

. January 2020 .

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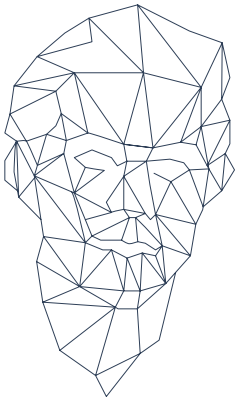
# OUTLOOK

*by* **S I L E X**





# EDITO



**Xavier Laborde**  
CEO, Co-founder  
SILEX

2019 proved a busy year for SILEX, with a lot of achievements that make us both proud of the distance travelled and excited about what's coming in 2020. Chief among them has been the build-up of our asset management capabilities.

Asset management is a key component of SILEX, the reason we created SILEX Investment Managers, a company regulated by the French AMF, in October 2018. Since then, we have launched a number of strategies in fixed income, equities, absolute returns and cross-asset, with most recently two core equity strategies in UCITS format.

After a year 2019 driven by exceptional performance in financial markets, we believe that 2020 may prove more challenging. Our clients and partners are keen to participate in the upside but appear increasingly wary about downside risks. This is where SILEX IM fits in. We believe that our quantamental process, bringing together human skill and quantitative robustness via our platform SPARK, will help us deliver performance while avoiding bad surprises. Our strategies are designed to maintain a focus on real-time risk management with an all-weather approach that abstracts from institutional benchmarks.

Today, I am delighted to present the first annual Outlook from SILEX Investment Managers. Our portfolio management team shares their convictions and recommendations for 2020. We hope you will enjoy it and look forward to getting the conversation going!

Happy New Year to all,

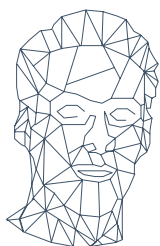
Xavier Laborde



# ASSET ALLOCATION VIEW

By Maxime Alimi, Head of Macro & Allocation

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Maxime joined SILEX in 2019 as Head of Macro & Allocation. He is in charge of both research and macro analysis on the one hand, and cross-asset portfolio management on the other. He began his career in London in 2007 as an economist at Lehman Brothers then as a multi-asset strategist at Goldman Sachs. In 2012, Maxime joined AXA Investment Managers and then became Head of Investment Strategy in Paris. Maxime holds a degree in international relations from Sciences Po Paris and the Freie Universität Berlin, and in economics from Paris I Sorbonne University and the London School of Economics.

## WHAT IS YOUR BEST TRADE FOR 2020?

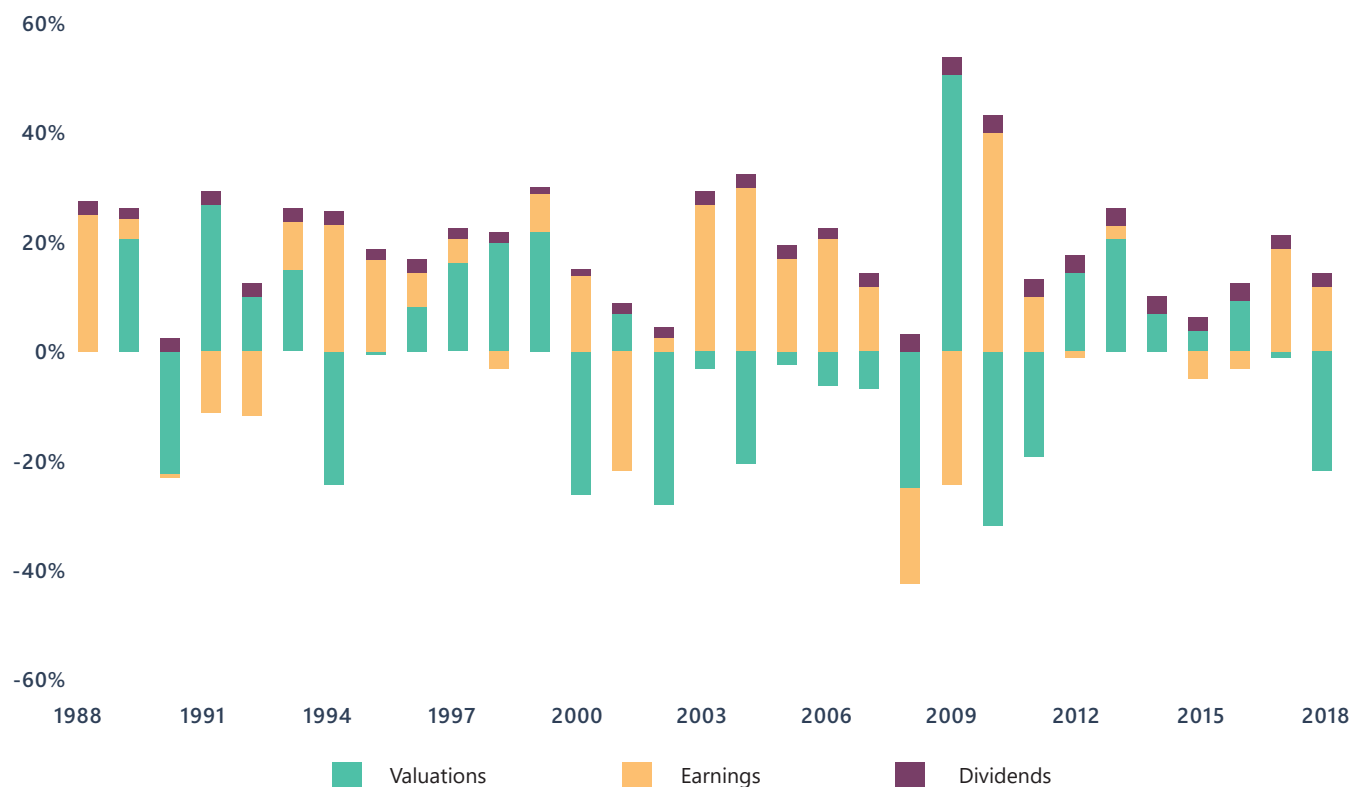
**Don't be too greedy and focus on valuations.**

As macro and political risks are now mostly priced out, there is limited room for upside surprise in markets. Monetary policy is likely to remain on the sidelines in 2020 while scope for significant fiscal easing is immaterial. As a result, we expect low returns across the board and focus on relative value trades rather than broad market exposure. Reduce the equity allocation to neutral and increase exposure to relatively cheaper asset classes: Emerging Markets, small caps and unloved cyclical sectors such as Energy and Materials.

## WHAT IS YOUR BEST CHART FOR 2020?\_

Phases of large equity multiple expansions like 2019 do not necessarily imply negative performance the following year. However, sustaining the rally requires earnings growth to materialise, as was the case in the early 1990s or in 2010.

### MSCI World performance decomposition



Source: MSCI, SILEX

## WHAT IS YOUR GREATEST RISK FOR 2020?\_

### An earnings disappointment.

Investors have now come round to our view that a recession is unlikely in the short run. Most expect an economic rebound that would translate into earnings growth around 5-10% in 2020. This for now remains elusive in the data. If earnings expectations are revised down, I would expect the stock market correction to be material.

## WHAT IS YOUR DEAREST WISH FOR 2020?\_

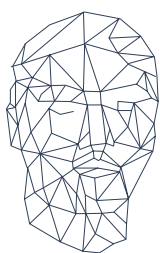
I wish that our clients follow us in the quantamental revolution and start using SPARK extensively!



# EQUITY VIEW

By Benoit Brochart, Senior Equity Portfolio Manager

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Benoit is senior portfolio manager at SILEX IM since 2018. He started his career as a quantitative analyst at Total Oil Trading in 2004. From 2005 until 2011 he worked at Crédit Agricole CIB in the equity derivatives department as a prop trader, leading the development of index and statistical arbitrage. In 2011, Benoit became portfolio manager for Unigestion. As a member of the investment committee, he participated in managing Equity Risk Managed funds. In 2017 he joined SILEX, taking the lead on developing the asset management business. Benoit graduated from ENSAE.

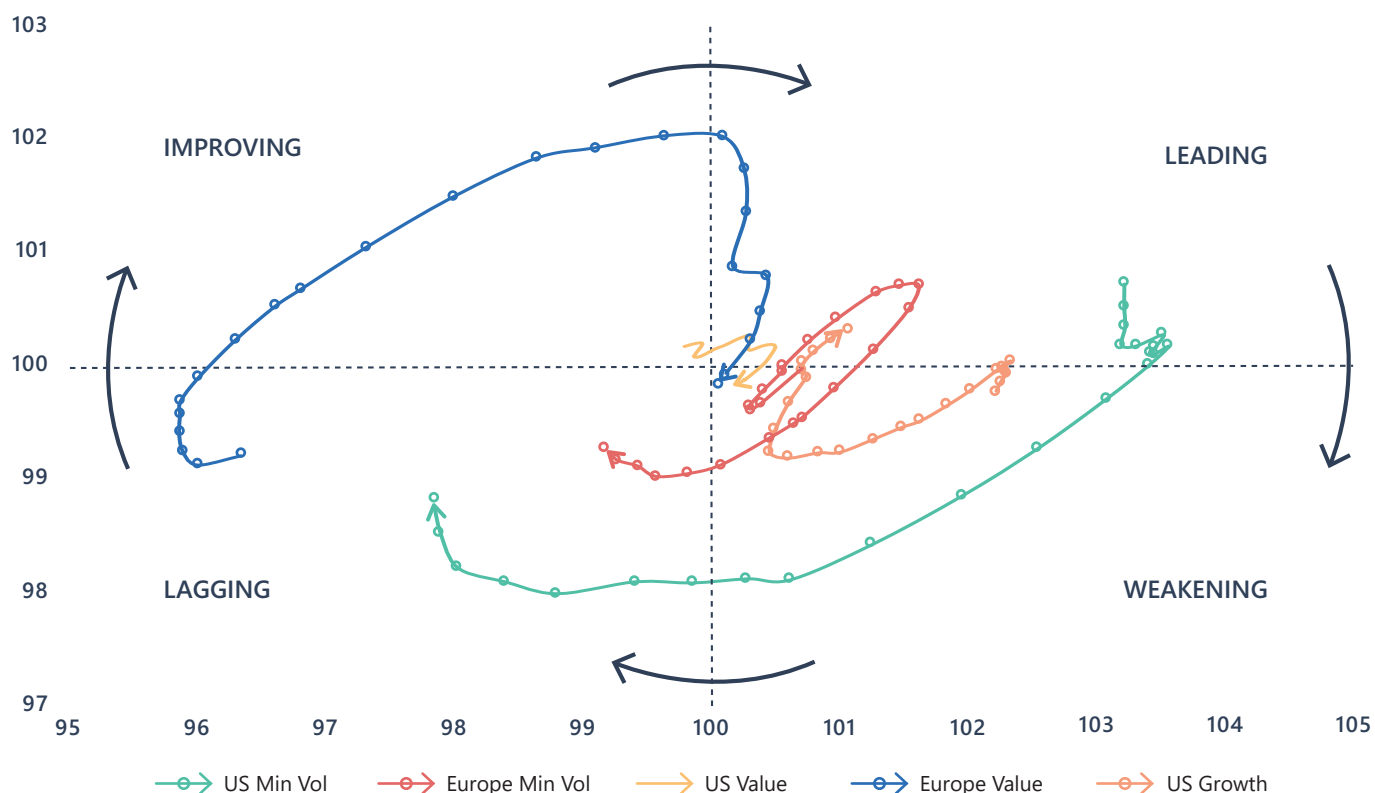
## WHAT IS YOUR BEST TRADE FOR 2020?

**Avoid the crowd! All investors are focussing on the same themes** with a market that has rotated out of defensive sectors to favour cyclicals and reflation stocks. The economic consensus looks very strong for 2020: trade tensions fading, manufacturing picking up and the Fed stepping back. As a result, most expect a continuation of the rotation from Momentum to Value, with Low Vol having the worst risk-reward profile. Given increasingly automated and technical markets, such a consensus can lead to extreme movements on stocks, sectors and styles: our main recommendation is to beware crowding risks. A way to do that is to use SPARK to reduce correlation within a portfolio.

## WHAT IS YOUR BEST CHART FOR 2020?\_

The relative strength of factor indices in the US and Europe since August 2019 highlights that Low Risk and Low Volatility have lagged while Value had a strong performance that seems to be already waning. Meanwhile, Growth continues to outperform in the US. Our take: even if we favour Cyclical and reflation stocks, market timing will be key in coming months and a dynamic use of options will help limit volatility.

### Performance of equity factors since August 2019



Source: Bloomberg, SILEX

## WHAT IS YOUR GREATEST RISK FOR 2020?\_

US elections are scheduled for November 3<sup>rd</sup> and the range of outcomes remains wide. Bernie Sanders and Joe Biden are favourites in current polls but uncertainty will remain high through the Democratic primary. From an equity perspective, many candidates have called for a rolling back of 2017 corporate tax cuts that would impact EPS by more than 10%. At industry level, Managed Care companies have the worst risk/reward profile due to policy risks including "Medicare for All" while "Big Tech" companies are also in focus with calls for regulatory and antitrust scrutiny.

## WHAT IS YOUR DEAREST WISH FOR 2020?\_

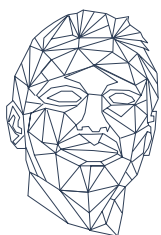
I wish George R. R. Martin would write a much better ending to the Game of Thrones saga than what the TV series came up with last year.



# FIXED INCOME VIEW

By Philippe Kellerhals, Head of Fixed Income

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Philippe started his career in 2003 at BNP Paribas, as a credit portfolio manager. In 2008, he joined Cairn Capital in London with responsibility for corporate credit strategies covering trading, portfolio management and research. Philippe joined SILEX in 2018 as Head of Fixed Income. He manages the SILEX Financial Credit and the SILEX Flexible Bond funds. Philippe holds a master's degree in Finance from ESCP Europe and is a CFA® charterholder.

## WHAT IS YOUR BEST TRADE FOR 2020?

### **Legacy subordinated bank debt with low regulatory value.**

As we get closer to the end of the grandfathering period (end of 2021), we expect the pace of liability management exercises to accelerate, resulting in favourable outcomes for bondholders. In particular, we like bonds issued indirectly, under non-EU law, with long call dates and no regulatory par call clauses: this combination of features results in more significant upside for bondholders, i.e. a larger difference between potential tender offers and current market prices.



## WHAT IS YOUR BEST CHART FOR 2020?\_

Implied volatility on US high yield is now lower than on 7-10yr Treasuries. Higher than average credit exposure and managing duration risk actively remain logical for now. SPARK will help us reallocate dynamically between fixed income segments as the market risk regime shifts.

### Yield vs. implied volatility on US fixed income ETFs



Source: Bloomberg, SILEX

## WHAT IS YOUR GREATEST RISK FOR 2020?\_

**A Chinese hard landing**, fuelled by a continued rise in corporate debt defaults and higher levels of financial instability. The recent debt restructuring of commodities group Tewoo underlines a growing tolerance for market-based solutions at state-owned firms as default volumes climbed to a record high in 2019. The banking sector's asset quality issues are likely to continue growing, especially at regional banks, potentially reducing the efficacy of monetary transmission.

## WHAT IS YOUR DEAREST WISH FOR 2020?\_

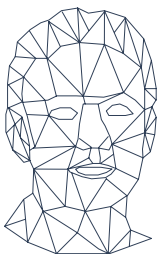
I wish that **SILEX continues to serve its clients well** by providing high-quality products and services whilst continuing to grow at its current pace.



# DERIVATIVES VIEW

By Matthieu Ressencourt, Head of Equity Absolute Return

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Matthieu began his career at BAREP Asset Management in 2003. He then joined Credit Agricole CIB, where he held several equity derivatives trading positions between 2004 and 2007 in London, New York and Paris. He continued his career at LEHMAN BROTHERS in London as an exotic trader. In 2008, he joined VTB Capital in London, where he became responsible for equity derivatives trading in 2011. Finally, in 2014, he ran equity derivatives trading operations at BCS Global Markets in London until joining SILEX in 2009. Matthieu Ressencourt is a graduate of ENSIMAG (2004), and holds the AMF certification (2019).

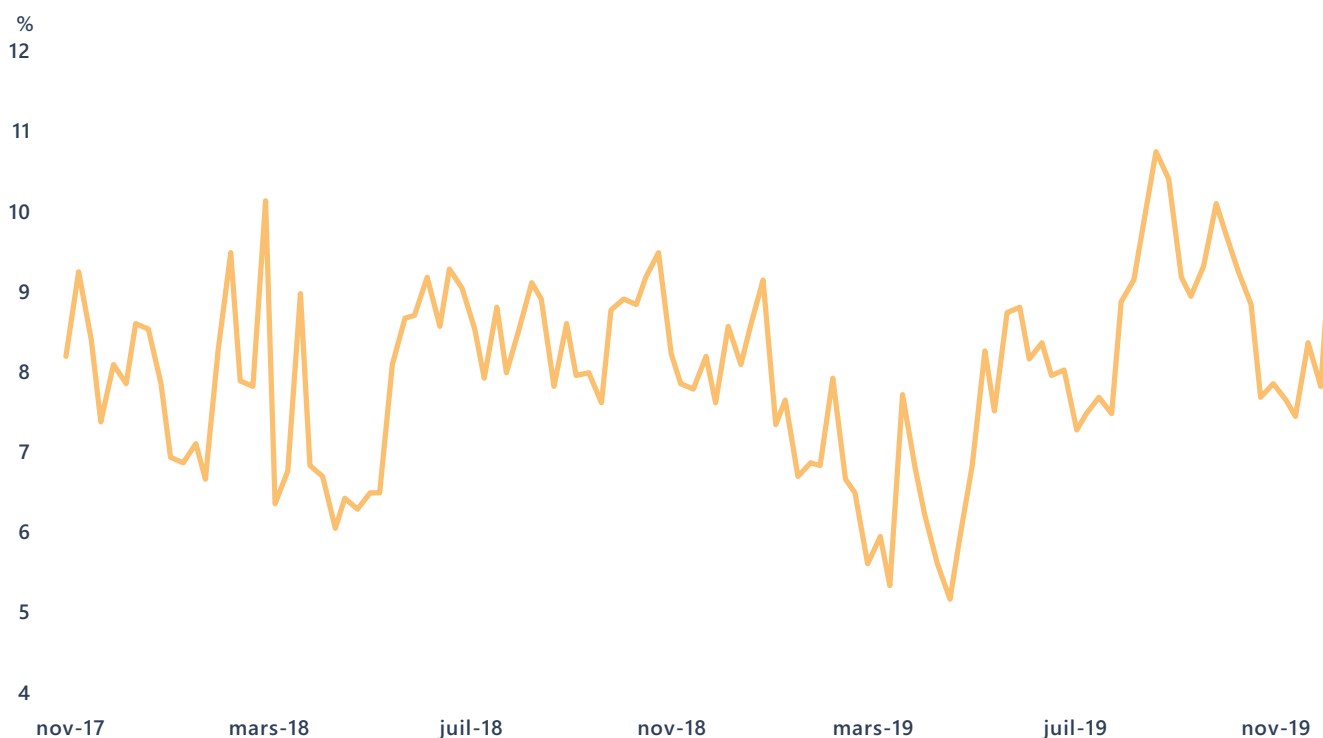
## WHAT IS YOUR BEST TRADE FOR 2020?

**Implied repo** deserves to be highlighted as one of the best trades for 2020, capturing the repo differential between short-term and long-term interest rates using listed Eurostoxx 50 total return futures. This is a trade investors should hold to avoid negative interest rates. Short-term repo is driven by market performance, evolving regulation and collateral availability while the longer term is impacted by structured products' issuance.

## WHAT IS YOUR BEST CHART FOR 2020?\_

A key trend last year has been the steepening in implied skew. Demand for protected returns is growing and we have seen the downside skew steepening across all markets as a result. However, investors do not want to spend outright premium for being protected and have been supplying the market with massive call overwriting. With limited equity market upside in 2020, we expect demand for protection to stay high. Investors can benefit by monetizing the high skew through put spreads or Down and Out put hedges.

### Implied 3 months 90-110% skew on Eurostoxx 50



Source: Bloomberg, SILEX

## WHAT IS YOUR GREATEST RISK FOR 2020?\_

**Liquidity and crowding risks in derivative markets.** As yields came down, the volatility asset class became popular for alternative returns. But short volatility strategies might be crowded, as confirmed by the tightening spread between implied and realized volatility, imbalances between option buyers and sellers and the impact of structured products like auto-callable bonds. Volatility premia might become more challenging to harvest going forward. One should now diversify its sources of carry in the volatility space with relative value, dispersion, term structure or risk transfer type strategies.

## WHAT IS YOUR DEAREST WISH FOR 2020?\_

As a football fan, I have not lost hope and wish that, in 2020, PSG finally wins the UEFA Champions League!



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