MARKET OPPORTUNITIES

February 2020

- Quantitative easing

When the US Federal Reserve started pumping up its balance sheet once again last October, chairman Jay Powell insisted that such activity should not be seen as another round of "quantitative easing" — the big post-crisis effort to relax financial conditions. Many investors were dubious then, and are still dubious now. It might not be explicitly recognised as QE — but it is QE. Definitions matter, as stocks and other risky assets have soared since the new scheme was put in place.

If the market considers it a similar form of extraordinary support as the earlier programme, then taking it away, or even tapering it, could be tricky. So what, exactly, is the Fed doing?

The Fed is purchasing $60bn of short-dated Treasury bills every month. That is in addition to pouring billions of dollars of cash into the repo market, where banks and investors borrow cash for short periods of time in exchange for high quality collateral such as Treasuries.

In September the repo market seized up, pushing borrowing costs sharply higher and sending shockwaves through the financial system. The Fed swung into action because control over short-term lending markets is crucial to its ability to implement monetary policy and effect changes in interest rates. The Fed's verdict was that bank reserves, or cash held at the central bank, had fallen too low, resulting in a squeeze of the amount of money that could be lent out to the repo market. Starting in October 2017, the Fed begun unwinding QE and reducing the size of its balance sheet.

As it stopped replenishing its stock of Treasuries, someone else had to buy them, pulling cash out of the banks and reducing reserves. The Fed is now buying Treasuries again to rebuild its balance sheet — and in turn increase the level of reserves — back to a level where the repo market can function as it should.

Quantitative easing was not just about the Fed buying Treasuries and mortgage bonds. The programme was designed to lower longer-dated interest rates to ease financial conditions, and by so, encourage investors out of safe assets such as Treasuries and into riskier investments like stocks and corporate bonds.

The Fed has explicitly said that this time around, it is not trying to alter its monetary policy through its purchases. It is not buying Treasuries to affect interest rates. This is why it is buying short-dated bills only. By limiting its purchases to debt that has a maturity of less than 12 months, the Fed is anticipating that the effect on longer-dated Treasury yields will be minimal. Still, some struggle to see the difference.

Core Capital Management S.A.

46, Place Guillaume II, L-1648 Luxembourg
info@corecapital.eu Tel:+352 2621 1969

www.corecapital.eu

Markets – January 2020

Equity indices	Jan-20	2020
MSCI ADWI	-1.17%	-1.17%
MSCI World	-0.25%	-0.25%
S&P 500	-0.16%	-0.16%
Euro Stoxx 50	-2.78%	-2.78%
DAX	-2.02%	-2.02%
FTSE 100	-3.40%	-3.40%
Nikkei 225	-1.91%	-1.91%
OMX 30	0.64%	0.64%
OMXC 25	1.91%	1.91%

Bond indices	Jan-20	2020
Global Treasuries	1.40%	1.40%
Global High Yield	0.13%	0.13%

Currencies	Price	Jan-20
EUR/USD	1.1093	-1.07%
EUR/SEK	10.6739	1.65%
USD/SEK	9.6248	2.77%
USD/DKK	6.7369	1.11%

Interests	Jan-20
US T-Bill 3 M	1.52
Euribor 3 M	-0.39
Libor Fix 3 M	0.76
Stibor Fix 3 M	0.19
Cibor Fix 3 M	-0.41

Other	Jan-20	2020
Gold	4.74%	4.74%
Brent Crude Oil	-11.88%	-11.88%
HFRX Index	-1.14%	-1.14%

Why is the market so sceptical ? Intention is one thing, but how a policy plays out in the market is another. Some analysts and investors say regardless of the Fed's stated rationale, the purchase of Treasury bills is pushing asset prices higher as investors flood into corporate bonds and equities.

This might not be because of any effect on interest rates. In fact, 10-year Treasury yields have risen since October. It could simply be that the Fed is removing Treasuries from the market at the same time as adding cash. Investors have to put this cash somewhere and if there are fewer Treasuries in circulation, it is more likely to go into stocks and corporate bonds.

Central bankers sometimes like to think of the theory first and then look for market impact later. Preferably one should do it the other way around and the impact on asset prices appears to be very QE-like. Why does it matter? Isn't it irrelevant what it's called? No. The Fed has been keen to emphasise that its bill purchases do not represent a shift in its monetary policy, but simply address a technical problem in the plumbing of financial markets.

The problem is that the Fed explicitly described quantitative easing as a way to ease monetary policy using its balance sheet, a programme the central bank said it halted five years ago. But the new purchases have the same effect; expanding the balance sheet.The risk is that when the Fed begins to slow or stop these purchases, as it intends to do, it will be read by the market as a policy tightening. That could weigh on stocks and bonds, regardless of what the central bank does with interest rates. It will be seen as tightening.

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MARKET OPPORTUNITIES

February 2020

- Portfolio update

During January we have implemented a couple of additional investments into equities as we have decided to take the overall equity exposure from underweight to a more neutral stance.

We increased our allocation to infrastructure companies slightly, where we believe the theme will unfold whereby countries will commit funding to improved infrastructure such as roads, railways, harbours, airports etc.

Secondly, we also allocated to the internet security theme which we have been monitoring for some time and here the idea is that companies, as well as private individuals, will need to invest into upgrading and maintaining a proper protection of their IT platform.

Thirdly, we invested into a European Financial Basket note that can generate a positive return in a negative market environment. The idea builds around 4 banks, of which 3 are Scandinavian, and likely to benefit as a result of the Swedish Riksbank moving official rates from negative to zero towards the end of last year. The fourth name is Banco Santander which generates a significant part of their revenue from Latin America and hence is not better protected compared to other European banking names.

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Holding of the Month

Credit Suisse Security Fund

The Fund invests in companies in the Technology, Healthcare and Industrials sectors that offer products and services related to health protection, environmental safety, IT security, transportation safety, and crime prevention.

- Market outlook

Fixed income

Equities have performed well during the first half of January, however the Chinese coronavirus has impacted equities slightly negative towards the end of the month. We are adamant that equities will perform better than bonds and cash.

Equities

We maintain a good blend of variable rate instruments as well as short duration fixed income placements, which have a very sensible
Environment during the second part of January.

Alternative Investments

Last year we saw a large number of hedge funds closing down and we retain our view that it's an expensive asset class which simply does not deliver.

Forex

We maintain our allocation to the US dollar from last year and believe it will still take a long time before the ECB will turn into rate hiking mode.

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