Market Review and Outlook September 2017

Macroeconomic environment and fixed income markets

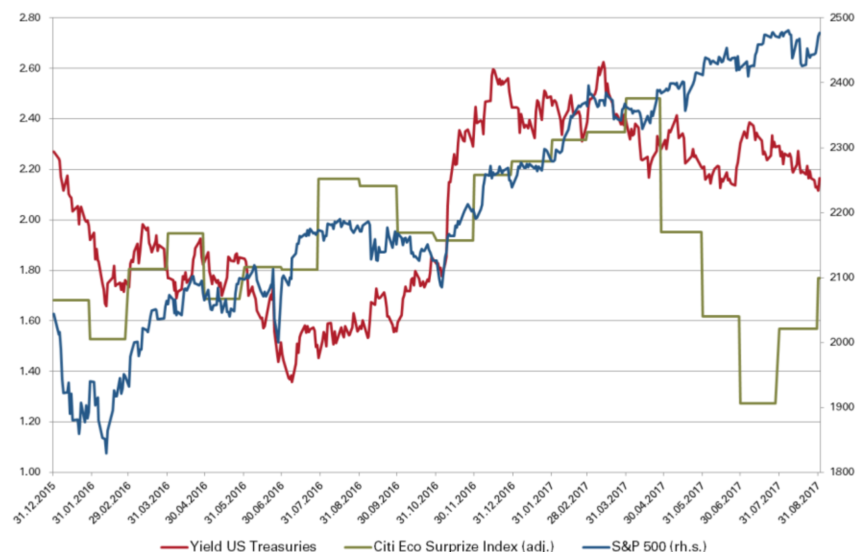
The sustained positive global picture of the purchasing managers indices (PMI) was also maintained in August. Most PMI figures even improved marginally. In absolute terms, PMI figures are now approaching peak levels. The positive trend in the development of corporate profits (12-month rolling EPS) also continued. The overall **economic picture** – a synchronous global growth – is clearly on a **pleasant** note, with a solid gap to a recession scenario.

On the other hand, **geopolitical risks increased** again. Tests of intercontinental missiles conducted by North Korea (but also the USA) and of a potent North Korean hydrogen bomb have fueled the conflict between the US and North Korea. Russia and China are becoming more and more neutral in the matter, preventing to some degree extensive sanctions against North Korea. Further missile tests are to be expected. Trump was able to gain some points in domestic politics, such as the increase in the "debt ceiling" in light of aid for hurricane victims and a related extension of the financing by mid-December as well as some progress regarding the change of tax law.

The **central banks** remain on an **expansive** track, with the exception of the USA. The ECB did not take any action at its September meeting, neither with regard to benchmark interest rates nor to the bond repurchase program. Draghi has only lukewarmly mentioned the strength of the EUR. He will provide more information to the markets after the elections in Germany at the October meeting. The planning for the succession of FED chair Yellen has begun. Vice-President Fischer will be retiring in mid-October, leaving a total of 4 out of 7 seats vacant. In the end, it is up to Trump to determine the right people. Given the importance of the US Fed, the selection of candidates may well influence financial and capital markets. Furthermore, it is interesting to see that both the ECB and the FED mention the high prices of commercial real estate.

It is striking that bond and equity markets currently interpret the macroeconomic overall picture differently. Falling yields on safe (sovereign) bonds signal a rather cautious assessment of the situation by bond markets, while stock markets seem to place the positive economy on the forefront. This divergence has to resolve at some point in time, either through higher interest rates or lower share prices.

Illustration 1: Divergent development of bond yields and stock markets (USA)



Stock markets

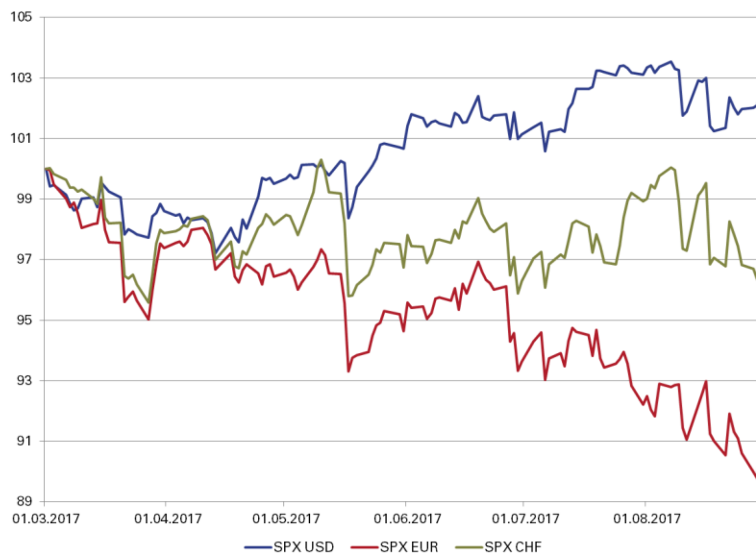
Since April, the performance of stock markets has **been strongly influenced by currency movements**. Only USD investors could benefit from rising prices during this period. On the other hand, EUR investors experienced significant price losses, both in home markets and in global markets valued in EUR. Last month, most stock marktes tended either sideways (USA) or slightly downwards (European and Asian

stock markets). The valuation advantage of stocks from Europe and emerging markets compared to those from the USA and Switzerland has not changed.

The sideways trading can be explained by the above-mentioned contrasting pulling forces of the positive economic picture / company profits on the one hand and the geopolitical uncertainty / relative high valuations on the other hand. So far, there are no decisive impulses to steer markets in one direction or the other.

The influencing factors observed by us show a neutral allocation to equities. However, we are currently weighing the risks from the geopolitical situation and a potential correction, which is to a certain extent overdue, higher and therefore **keep the slight underweight for the time being**. If markets are to move upwards again, the acquisition of broad ETFs (for example on the Stoxx50, SPI or S&P 500) is intended to rapidly acquire relevant market exposure. This tactic appears to us to be most useful in this environment, which is characterized by rather high event risks.

Illustration 2: US-stocks were only interesting for USD-investors. Development of the S&P 500 (SPX) in USD, CHF and EUR



Currencies and Gold

Gold was able to break the long-term downtrend and the mark of USD 1'300 to the upside. Even in EUR- and CHF-terms - after only a mixed development during the current year - a new upward trend seems to manifest itself. We are still convinced about our overweight in this asset class. Adding some goldmine stocks in addition to physical gold holdings seems sensible to us.

Some arguments in favour of a stronger USD against the EUR are:

- the interest rate difference
- limited scope for interest rate hikes by the ECB
- low European interest in a (even) stronger euro

Some arguments in favour of a weaker USD against the EUR are:

- political conditions in Europe are currently viewed as more stable than in the USA
- market development (stronger EUR even with rising political risks)
- low interest of USA in a strong USD

The role of China, which holds huge USD-holdings in the form of government bonds, can be crucial for the further development of the USD. Since 2014, the Chinese foreign currency reserves have fallen by around USD 1'000 bn. Since we currently hold a neutral allocation to the **USD** in the portfolios entrusted to us, and given a **possible range of fluctuation in the area of 1.15 to 1.23 against the EUR**, we are not currently looking for any direct measures.

Industrial metals (i.e. copper and aluminum) continued to show a strong performance last month. After a certain slump in the wake of the severe weather damage in Texas, oil prices increased quite significantly. Both developments can be attributed to a large extent also to the weakening USD. A **tactical positioning in oil** seems reasonable to us at the moment.

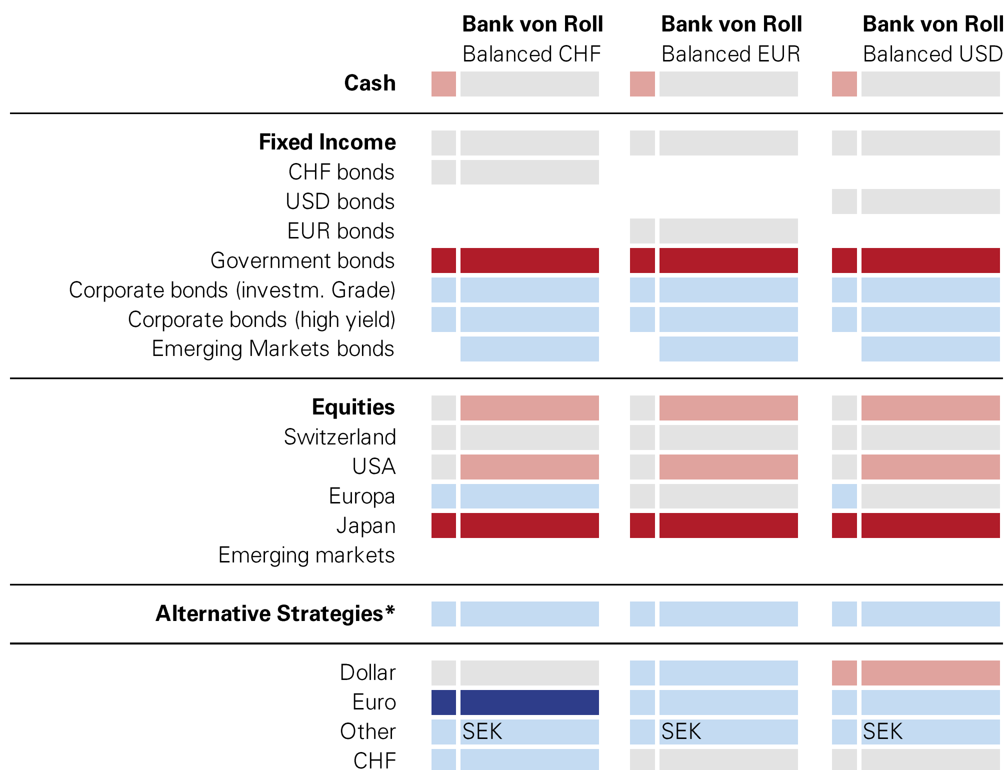
Outlook

Despite a slight stabilization tendency on stock markets, we see markets to remain in deadlock caused by mutually neutralizing forces. We hold on to our opinion and anticipate a sustained sideways movement, with a somewhat higher weighting of event risks stemming from geopolitics, which is why the allocation to equites is slightly below the neutral allocation.

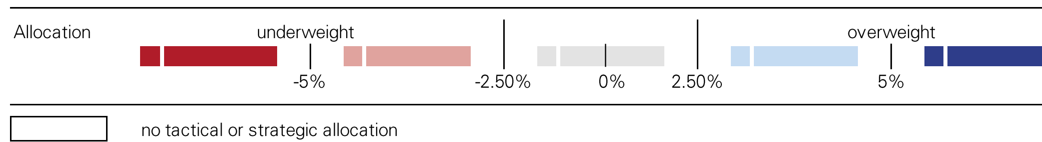
Asset Allocation (with change vis-à-vis previous month)

Equity allocation = slightly underweight

Small square = previous month; large bar = target quota



Basis:Balanced portfolio for a CHF investor



*) contains Gold, commodities, real-estate, hedge funds, private equity etc.

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