Investment Strategy November 2017

Mario Draghi and a synchronous upswing in the global economy make the stock markets cheer. Worries and unresolved geopolitical problems are bouncing off. All fine?

Macroeconomic Environment

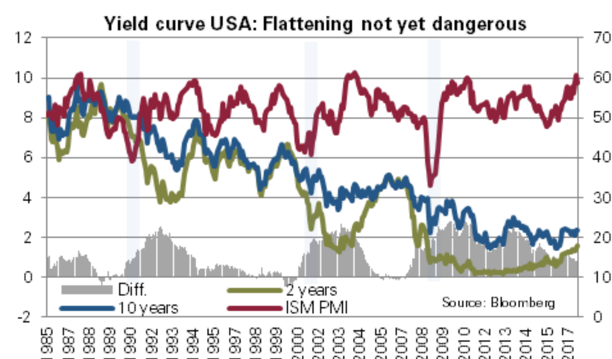
Upswing with low inflation

The global purchasing manager indices (PMI) are trading at high levels, indicating continued economic growth. Data in developed countries points to a slightly better development than in emerging economies. Growth had no noticeable impact on inflation so far which is a positive. The term **"Goldilocks" scenario** seems apt to describe the current environment. *All fine?* For the time being, yes. The upswing could even accelerate given the below-average recovery compared to earlier periods, and assuming that the central banks will continue on the path of only very cautiously tightening interest rates and carefully preparing capital markets for any changes to come.

From the perspective of **geopolitical risks**, the greatest uncertainty currently stems from the planned tax reform in the US, as a) the ultimate effects on taxpayers and the government deficit and b) the required majority in the senate to pass the reform are presently unclear. In addition, time is pressing for a decision and a "Government Shutdown" threatens once again on December 8th. Finance Minister Mnuchin has tentatively warned that the stock markets will react to a "No" with a diver. JP Morgan, on the other hand, calculates that an approval can lead to a gain of an additional 200 points in the S&P 500.

Following its October meeting, the ECB has confirmed that the reduction of the extremely expansionary **monetary policy** of the central banks will take place only in small steps and depending on the current economic situation ("data dependent"). The very modest statements by Mario Draghi led, as so often in the recent past, to immediate capital gains in the stock markets. Another rate hike by the US Fed in December is virtually certain and markets are currently pricing in three more steps for 2018. The economy should be able to handle the planned speed of rate increases. With the newly appointed US Fed Chairman Powell, Trump has again shown his unconventional acumen as the elected is not an economist. However, Trump puts also weight on continuity as Powell is a longtime member of the Federal Reserve board of governors. In addition to the chairman, Trump must appoint up to four other members. Time will tell how much dynamism the new panel will develop in view of monetary policy and his deregulation plans.

The interest rate curve in the US has again slightly flattened despite the pleasing economic trend. Very flat or inverse yield curves have historically been a very good indicator of a weakening economy or a recession. The difference between long-term and short-term interest rates still leaves some room for further flattening and therefore does not pose an immediate threat to the markets.



This development is being discussed controversially and there are highly recognised voices questioning the quality of the economic development especially in the USA. Another interesting point was raised in a statement by the US Treasury: the average maturity of the outstanding debt shall be reduced in order to avoid an excessive increase at the long end of the yield curve. On the one hand, the measure would have a dampening effect of high long-term interest rates for example on the housing market, and on the other hand, it could help the US Fed to reduce its balance sheet. This would speak for a persistently flat yield curve.

In Europe, the German Council of Economic Experts (Sachverständigenrat) has stated that the German economy is currently growing above its potential and consumer prices are rising as a result.

All fine? Monetary policy as a major driver of the stock market boom has not disappeared; market reaction to the ECB decision has shown it. The influence will undoubtedly change in the near future. The risk is that

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the central banks will wait too long with tightening monetary policy measures for fear of slowing the sub-par recovery to early, and will allow overheating the economy with rising inflation. We closely monitor the development of inflation and yield curves as these are important indicators.

Equity Markets
Teflon markets?

As mentioned above, the ECB helped the shares to jump again in October. By the time the decision was made, most of the markets moved sideways. The described good economic situation and a positive reporting season especially in the US for the third quarter on the basis of comparatively less ambitious expectations were supportive. For the moment, the stock markets have been right in the assessment of the economic development compared to the rather pessimistic bond markets. Overall, corporate profitability is solid and backed up by the economy. This helps to slightly improve the high valuations. The Japanese market is becoming increasingly popular. Contributing to this is the overcoming of a sideways movement that started in 2015. Especially for foreign investors it is interesting that a positive change in the Japanese equity culture is noticeable.

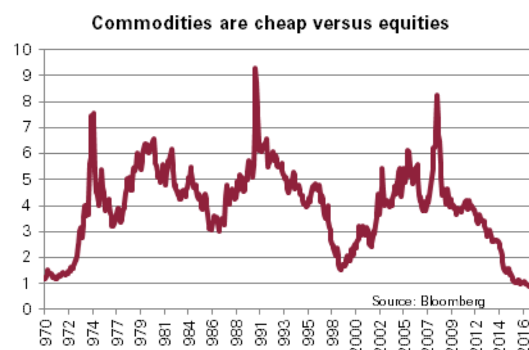
All fine? Last month, we noticed a number of abnormalities and risk factors. The stock markets seem to negate the negative factors which is reflected in a strong trend and a record-low volatility. Markets have reached a point where it may even come to a final "melt-up", similar to the period from 1997 to 1999, which was characterised by sharply rising prices and rising volatility at the same time. Traditional criteria for valuing stocks did not matter at all during this time. Incidentally, IPO activity is also heating up again. These days, China Literature was floated in Hong Kong. 6.25-fold over-subscribed and a jump of almost 100% on the first day! We stick to the motto "forward, but with foresight" and keep a close eye on the various factors that urge us to be careful.

Bonds
Diversification and flexibility

We are not changing anything about our neutral stance towards bonds, in which we prefer corporate bonds to government bonds. In the current year, diversification and flexibility have paid off. Despite the low spreads, corporate bonds still offer a certain yield buffer in contrast to government bonds. For next year, we expect a performance that corresponds to the current interest plus minor increases in prices. We currently weigh so-called high-yield bonds rather low.

Commodities, Currencies and Gold
Commodities on multi-decade lows versus stocks

Commodities have lost significant value relative to equities. Cyclic movements play a not insignificant role. A more efficient use of raw materials or alternative energies are factors that have led to a fall in prices, even from the perspective of an absolute price change. The current price level for commodities appears to us to be excessively low, which motivates us to build a position in this asset class.



The USD continued its strength last month and has trended sideways against the EUR and CHF since the end of October.

Gold weakened slightly against the USD in October, moved sideways to EUR and slightly improved against CHF.

Quintessence

Seasonal aspects are currently in favor of stocks. The tax reform in the US is the next trigger that can move the market one way or the other. So far, market forces have only moved in one direction, upwards. *All fine?* For the time being, yes. However, following the strong price appreciation, record-low volatility and geopolitical risks, as well as changing central bank monetary policy, a more cautious allocation of assets cannot hurt.

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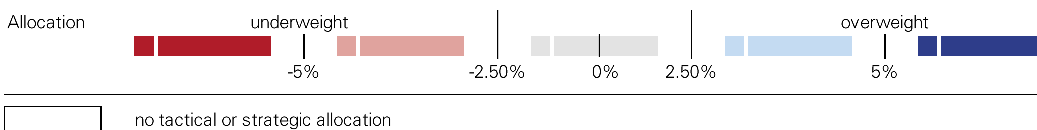
Asset Allocation (with change vis-à-vis previous month)

Equity allocation = neutral

Small square = previous month; large bar = target quota

	Bank von Roll Balanced CHF	**Bank von Roll** Balanced EUR	**Bank von Roll** Balanced USD
Cash			
Fixed Income			
CHF bonds			
USD bonds			
EUR bonds			
Government bonds			
Corporate bonds (investm. Grade)			
Corporate bonds (high yield)			
Emerging Markets bonds			
Equities			
Switzerland			
USA			
Europe			
Japan			
Emerging markets	Asia	Asia	Asia
Gold and Alternative Strategies*			
Currencies			
Dollar			
Euro			
Other	SEK	SEK	SEK
CHF			

Basis:Balanced portfolio for a CHF investor



no tactical or strategic allocation

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

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