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A gloomy 2018, a cautiously optimistic outlook for 2019

2018 was a disappointing year for many investors. Rarely before has it been so difficult to achieve a positive return with a diversified portfolio. This was because there was no money to be made with equities or almost all bonds this year. And even for gold, which normally functions as a "safe haven" in uncertain times like these, the price has fallen this year. Twelve months ago, the conditions seemed to have been in place for a successful capital market year; after all, the global economy was in better shape at the end of 2017 than it had been for a long time. Nevertheless, many stock market indices have declined significantly this year. Recently, the downward trend has even intensified, and in the USA December 2018 is even the worst December since 1931! In the DAX, the prices of Deutsche Bank, Covestro and Continental halved this year, while the losses of Daimler, FMC, Thyssenkrupp, BASF, Fresenius, Deutsche Lufthansa, Deutsche Post, Bayer and HeidelbergCement have totaled 30 to 40 percent each since the beginning of the year.

This is due to the economic framework conditions, which have deteriorated further until recently. It seems that in the last few weeks of the year business at many companies was once again worse than expected. This is indicated, for example, by the Ifo Business Climate Index or the Purchasing Managers' Indices from the manufacturing and service sectors. We are therefore reducing our GDP forecast for 2019 from 1.4 to 1.1 percent. In view of the fact that the forecasts for corporate earnings are still too optimistic despite the adjustments made in the meantime, we are also adjusting our DAX forecast for the end of 2019 from 12,600 to 11,800 points. As described in our recently published annual outlook, an increase in share prices depends to a large extent on the further development of the various political risks. If no solutions are found, the DAX could even slide below the 10,000 point mark, but if the risks quickly dissolve into favor, the German stock market could also gain more than expected. Hence, it is extremely difficult to give a reliable forecast.

It is precisely because investment decisions always have to be made under great uncertainty that diversification makes sense. The advantage resulting from the possibility of spreading risks is practically the only gift capital market investors get. They should therefore utilize this advantage – anything else would be like making a risky wager. One should not assume, however, that efficient diversification alone is adequate protection against temporary losses. Even the best distribution does not help when almost all investable markets are quoting in negative territory over a certain period. After all, the performance of a multi-asset portfolio – regardless of diversification effects – is not black magic, but rather simply the sum of its parts.

This is the very reason for the unsatisfactory performance this year. But how difficult was 2018 for investors compared to previous years? In order to answer this question objectively and scientifically, we used a random number generator to construct a thousand multi-asset portfolios, which could all have existed in exactly the same way in 2018. All portfolios are based on a diversified mix of 20 different equity, bond and commodity markets, all of which could be invested through single stocks or ETFs. The simulated portfolios fluctuate in the stock quota between 20 and 80 percent with a foreign currency quota of 40 percent on average. For each simulated portfolio, a weighting of asset classes and markets was determined at the beginning of the year and no further transactions were carried out thereafter. It was assumed that the cash position would always be zero percent. The result of the simulation is striking: the best possible diversified portfolio showed a performance of just over zero percent in this simulation, while the worst portfolio lost more than ten percent. Of the thousand possible portfolios, only six would have slightly exceeded the zero threshold. This shows how ungrateful and difficult this year was for investors.

We performed this form of calculation until 2005 and came to the conclusion that, even in this historical context, 2018 was indeed an extremely difficult year for diversified multi-asset portfolios. It is perhaps a small relief that two consecutive years with such a result are the absolute exception. But even assuming that 2019 as a whole will be less challenging, the question naturally remains how to position yourself with your tactical allocation in order to be able to position yourself at the upper end of the range of possibilities. After all, this is exactly what tactical allocation is all about: moving within the possible spectrum of results in the upper range of this distribution.

Political and economic news must improve again in order to achieve a better and above all a positive performance with equity investments in the coming year. Since Christmas is the time of wishes, we wish that the political anarchists in the White House, London and Rome, but also in many other places around the world, will finally come to their senses and return to a more constructive course. Let us hope that this will not remain just a pious wish.

We wish all our readers a Merry Christmas and a Happy New Year. We are delighted that you have remained loyal to us in 2018. We are looking forward to your suggestions and comments. Please do not hesitate to contact us again next year.

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Carsten Klude
+49 40 3282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com

Bente Lorenzen
+49 40 3282-2409
blorenzen@mmwarburg.com

Julius Böttger
+49 40 3282-2229
jboettger@mmwarburg.com