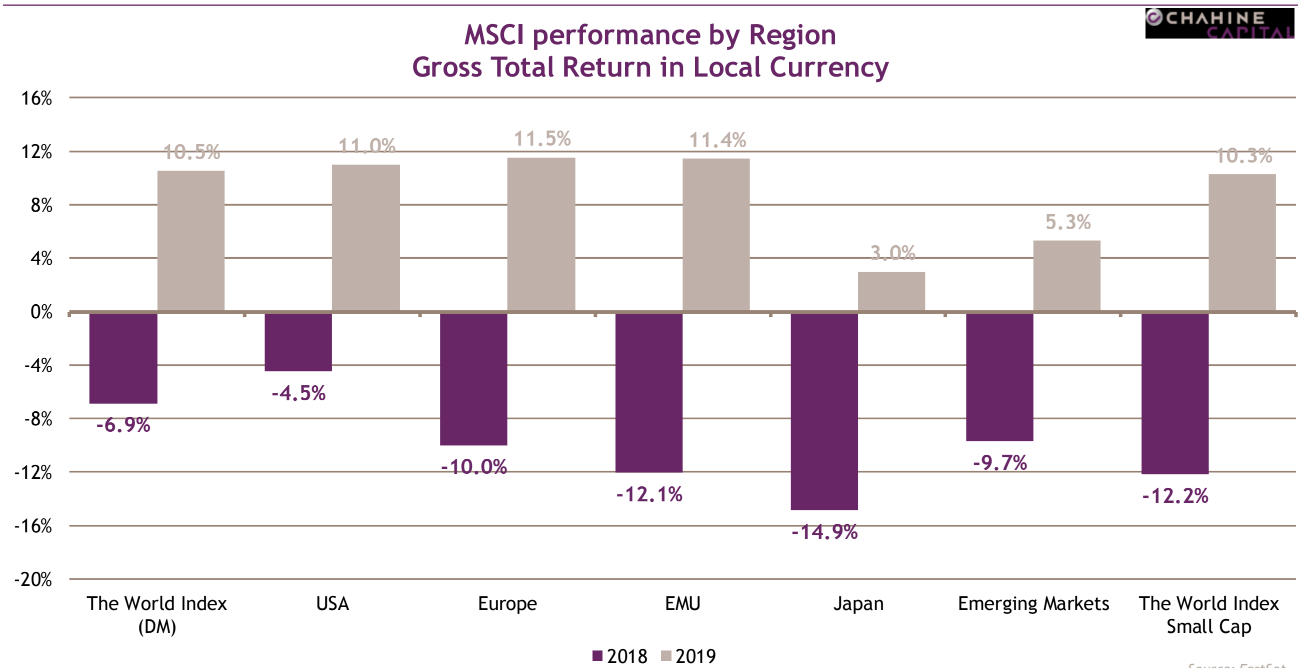


In short, QE has ended up benefiting those who have the least need of support and has failed to stimulate activity in Europe. It has simply aggravated inequalities, especially in the USA where there is not much of a safety net. In Europe, where the ECB has used up all its conventional monetary policy levers, any recession or slowdown would leave it with nowhere to go. Its own intervention rates are negative and long rates are extremely low. It says that it has other measures in its toolbox and that helicopter money would be interesting, but we wonder whether eurozone governments would be bold enough to adopt them, despite the sort of social unrest that we have seen in France and despite the good it would do to Europe's over-bureaucratic image.

A correction in May, but equities still up this year

Despite their correction last month, equities have rallied strongly this year. Wall Street is up 11% on a total return basis, although it was up 18%. European markets have risen by a like amount, but emerging equities have still to make up their losses of 2018. Japan is underperforming. The VIX index did jump to a feverish 20.5%, but that still pales compared with last year's peak at 37%. Investors are nervous but retain hopes that everything will work out in the end.

A correction, but progress overall



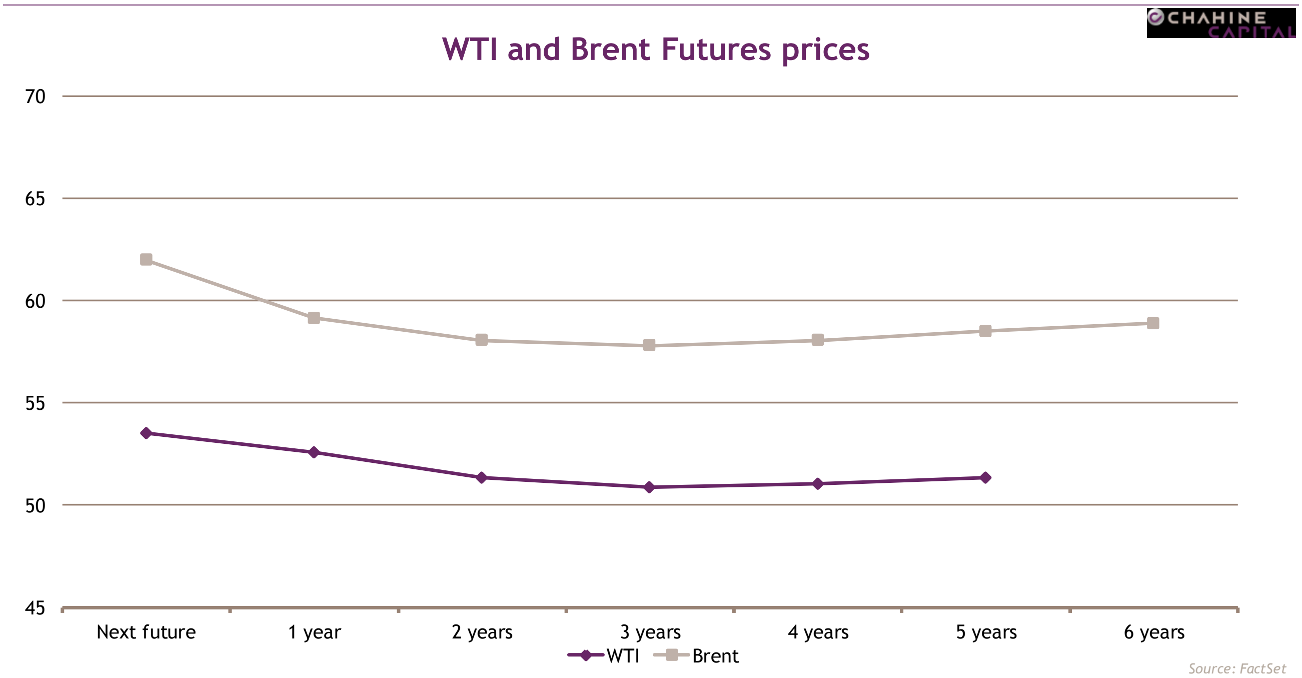
Source: FactSet

Worries over growth hit oil prices

The slide in oil prices last month was an important signal. WTI depreciated from $66.20 per barrel to $53.50, or by 19%, and the futures point to a further fall to around the $50 mark rather than any rebound. The international situation is unsettled, given developments in Iran and Venezuela, but the Americans are taking up the slack. The more disquieting factor underneath all that is the tailing off of demand prospects amid fears of slower economic growth. Lower prices will be welcome in Europe, however, and will enable

President Macron to explain to yellow jacket protesters that pump prices do not depend entirely on the government.

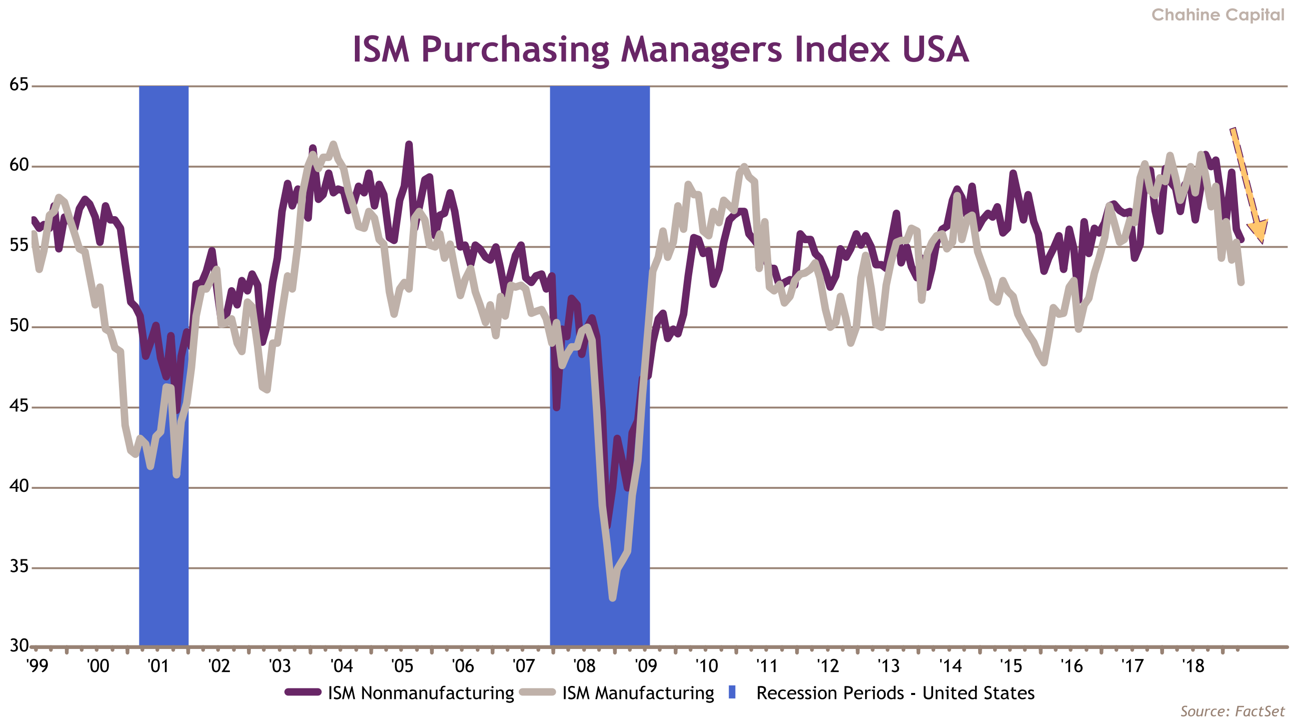
Oil futures rule out a rebound



Macroeconomic indicators generally stable

Nervousness around financial indicators has not spread to macroeconomic data, or at least not yet. World GDP growth is still expected to amount to 2.9% this year, down from 3.3% in 2018, and regional figures are unchanged. The USA is at 2.4%, the eurozone at 1.2% and Germany at only 0.9%, reflecting the impact of the ongoing trade war. Emerging countries are at 5.7% and the Chinese government is maintaining its forecast at 6.2%. The catch is that these numbers are effectively lagging indicators, and we should look at equity markets – where investors are risking their capital – for a better idea. The signals are mixed at the moment but could come together very negatively upon any bad news. Among leading macro indicators, we note a sharp downturn in the manufacturing and services ISM indices in the USA over the past few months. In the meantime, the US budget deficit has widened to $1 trillion, or 5% of GDP, but nobody appears to be worried about it.

Worsening sentiment in industry and services



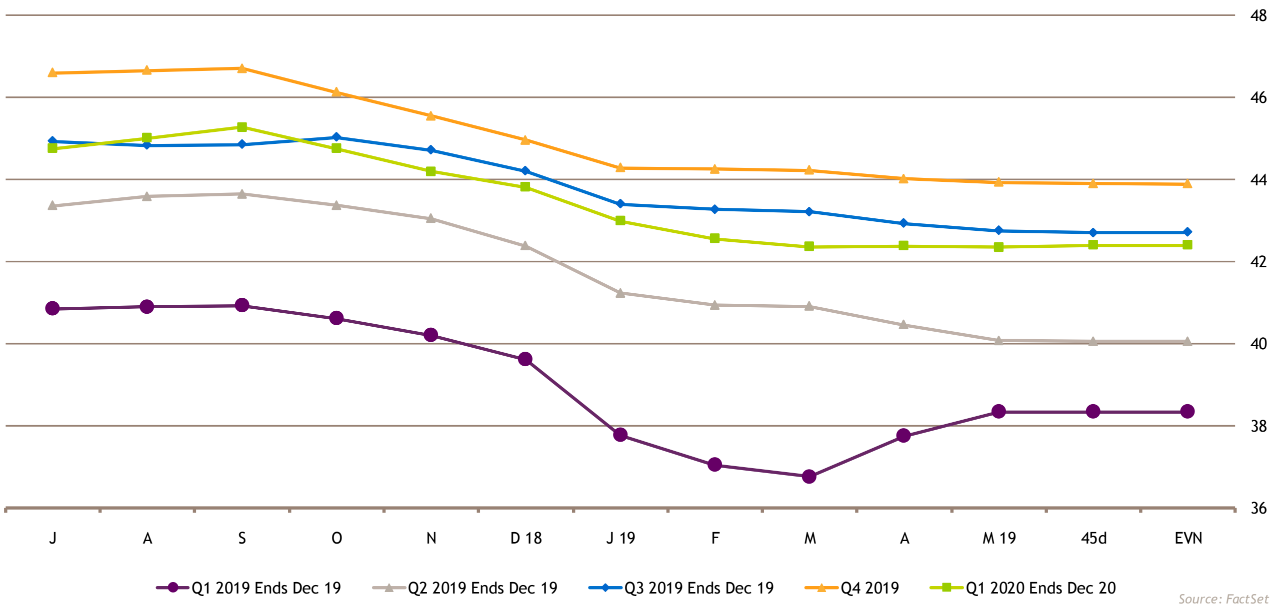
No change in corporate earnings estimates

The outlook for US corporate earnings is much the same, too. The Q1 revisions chart shows better than expected profits, but then corporate managers spent February and March issuing worse than expected guidance in order to get there. The same is going on in respect of Q2, with the same 'better than expected' result likely at the end. Even so, 2019 will not be a great year for profits. Quarterly earnings growth will be negative or unchanged until Q4, which is expected up 7.2% because of a base effect. A worsening trade war would do damage to these numbers, particularly via high-tech stocks. We expect American EPS to rise 2.1% this year, with a 3% drop in IT. Consensus analysts expect an 11% gain in 2020; we are going for 9% under the assumption of stable economic growth. In the event of recession, we would switch to -3%, with a 6% rebound in 2020.

The correction has dropped S&P 500 PERs to 16.6x 2019 and 15.1x 2020. Dividends amount to 2.1% of the index price, more or less in line with interest rates. US firms bought back shares at an annual rate of 4.2% in Q4 when prices dropped sharply; buying slowed to 3.4% in Q1 during the subsequent rally. That said, Apple bought back \$23 billion of its own shares in Q1, up from \$9 billion in Q4, to support their prices. Given the state of demand, corporate treasurers are finding buybacks a more profitable enterprise than development.

Profits forecasts stable for 2019

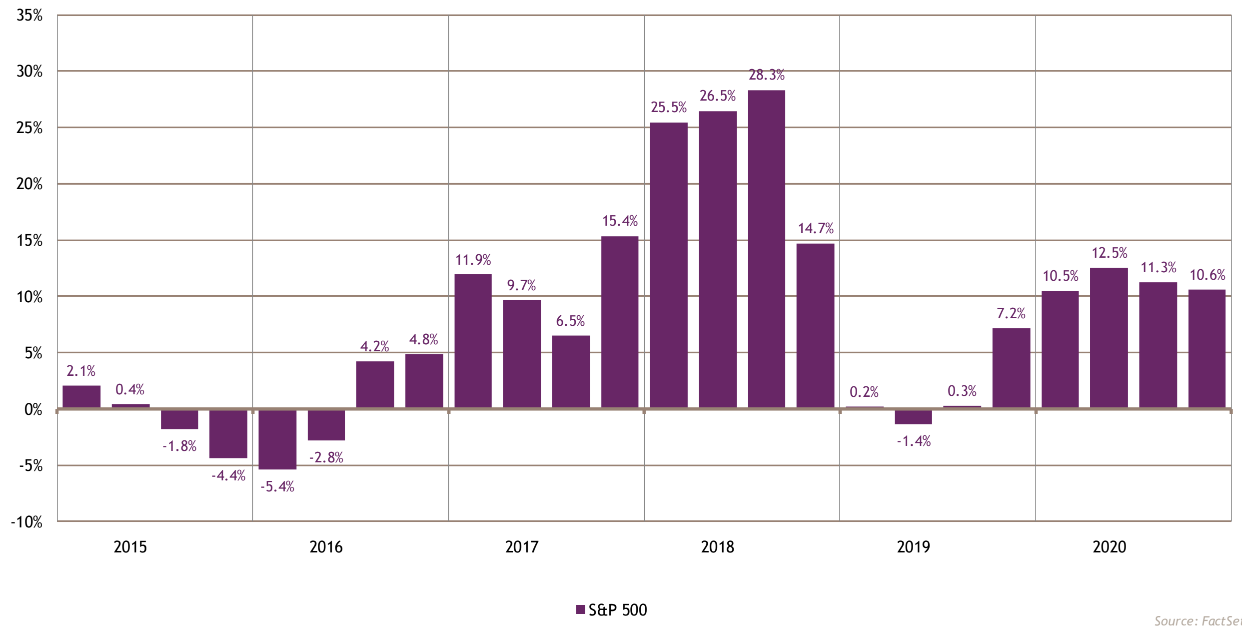
Quartely estimates revisions for S&P 500



Source: FactSet

A mediocre year in prospect but a rebound in 2020

Quarterly Earnings per Share growth S&P 500



Source: FactSet

S&P 500, main sector ratios

Data as of 31/05/19	Weight vs S&P 500	Perf 2019	Perf 2018	Weighted P/E 2020	Weighted P/E 2019	% Wted EPS Chge 2020	% Wted EPS Chge 2019	% Wted EPS Chge 2018	Div Yield 2019	Revision vs M-2% Fiscal 20	Revision vs M-2% Fiscal 19
S&P 500	100.0%	9.8%	-6.2%	14.9 x	16.6 x	11.0%	3.0%	21.8%	2.12%	-0.3%	0.0%
S&P 500 ex Energy	95.2%	10.2%	-5.2%	15.1 x	16.6 x	10.2%	3.7%	18.9%	2.02%	-0.3%	0.0%
Consumer Discr.	10.6%	12.4%	0.7%	18.5 x	20.9 x	12.7%	6.4%	18.3%	1.43%	-0.6%	-0.6%
Consumer Staples	8.1%	9.2%	-11.3%	17.7 x	18.9 x	6.9%	1.7%	12.0%	3.06%	0.2%	0.2%
Energy	4.8%	1.9%	-20.2%	12.7 x	15.9 x	25.4%	-8.5%	105.4%	3.93%	0.3%	1.1%
Financials	12.7%	8.8%	-14.8%	10.6 x	11.5 x	8.4%	7.9%	28.3%	2.36%	0.1%	0.4%
Health Care	14.0%	0.5%	4.6%	13.8 x	15.1 x	9.5%	6.2%	12.9%	1.87%	-0.1%	0.2%
Industrials	9.4%	11.6%	-15.0%	13.8 x	15.7 x	13.4%	5.6%	19.4%	2.13%	-0.4%	-0.2%
IT	20.9%	15.6%	1.9%	16.5 x	18.4 x	11.2%	0.5%	19.4%	1.62%	-0.6%	-0.2%
Materials	2.6%	4.1%	-16.3%	14.1 x	15.9 x	12.5%	-8.4%	30.2%	2.37%	-2.0%	-2.2%
Real Estate	3.1%	17.0%	-5.6%	41.2 x	42.7 x	3.6%	-14.8%	15.4%	3.28%	-0.1%	3.3%
Comm Services	10.4%	13.2%	-7.8%	16.0 x	17.9 x	12.0%	4.4%	18.6%	1.46%	-0.2%	-0.3%
Utilities	3.3%	10.0%	0.6%	17.7 x	18.7 x	5.6%	0.3%	8.4%	3.40%	-0.1%	-0.1%

Benchmarks source iShares ETF - Data as of 31/05/2019

US market valuation

The market has priced in poor earnings growth in 2019, but we are perplexed at the 2020 consensus projection of an 11% gain, and 10.2% ex-energy. Our top-down estimate is 9%, and consensus analysts are heading our way. US GDP growth forecasts for 2020 are uninspiring: 1.8%, compared with an expected 2.9% for the world economy. These figures are in line with Fed forecasts.

Analysts attribute this slowdown to the trade war. If Mr Trump is to be re-elected, he will need some kind of settlement with China and Europe. If not, his ‘successful economy’ story will be quickly forgotten.

The fall in long rates is a support factor in our valuation model, on condition that profits do not evaporate more quickly than that decline.

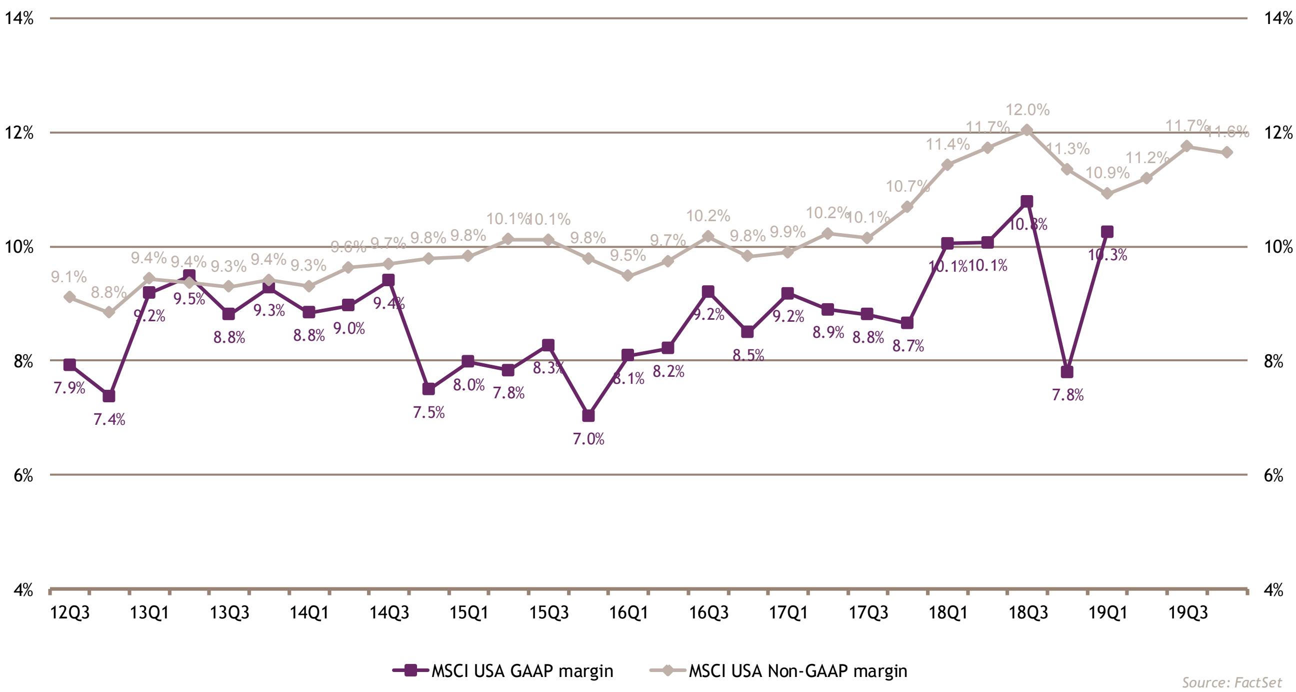
If we retain these hypotheses in our base scenario, we obtain an end-2019 objective of 2,993 points for the S&P 500 with 30-year rates at 2.65%. With a more logical 3%, we obtain 2,785 points, compared with Friday’s close at 2,752 points. Our instantaneous objective last month was 2,690 points.

Our instantaneous objective with a long rate of 2.67% is 2,886 points, some 100 points above Friday’s close. In a recession scenario, it would be 2,666 points with long rates down to 2.5%, some 100 points lower than current levels. So should investors rush in and buy? We think not. As the high VIX suggests, the risk-reward balance is not good right now. If relations with China deteriorate further, long rates would probably rise again and the market would swiftly look too expensive. One strategy that might make sense is to enter the market at the 2,666 points that would price in recession. As the market would be likely to exaggerate to the downside in that event, we would invest only some of our cash at that level and buy into lower (or higher) prices from there, depending on the situation at the time. We are therefore maintaining our decision to underweight our benchmark for the time being (35% instead of 40%, in our case).

The CAGR plays as important a role as interest rates and has dropped sharply in line with interest rates. The market’s current level implies a CAGR of 2.9% over eight years, which looks low given long-term GDP growth and inflation. The reason for this divergence is the high probability of a recession in profits during the period, especially as we are at a high in the profits cycle already. Following an atypical Q4 marked by substantial goodwill write-downs, Q1 saw a drop in margins from their highs. Non-GAAP margins published or expected in 2019 are also down.

Margins coming off their highs?

MSCI USA Net Margin GAAP vs. Non-GAAP



Source: FactSet

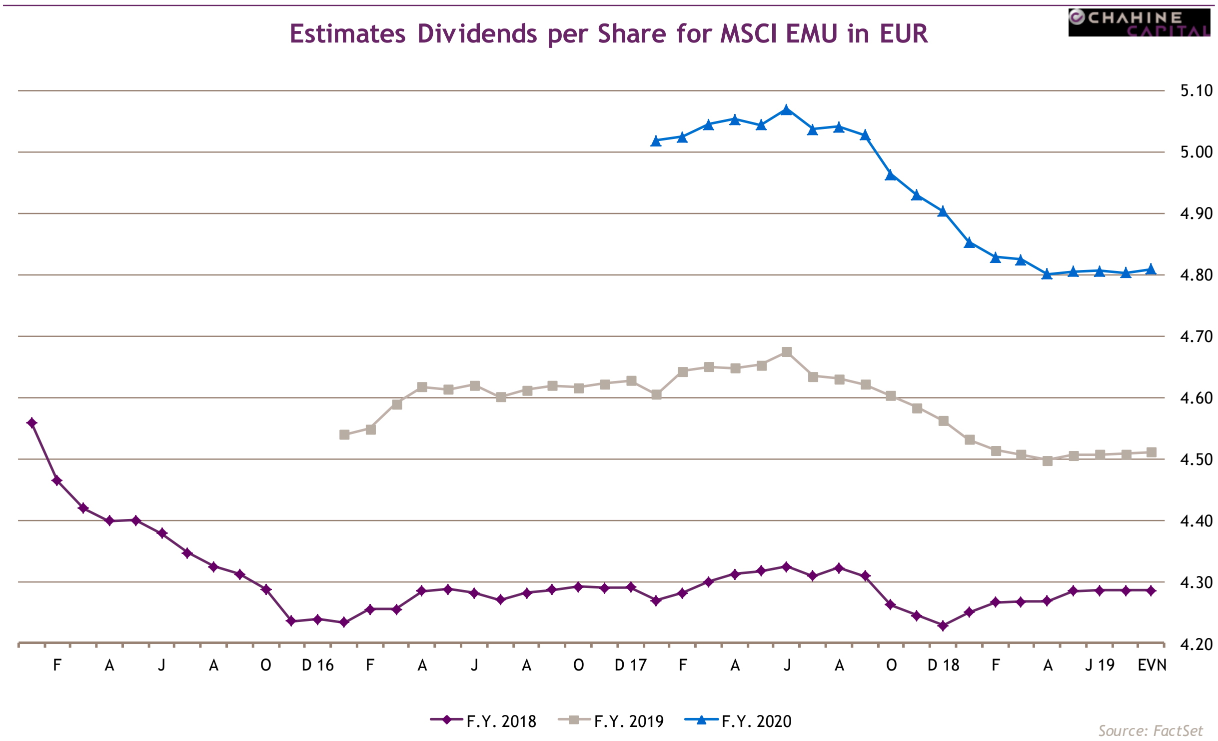
Lower interest rates make Wall Street more affordable

S&P 500 - Valuation end 2019 except implied scenario					
CAGR Compounded Annual Growth Rate from 2018	30 Years Gvt bonds				
	2.25%	2.50%	**2.65%**	2.75%	3.00%
Mild recession: -3.0% in 2019, and 6% in 2020 - CAGR =1.9%	**2 913**	**2 757**	2 670	2 615	2 485
Implied Scenario CAGR 2.9% over 8 years	3 048	2 882	**2 789**	2 730	2 591
Base scenario: 2.1% in 2019 and 9% in 2020 - CAGR = 3.4%	3 267	**3 091**	**2 993**	**2 931**	2 785
Current Index S&P 500			**2 752**		

European market valuation

Eurozone long rates have fallen steeply, giving us a weighted average 30-year yield of 1.18% after 1.34% last month. Dividend payouts – a more reliable guide than Europe's questionable earnings estimates – are worth 3.85%. The chart below shows that dividend per share is expected to climb from €4.30 in 2018 to €4.50 this year. Remember that 2018 dividends are generally payable in Europe from May 2019 onwards. The biggest dividend payers are financials, energy and utilities. All these sectors are sensitive to the state of the economy and are liable to cut dividends in the event of a downturn.

Dividends more predictable than profits



For what it is worth, EPS growth is being revised lower, and the projected 8% for 2019 will end up no better than 3%. Our base scenario gives us an index objective of 131 points, compared with Friday's close at 117. The fall in long rates has been crucial to this change. With a 30-year at 1.5%, our objective would be 122 points. If profits growth could hold up at its present level, the European market would be an attractive proposition.

European equities close to our objective

MSCI EMU - Valuation end 2019 *CAGR Compounded Annual Growth Rate from 2018*	**30 Years Gvt bonds**				
	0.75%	1.00%	**1.18%**	1.25%	1.50%
Depression scenario: -10% in 2019, and +5% in 2020 - CAGR =-6.8%	**123**	**115**	110	108	102
Implied Scenario: CAGR -6.3% over 8 years	132	124	**118**	116	110
Base scenario: 3% in 2019, and 5% in 2020 - CAGR = -4.6%	147	138	**131**	**129**	**122**
Current Index MSCI EMU			**117**		

Conclusions

Each time the equity markets wobble and the yield curve inverts, investors start worrying about the next slowdown or recession – and here we are again. Our 27 April letter turned out to have been bang on: we pointed out that Wall Street was 9% overvalued, according to our models, and the S&P 500 was at 2,940 points at the time. It closed at 2,752 points last Friday. It took another twist in America's trade war with China to focus investors on the reality of the situation, and the war of words between the two has only worsened since. Instead of joining forces with Europe, which has also been sucked into China's game, Donald Trump is looking to attack it. On equity markets, specialist retailers hit by higher tariffs have been notable casualties, while IT firms are looking at lower exports because of the embargo and weaker demand. Amid fears of slower growth and net sales of equities, long rates have slumped again in America and Europe. German yields are negative out to 15 years! The US 30-year is down to 2.58%, the curve is inverted out to 3 years and the market appears to be ordering the Fed to ease swiftly even though the state of the economy suggests the opposite.

The eurozone economy has never really bounced back from the financial crisis, even though the ECB's balance sheet has ballooned to €4.7 trillion (61% of eurozone GDP) and its interest rates are negative. The ECB says that it has enough in its toolbox to cope with a significant deceleration or recession: could that be so-called helicopter money, given that it has described the idea as 'interesting'?

Simply handing out €50 per month to each adult in the eurozone would cost €160 billion per year, compared with the ECB's sterile €4.7 trillion and could boost growth by over 1%. It would also generate tax revenue. The poorer the country, the more this windfall would be appreciated, and this sort of imaginative intervention could help reconcile EU citizens with an institution that comes in for heavy criticism. Unlike qualitative easing, which parks money among banks before it seeps out to the already rich, direct subsidies to households would boost consumption and inflation expectations. In the USA, QE has raised the prices of financial assets: equities have gained an average 12% per year over the past decade on Wall Street and Mr Trump's tax reforms have only accelerated the process. America's inequalities have widened still further. The gap between remuneration on capital and that on actual work is hitting such high levels that the law of the market is bound to correct it.

Macroeconomic indicators are very stable, giving us an unchanged world growth figure for this year of 2.9%. America's ISM series, which measures expectations for activity in manufacturing and services, is the only indicator showing a marked decline, although nervousness over demand has cut oil prices 19% from their recent highs. France's 'yellow jacket' protesters will be pleased about that. Earnings estimates are also largely unchanged, with S&P 500 profits expected to rise 2.1% this year. The drop in share prices has cut the index's PERs to 16.6x 2019 and 15.1x 2020.

Lower interest rates have boosted our S&P 500 valuation to 2,993 points for the end of 2019. It would be back down to 2,785 points with a 30-year yield of 3% in a trade war ceasefire scenario. In the event of modest recession with long rates easing to 2.5%, our instantaneous index objective would be 2,666 points, some 100 points below Friday's close. We suggest re-entering the market at this level, although only partially as it could exaggerate to the downside. We are sticking with our decision to underweight our equities benchmark (an allocation of 35% rather than 40%, in our case). European equities look attractive with such low interest rates but continue to track Wall Street.

Jacques Chahine

Main ratios for markets and sectors as of 31/5/2019 (in local currency)

Data as of	Weight vs	Perf		Weighted P/E		% Wted EPS Chge			Div Yield	Revision vs M-2%	
31/05/19	MSCI World	2019	2018	2020	2019	2020	2019	2018	2019	Fiscal 20	Fiscal 19
MSCI The World Index	**100.0%**	**8.6%**	**-10.3%**	**13.9 x**	**15.3 x**	**9.9%**	**4.1%**	**12.2%**	**2.69%**	**-0.5%**	**-0.4%**
MSCI USA	60.7%	10.0%	-6.5%	15.0 x	16.8 x	11.4%	3.0%	21.9%	2.09%	-0.3%	-0.1%
MSCI Japan	8.3%	1.8%	-15.8%	11.4 x	11.9 x	5.0%	-0.6%	1.2%	2.82%	-2.1%	-2.4%
MSCI EMU	14.0%	8.5%	-14.5%	11.8 x	12.9 x	9.8%	7.9%	0.4%	3.85%	-0.3%	-0.4%
MSCI Europe	25.6%	9.0%	-13.0%	12.3 x	13.4 x	9.3%	8.1%	5.3%	4.03%	-0.6%	-0.6%
MSCI Europe ex Energy	23.7%	9.2%	-13.7%	12.6 x	13.7 x	8.7%	8.5%	2.1%	3.87%	-0.6%	-0.7%
MSCI Austria	0.1%	3.3%	-26.7%	8.3 x	9.0 x	8.2%	-12.0%	11.2%	4.63%	-0.3%	-1.1%
MSCI Belgium	0.6%	11.6%	-24.9%	14.0 x	14.8 x	5.7%	14.6%	-0.6%	3.44%	-0.7%	0.9%
MSCI Denmark	0.7%	10.1%	-12.4%	17.3 x	19.7 x	14.1%	0.4%	-0.9%	2.50%	-1.1%	-0.7%
MSCI Finland	0.4%	2.5%	-1.5%	13.6 x	15.6 x	14.0%	5.7%	2.3%	5.03%	-0.4%	-0.2%
MSCI France	5.2%	10.3%	-9.7%	12.5 x	13.8 x	10.7%	8.7%	6.3%	3.59%	0.0%	-0.1%
MSCI Germany	3.6%	6.9%	-20.2%	11.1 x	12.3 x	10.8%	8.9%	-9.7%	3.60%	-0.4%	-1.1%
MSCI Great-Britain	5.8%	6.0%	-12.7%	11.5 x	12.5 x	8.3%	4.0%	9.7%	4.89%	0.6%	0.7%
MSCI Ireland	0.2%	12.8%	-23.5%	14.0 x	14.9 x	6.3%	-1.5%		2.00%	-0.1%	0.8%
MSCI Italy	1.0%	7.8%	-15.5%	9.1 x	9.7 x	6.0%	9.9%	14.1%	5.18%	0.6%	2.3%
MSCI Netherlands	1.4%	11.0%	-10.9%	13.7 x	15.2 x	11.1%	-0.7%	7.9%	3.42%	-1.4%	-2.2%
MSCI Norway	0.5%	2.9%	-6.0%	11.8 x	13.5 x	15.2%	2.0%	19.5%	4.85%	0.1%	0.9%
MSCI Spain	1.4%	5.9%	-15.0%	10.8 x	11.5 x	6.7%	11.5%	-5.4%	4.85%	-0.4%	-0.6%
MSCI Sweden	1.0%	7.6%	-8.1%	13.4 x	14.2 x	6.1%	30.2%	-7.5%	4.46%	0.8%	1.3%
MSCI Switzerland	3.3%	14.5%	-10.1%	15.5 x	16.9 x	9.3%	11.7%	25.0%	3.30%	0.1%	0.1%
MSCI Europe Consumer Discretionary	2.9%	10.8%	-17.5%	11.1 x	12.1 x	9.1%	9.4%	-7.9%	3.53%	-1.0%	-1.9%
MSCI Europe Consumer Staples	4.0%	16.0%	-11.3%	17.0 x	18.4 x	8.3%	9.4%	7.6%	3.07%	-0.6%	-0.7%
MSCI Europe Energy	2.0%	5.9%	-5.0%	9.8 x	11.3 x	15.3%	4.1%	49.0%	5.79%	0.0%	1.0%
MSCI Europe Financials	4.4%	5.0%	-21.8%	8.9 x	9.6 x	7.2%	10.9%	5.9%	5.63%	-0.7%	-0.3%
MSCI Europe Health Care	3.1%	7.0%	-2.5%	14.5 x	15.8 x	8.7%	5.3%	4.9%	3.24%	0.2%	0.2%
MSCI Europe Industrials	3.4%	12.1%	-15.0%	14.3 x	15.8 x	10.4%	7.8%	3.2%	3.03%	-0.7%	-0.6%
MSCI Europe Information Technology	1.4%	17.5%	-8.2%	17.3 x	20.5 x	19.0%	11.6%	12.6%	1.60%	1.4%	1.4%
MSCI Europe Materials	1.7%	7.1%	-16.4%	11.8 x	12.7 x	7.0%	10.3%	1.2%	4.32%	-0.9%	-2.0%
MSCI Europe Real Estate	0.3%	8.2%	-17.5%	14.3 x	13.6 x	-4.4%	-16.6%	11.3%	4.85%	-1.0%	0.9%
MSCI Europe Communication Service	1.3%	-1.6%	-10.7%	12.7 x	13.9 x	9.8%	6.0%	-7.9%	4.87%	-2.2%	-3.0%
MSCI Europe Utilities	1.2%	8.0%	-1.3%	13.2 x	14.7 x	11.6%	13.7%	-13.1%	5.22%	-0.7%	-1.0%

Benchmarks source iShares ETF - Data as of 31/05/2019