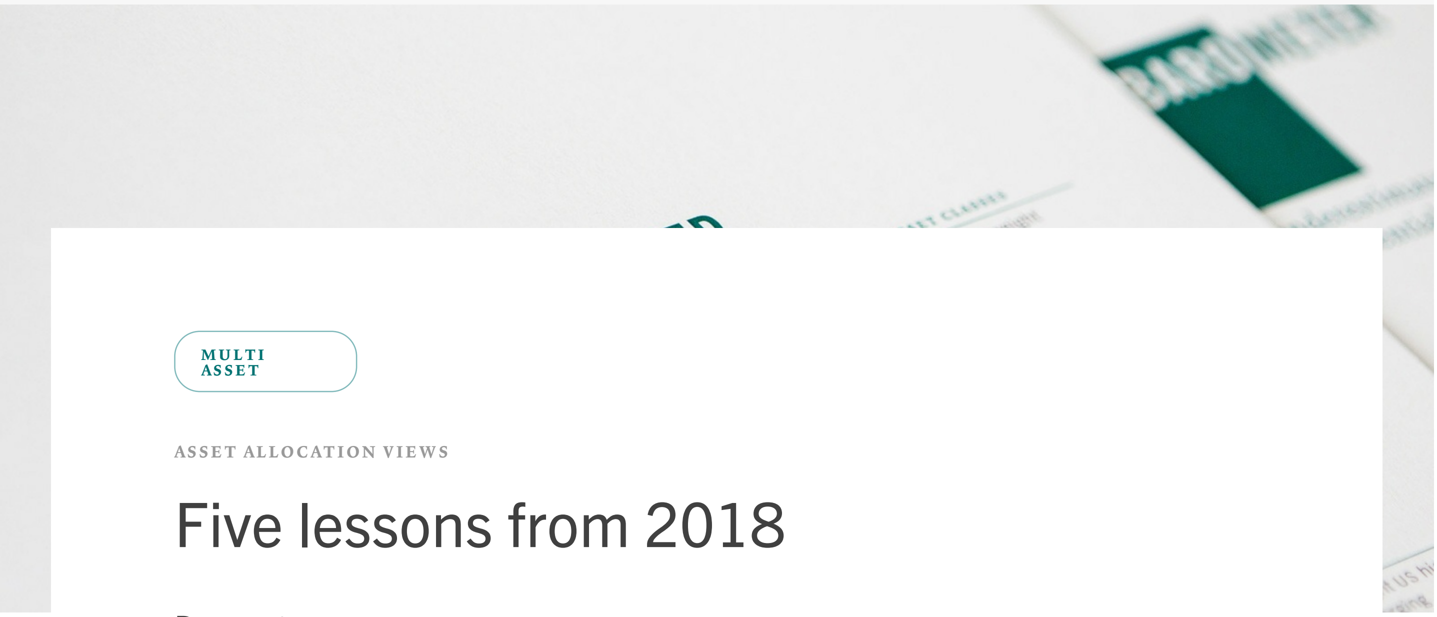
PICTET
Asset Management



MULTI ASSET

ASSET ALLOCATION VIEWS

Five lessons from 2018

Barometer

January 2019

Luca Paolini, Chief Strategist

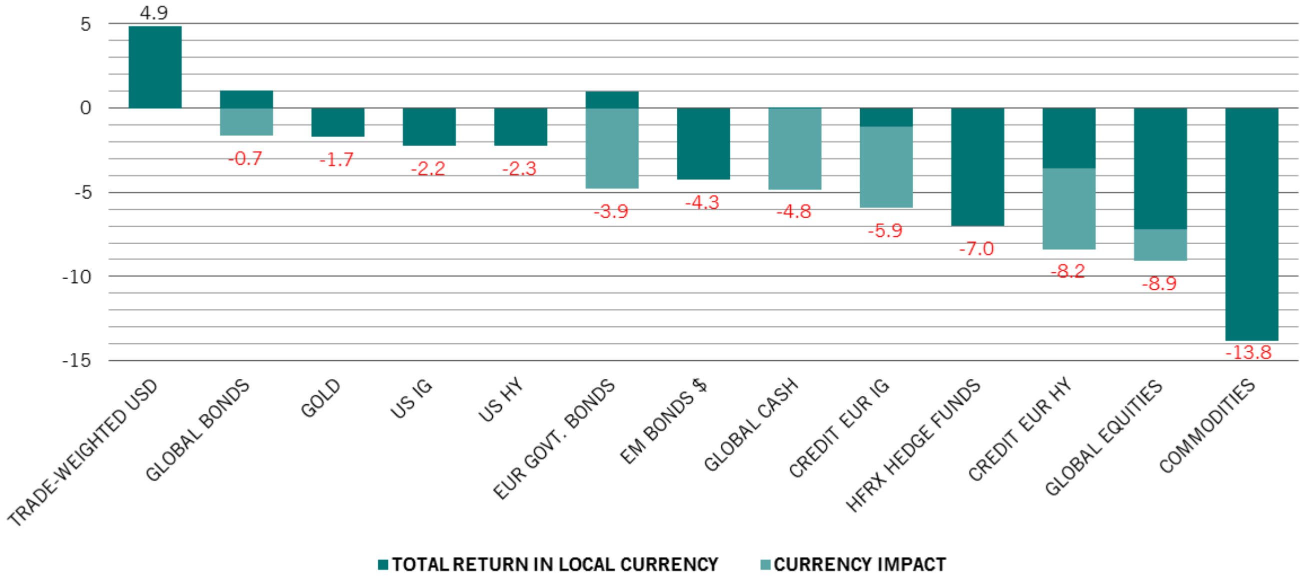
2018 was painful for most investors, a year that forced them to learn (or re-learn) a number of important lessons.

No hiding place in 2018

Diversification was not a winning strategy in 2018. The vast majority of regional stock markets and industry sectors that make up the MSCI World Index ended in the red last year, as did US Treasuries and corporate bond indices. Global government bonds would have done the same had it not been for a sharp December rally. Indeed, for US dollar-based investors, all major asset classes finished underwater, leaving US cash as the best performing asset class for the first time since before 1986 (see chart).

A TOUGH YEAR FOR INVESTORS

Total return % in USD and local currency



Source: Thomson ReutersDatastream, Pictet Asset Management. Currency impact equals the appreciation of the local currency vs USD. Data covering period 31.12.2017-31.12.2018

A risk parity portfolio – one in which 75 per cent of assets are invested in global bonds (JPM Global Government Bonds in local currency) and the balance in global equities (MSCI World) – would have fallen in value by 1 per cent by year-end. That's the first time such a portfolio has suffered a loss since 2008, and, before that, 1994.

Central bank stimulus matters...

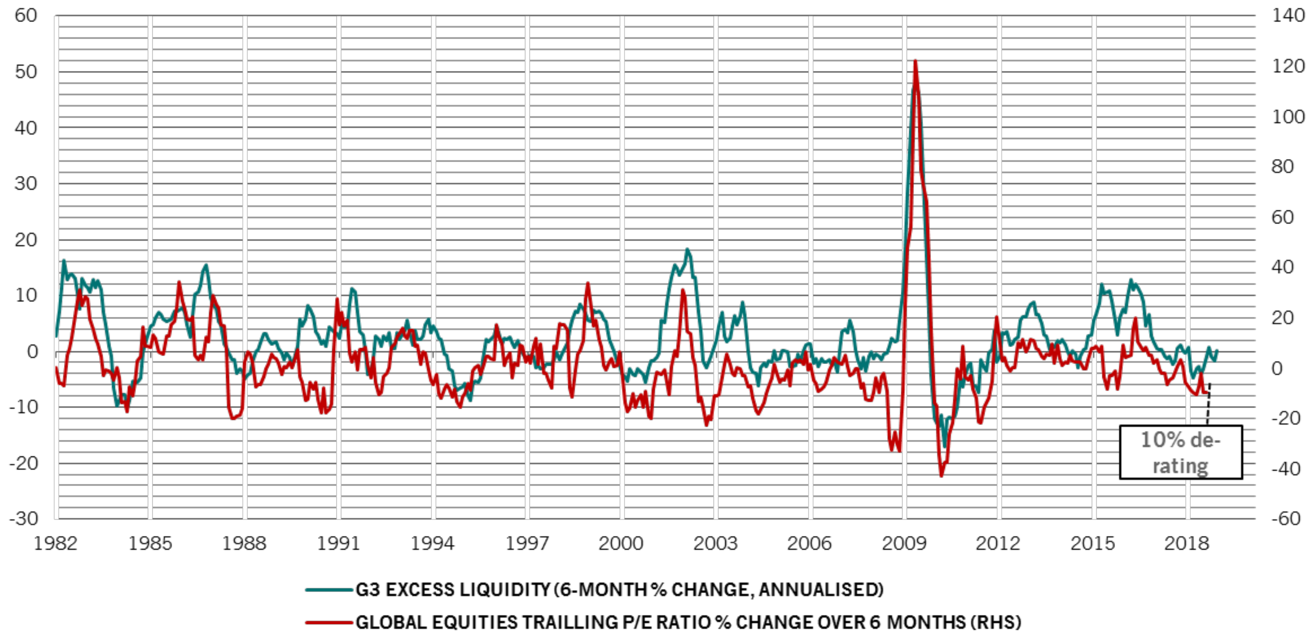
What goes up must come down? Quantitative easing by global central banks has pushed up asset prices since the financial crisis, resulting in a record-breaking bull run in global stocks. But in 2018, and for the first time in 10 years, the world's major monetary authorities have turned net sellers of financial assets: their stimulus has fallen to USD600 billion in 2018 from USD2.6 trillion in the previous year.[1]

Our analysis shows that the withdrawal of liquidity has already started to weigh on price-earnings multiples.

Looking ahead, we expect excess liquidity to keep falling. This would likely prompt a 10 per cent drop in the valuation of global equities on a price earnings basis (see chart)[2].

WHERE LIQUIDITY GOES, EQUITIES FOLLOW

G3 excess liquidity and global equities trailing price-to-earnings ratio



Source: Thomson Reuters Datastream, Pictet Asset Management. Data covering period 30.04.1982-29.03.2019 (estimated).

…and so does geopolitics

All politics may be local, but then again, so are earthquakes. 2018 reminded us that political tremors can travel a long, long way. One of US President Donald Trump's main populist platforms was his argument that the US gets a raw deal from its trade partners, particularly China. Using his executive powers, he imposed substantial tariffs while threatening even bigger ones. So far, global trade has been relatively resilient. Manufacturers or consumers have managed to absorb the costs or, alternatively, to find new customers or new suppliers.

But for how long can the real global economy remain immune is questionable. Trade wars have already had a big impact on business sentiment. Take the export orders component of the global purchasing managers' index. Having hit 55.7 in February, its highest point since 2011, PMI export orders dropped to 50.6 in October, which is barely in expansion territory — a slump that's likely to have been driven by global trade tensions (see chart).

What is more, trade isn't an issue that's likely to go away soon. That is because at its heart is the tug of war for global supremacy between the US and China, something that will play out over years to come.

EXPORTING WORRIES

Global economic activity (PMI) vs export orders

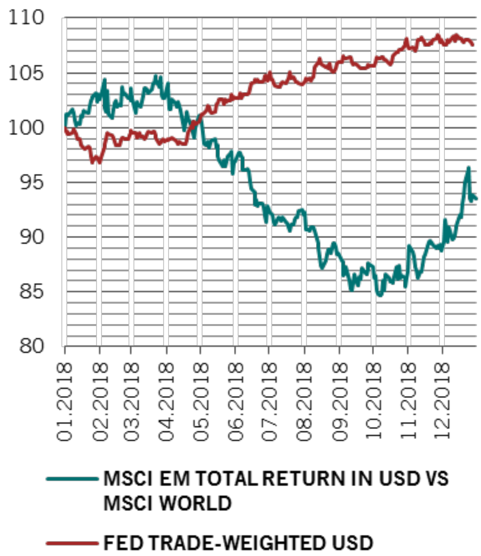
World PMI based on 34 manufacturing PMIs, GDP-weighted. Export orders based on 22 PMIs, GDP-weighted. Source: Thomson Reuters Datastream. Data as of 30.11.2018.

A stronger US dollar is always bad news for emerging markets

Emerging markets looked good on paper at the start of 2018: strong economic growth, low inflation, recovering commodity prices, attractive valuations… But one fly found its way into the ointment: the US dollar.

DOLLAR DRAG

MSCI EM total return in local currency relative to MSCI World; Fed trade-weighted USD



Rebased to 01.01.2018. Source: Thomson Reuters Datastream. Data covering period 29.12.2017-30.11.2018.

The greenback climbed some 8 per cent against a trade-weighted basket of currencies. For emerging markets that proved a sharp blow, raising fears of higher costs of servicing dollar-denominated debt and rising prices for foreign goods. As a result, total returns on developing market equities, in dollar terms, lagged the global benchmark by around 7 per cent (see chart).

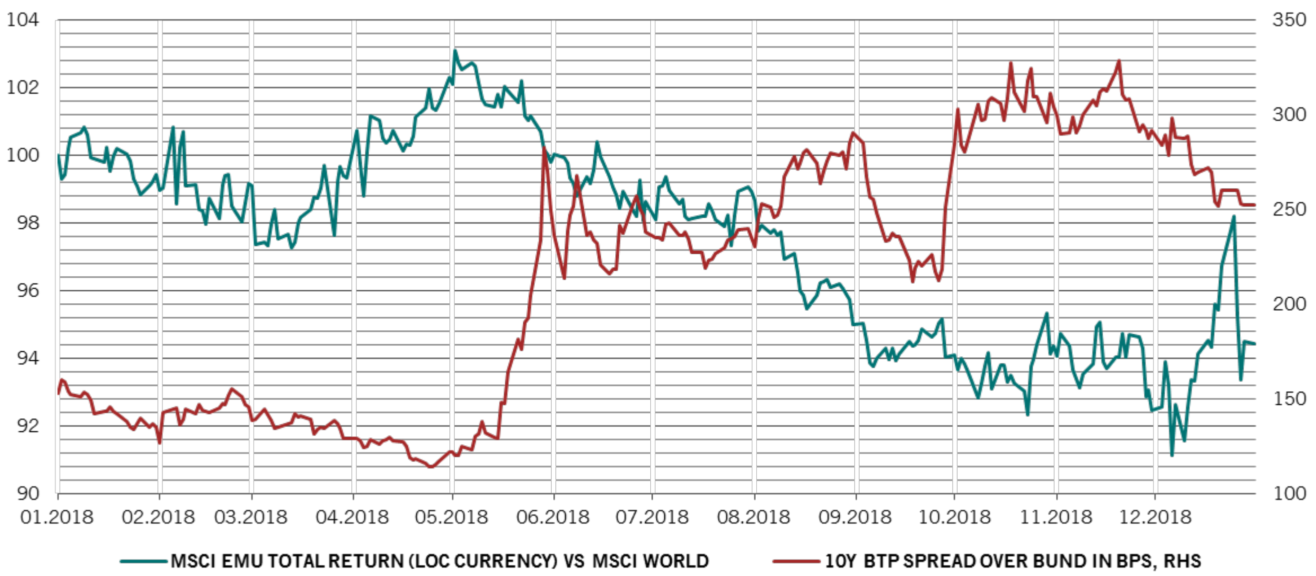
Going into 2019, there are grounds to expect that the dollar will reverse course, as US growth slows, Fed tightening loses some steam and fiscal stimulus effect fades. High valuations and very bullish sentiment are additional headwinds. However, whichever way the wind blows, it seems likely that returns from emerging markets will remain closely tied to the path of the greenback.

Never under-estimate Europe's ability to disappoint

Emerging markets weren't the only region to disappoint. The poor performance of European stocks – a consensus long last January – proved that the region's troubles are far from over. Italy was the chief cause for concern, both politically and economically. While the Italian government clashed with Brussels over plans for an expansionary budget, the country's economy stagnated, dragging down growth for the euro zone as a whole. The yield spread between 10-year Italian sovereign bonds and their German peers climbed above 300 basis points in the autumn – the highest since July 2013. That, in turn, pegged back European equities (see chart). In both local and US dollar terms, European equities hit an all-time low relative to their US peers in December.

YIELDING PROBLEMS FOR STOCKS

MSCI EMU total return in local currency relative to MSCI World; 10-year yield spread between Italian BTPs and German bunds, basis points



Source: Thomson Reuters Datastream. Data covering period 01.01.2018-30.11.2018.

[1] Policy liquidity flow is calculated as central bank net injection over preceding 6 months, as % of nominal GDP, using current USD GDP weights.

[2] Excess liquidity is measured by broad money minus value of domestic industrial production (volume times producer price index) growth over the past 6 months (GDP-weighted)

expression of an opinion, based on available data at a specific date. The effective evolution of the economic variables and values of the financial markets could be significantly different from the indications communicated in this document.

Information, opinions and estimates contained in this document reflect a judgment at the original date of publication and are subject to change without notice. Pictet Asset Management has not taken any steps to ensure that the securities referred to in this document are suitable for any particular investor and this document is not to be relied upon in substitution for the exercise of independent judgment. Tax treatment depends on the individual circumstances of each investor and may be subject to change in the future. Before making any investment decision, investors are recommended to ascertain if this investment is suitable for them in light of their financial knowledge and experience, investment goals and financial situation, or to obtain specific advice from an industry professional.

The value and income of any of the securities or financial instruments mentioned in this document may fall as well as rise and, as a consequence, investors may receive back less than originally invested. Risk factors are listed in the fund's prospectus and are not intended to be reproduced in full in this document.

Past performance is not a guarantee or a reliable indicator of future performance. Performance data does not include the commissions and fees charged at the time of subscribing for or redeeming shares. This marketing material is not intended to be a substitute for the fund's full documentation or for any information which investors should obtain from their financial intermediaries acting in relation to their investment in the fund or funds mentioned in this document.

EU countries: the relevant entity is Pictet Asset Management (Europe) S.A., 15, avenue J. F. Kennedy, L-1855 Luxembourg
Switzerland: the relevant entity is Pictet Asset Management SA , 60 Route des Acacias – 1211 Geneva 73

Hong Kong: this material has not been reviewed by the Securities and Futures Commission or any other regulatory authority. The issuer of this material is Pictet Asset Management (Hong Kong) Limited.

Singapore: this material is issued by Pictet Asset Management (Singapore) Pte Ltd. This material is intended only for institutional and accredited investors and it has not been reviewed by the Monetary Authority of Singapore.

For Australian investors, Pictet Asset Management Limited (ARBN 121 228 957) is exempt from the requirement to hold an Australian financial services license, under the Corporations Act 2001.

For US investors, Shares sold in the United States or to US Persons will only be sold in private placements to accredited investors pursuant to exemptions from SEC registration under the Section 4(2) and Regulation D private placement exemptions under the 1933 Act and qualified clients as defined under the 1940 Act. The Shares of the Pictet funds have not been registered under the 1933 Act and may not, except in transactions which do not violate United States securities laws, be directly or indirectly offered or sold in the United States or to any US Person. The Management Fund Companies of the Pictet Group will not be registered under the 1940 Act.
Pictet Asset Management Inc. (Pictet AM Inc) is responsible for effecting solicitation in North America to promote the portfolio management services of Pictet Asset Management Limited (Pictet AM Ltd) and Pictet Asset Management SA (Pictet AM SA).

In Canada Pictet AM Inc. is registered as Portfolio Manager authorised to conduct marketing activities on behalf of Pictet AM Ltd and Pictet AM SA. In the USA, Pictet AM Inc. is registered as an SEC Investment Adviser and its activities are conducted in full compliance with the SEC rules applicable to the marketing of affiliate entities as prescribed in the Adviser Act of 1940 ref. 17CFR275.206(4)-3.