

INVESTMENT INSIGHTS

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SM-ART DIVERSIFICATION

EDITORIAL VIEW

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- 2018 was another record year for art auction houses - The hype is real but can it last?
- Art brings welcome portfolio diversification - but it also lacks transparency and liquidity...
- Amid current late-cycle signs, selectivity should overrule speculative considerations

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- No Santa rally for equities in 2018... yet all is not doom & gloom for markets!
- Healthy market fundamentals overall but 2019 won't be for the faint-hearted...
- With no global recession in sight and depressed valuation, much now seems priced in

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- Equities - Focus on defensive/resilient markets and favor a more balanced sector & style approach
- Fixed Income - Continue to view the US Treasury (10-year) as a safe haven
- Gold - Still a valid hedge against geopolitical risks & market disruption

Editorial View

Sm-art Diversification

- 2018 was another record year for art auction houses – The hype is real but can it last?
- Art brings welcome portfolio diversification – but it also lacks transparency and liquidity...
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As we look to 2019, which marks the 500th anniversary of Leonardo da Vinci's death, should investing in art figure prominently in investors' New Year resolutions?

After all, 2018 saw price records be broken across many art categories, including female artists, contemporary African-American works, and even street-based urban art – which, in a somewhat ironic twist, is fast becoming mainstream. And although the November 2017 auction record set by a long-lost Leonardo da Vinci (him again!) painting, for which the hammer finally fell at a mighty USD 450 million, was not surpassed in 2018, transaction volumes continued to increase. Full year art sales are thus likely to be on par with the peak years of 2014-2015.

From an investment perspective, art obviously boasts diversification appeal, particularly in a period of low – if not negative in our part of the world – interest rates. While advisory and risk management services are increasingly being made available to investors who wish to build up an art portfolio, the business of *art lending*, which enables art owners to use their prized holdings as collateral for securitized loans, is also expanding rapidly. Moreover, investing in young and little-known artists is very much akin to venture capital financing.

Still, art is no classic financial asset. It follows its own rules, with subjectivity playing a considerable part. Investors should also be aware that the business of art remains little regulated. The danger of falling prey to manipulation by the large galleries, vying to push up the prices of “their” artists, always lurks. So does the risk of total loss, as was notoriously illustrated in October 2018 by the spontaneous shredding of

Banksy's “Girl with Balloon” just moments after the closing bid. (That said, as fate would have it, the shredding “*did not go fully to plan*”, leaving a partial work that Banksy renamed “Love is in the Bin” and whose value actually increased thanks to the worldwide buzz generated).

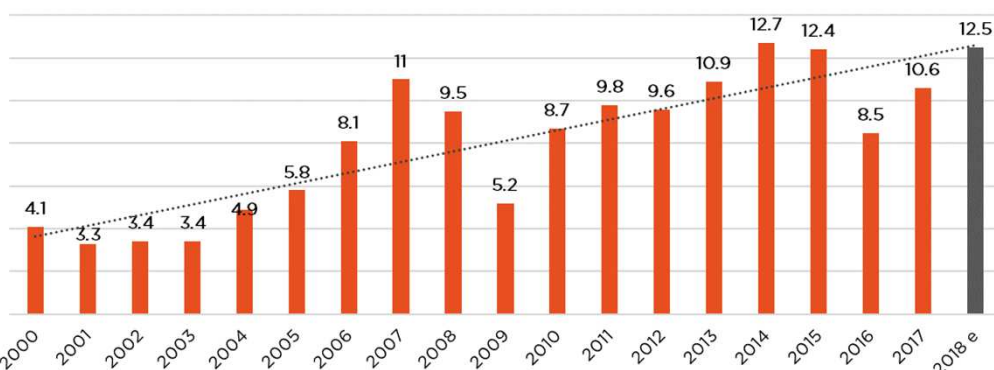
Liquidity can also be a concern: what was “easy” to buy may prove much more difficult to resell. Remember that only a very small share of all existing art work is on sale at any point in time. And that art price indices only reflect actual transactions. To some extent, though, technology, be it through the internet or more recent block chain developments, now helps mitigate these opacity and illiquidity issues.

Just as for the more traditional asset classes, elevated prices and the considerable hype that currently surrounds art also calls for some caution. Looking beneath the media headlines, it would seem that the big auction houses had to put down several billion dollars of pre-sales guarantee money in order to convince owners to bring high-end art pieces to auction in 2018. And the most recent *Art Basel Miami Beach* fair was less vibrant than usual. Early signs perhaps that last summer's emerging markets rout, and steadily rising US rates are taking their toll? Over the years, these two regions have certainly been key to the growing demand for art.

So, with *artgenève* just a few weeks away, let us offer a couple of words of advice to prospective art buyers. At this point of the cycle, selectivity is paramount, staying clear of funds in particular. And perhaps most importantly: follow your instinct and buy art that speaks to you, beyond purely speculative considerations, as it may decorate your home for longer than you think...

Chart of the Month

Sotheby's and Christie's Auction Activity (Bn USD)



Please see appendix at the end of this document for information on sources, important disclosures, and disclaimers

Global Strategy

A New Year, A New Start?

- No Santa rally for equities in 2018... yet all is not doom & gloom for markets!
- Healthy market fundamentals overall but 2019 won't be for the faint-hearted...
- With no global recession in sight and depressed valuation, much now seems priced in

In the same vein as the bitter month of October, December has proven a bloodbath for most risky assets, especially equities, with mounting uncertainties taking their toll on sentiment. As already highlighted, we are currently undergoing a “transition period”, with major markets adjusting to changing expectations on both the macro & micro fronts. As such, we believe that the current heightened volatility regime is here to stay, supported by a gradual deterioration of the global economic backdrop alongside diverging major central bank policy normalization paths, sustained geopolitical risks, and concerns regarding a potential peak in corporate earnings. 2019 is therefore likely to be another bumpy year for investors on many fronts. We do not, however, anticipate a recession at this stage and expect major central banks to remain flexible and *data dependent* as recently suggested by the FED.

While acknowledging the ongoing change in dynamics, and the fact that the *Goldilocks* era is now well behind us, we still fail to identify clear signs of a lasting bear market as we enter 2019. Indeed, notwithstanding investors’ recent heebie-jeebies, fundamentals remain healthy across the board, supporting our constructive stance. In terms of asset allocation, though erring on the side of caution, we keep our Neutral equity exposure unchanged after the recent sell-off with current *oversold* market conditions in the US providing some near-term downside protection, in our view. Elsewhere, we cut our Credit Investment Grade allocation somewhat further and reinforce traditional “safe haven” assets including US Treasuries, Gold and the Swiss franc.

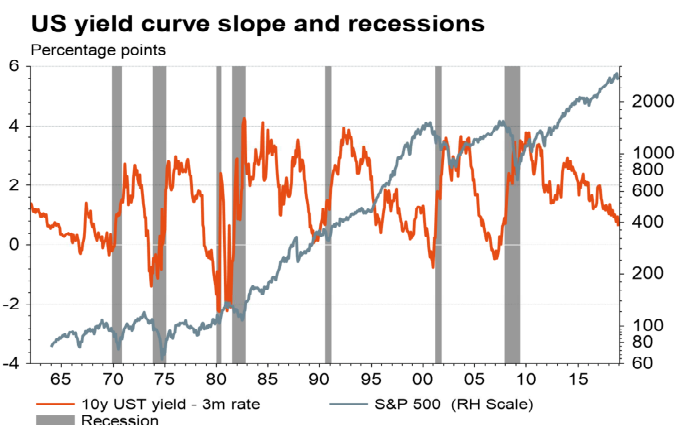
We recommend keeping a cautiously selective stance on equities and entering 2019 without taking significant allocation bets but staying focused on *quality*. Admittedly, depressed valuation likely now provides a floor, but visibility remains limited overall. Hence, we continue to favor defensive markets (e.g. US & Switzerland) as well as a balanced approach in terms of sectors & styles, while considering beaten-up opportunities on a very selective basis only.

We remain underweight Fixed Income in this market environment, having become even more cautious on Credit given unattractive spreads and the latest General Electric contagion risks. Still, we keep our 10-year US Treasury position as a hedge against political turmoil.

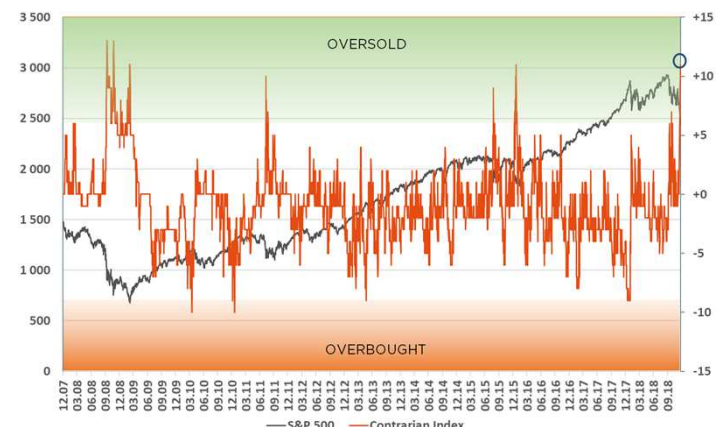
As regards currencies, notwithstanding a more dovish rate hike by the FED in December, we maintain our near-term bullish stance on the USD and CHF (vs. EUR). Whereas the former benefits from higher US rates, a stronger domestic economy, and favorable investor positioning, we view the latter as an attractive safe haven. That said, fundamentals (relative valuation, current account, budget deficit, debt) still suggest a stronger EUR medium-term.

In commodities, we continue to advocate gold exposure as a geopolitical hedge and take a more balanced view on oil fundamentals though we believe the worst is now likely behind. Finally, uncorrelated hedge fund strategies (market neutral, arbitrage) and private equity remain our preferred plays in the Alternatives space.

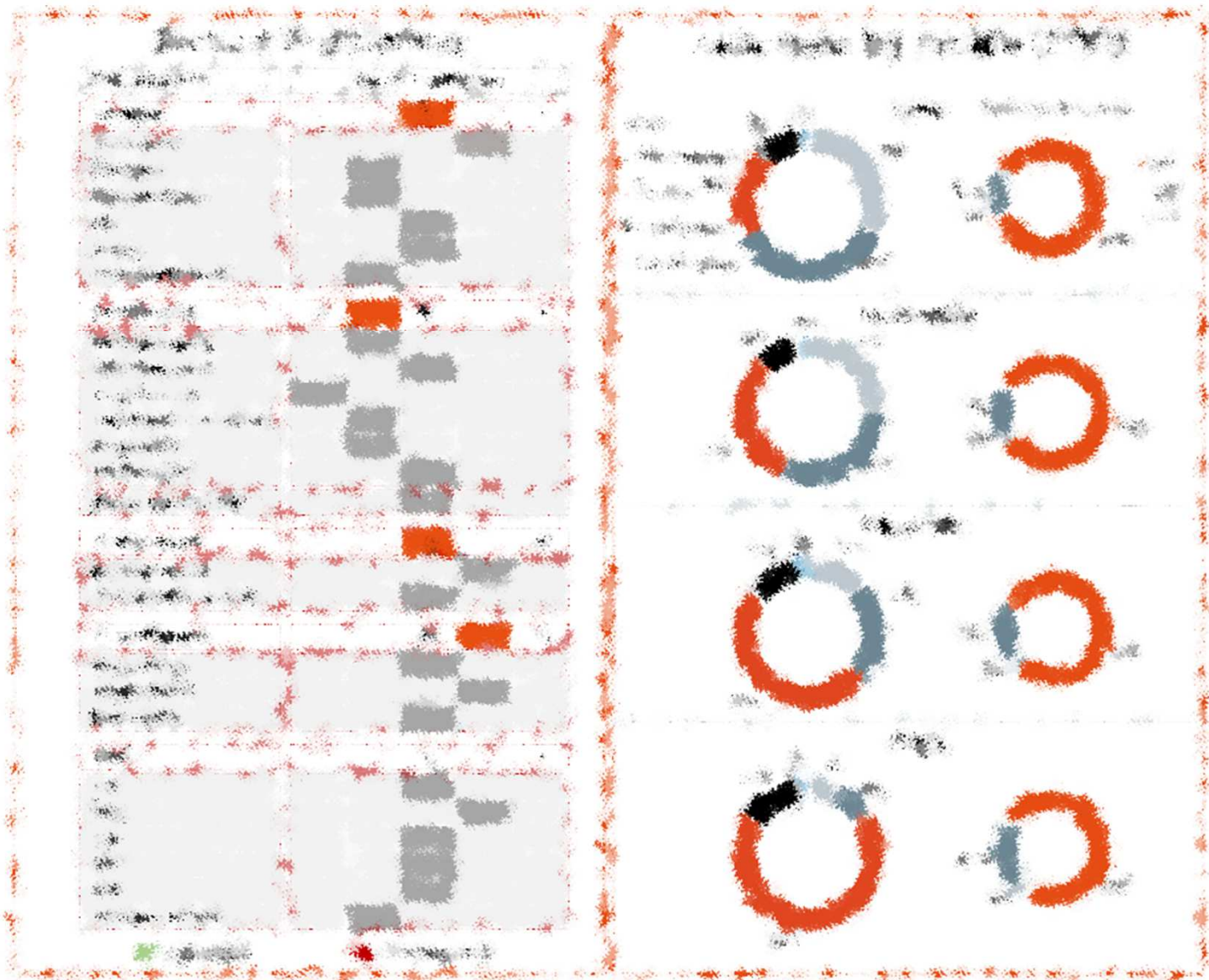
No Recession anticipated for 2019



Decalia Equity Contrarian Index (US)



Asset Allocation



- Equities – Focus on defensive/resilient markets and favor a more balanced sector & style approach
- Fixed Income – Continue to view the US Treasury (10-year) as a safe haven
- Gold – Still a valid hedge against geopolitical risks & market disruption

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External sources include: Thomson Reuters Datastream, Bloomberg, Sotheby's
Finished drafting on December 31st, 2018