LimmatWealth

Investment Strategy – September 2017

Data & Forecasts

	Growth (%)		Inflation (%)		Equities		
	GDP 17	GDP 18	CPI 17	CPI 18	Actual	3 Mths	12 Mths
Switzerland	1.4	1.7	0.5	0.6	10'128	↘	↗
Germany	1.9	1.8	1.7	1.6	12'118	↘	↗
Eurozone	2.0	1.7	1.5	1.4	3'433	↘	↗
UK	1.5	1.2	2.7	2.6	7'418	↘	↗
USA	2.1	2.3	2.0	2.1	2'477	↘	↗
Japan	1.4	1.0	0.5	0.8	19'508	↘	↑
Brazil	0.5	2.1	3.6	4.2	71'923	↘	↗
Russia	1.5	1.6	4.3	4.1	1'089	↘	↗
India	7.1	7.3	4.5	3.5	31'702	↘	↗
China	6.7	6.4	1.7	2.2	3'380	↗	↑

	Bonds (10 Years)			Currencies (vs USD)		
	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Switzerland	-0.13	0.00	0.25	0.96	0.97	0.97
Germany	0.37	0.50	0.75	-	-	-
Eurozone	-	-	-	1.19	1.17	1.17
UK	1.05	1.25	1.50	1.30	1.29	1.29
USA	2.17	2.50	2.75	-	-	-
Japan	-0.01	0.00	0.25	110	113	114
China	3.68	3.50	3.50	6.53	6.80	6.90

Review – Decreasing interest rates in August

Equity markets in developed markets ended August largely unchanged while indices in Emerging markets advanced. Equity markets in the US (+0.1%) and in the UK (+0.8%) were marginally positive, whereas Switzerland (-1.3%), Germany (-0.5%), and Japan (-1.4%) marginally negative. Emerging markets as a whole had another positive month as Brazil (+7.5%) and Russia (+8.8%) advanced substantially.

Yields on ten-year government bonds fell world-wide in August having a positive effect on prices of government and corporate bonds. In Europe, interest rates decreased by about 20 basis points in most countries and therefore ten-year government bonds in Switzerland are back in negative territory (yielding -0.14%).

Volatility in currency markets was low in the past month. The Euro appreciated marginally against the US Dollar (+0.6%) but weakened against the Swiss Franc (-0.6%). The US Dollar also weakened against the Swiss Franc (-0.8%) and now trades below 0.96 Francs again.

Alternative investments like hedge funds and gold had another positive month. While hedge funds printed their tenth consecutive positive month (+0.3%), gold appreciated to the highest level in eleven months (+4.1%) driven by geopolitical concerns.

Outlook – Positive for European Banks

The European stock market as measured by the Euro Stoxx 50 Index appreciated +4.0% year-to-date as of end of August (+6.9% including dividends) but lost -6.1% since mid-May (-5.2% including dividends). Despite this drawdown, Eurozone banks held up well even though they are traditionally considered as high beta stocks. Banks in the Eurozone appreciated +11.7% since the beginning of the year (+15.0% including dividends) and gave back only -4.5% (-2.7% including dividends) since mid-May. There are basically two reasons why banks will continue to outperform the general market in the near future:

- There is a high correlation between the banks' performance and German ten-year bond yields. This suggests that German yields need to move higher for further upside in banks and we think this is likely to happen (please see forecast on page 1). The European Central Bank (ECB) is likely going to perform a key turn in monetary policy with a tapering announcement in fall.

- In addition to increasing interest rates, we have seen an uplift in earnings at European Banks since the end of April this year. 75% of the banks in the Eurozone bank index recently revised their earnings for the year 2018 upwards, in complete contrast to the trends observed over the past few years. There is a pickup in Eurozone loan growth and greater optimism regarding net interest rate margins. Furthermore, non-performing loans (NPLs) are clearly on a downtrend. In addition to this, Eurozone banks are still valued attractively with a forward price/earnings ratio of 10.6 compared to 13.5 for the overall market.

We continue to be cautious in terms of our exposure to equity markets. We expect a sideways trending market for the near future, in developed markets as well as in emerging markets.

Analysts believe that the probability of a further interest rate hike by the FED before year-end is only about 30 percent. We do not exclude the possibility of a further rate hike which could lead to some volatility in rates in the short-term as a further rate hike is not fully priced in at the moment. We do expect only gradually higher interest rates in developed markets in the mid-term and accordingly this should not lead to large price changes in bond markets.

We do not expect a lot of volatility in the currency markets short- to mid-term.

The current environment with higher volatility and lower correlations is ideal for most hedge fund strategies. We expect good results in 2017 and this year is on course to be the best year for hedge funds since 2013. Geopolitical tensions will continue to support the gold price and we therefore maintain our position.

September 7th, 2017
Limmat Wealth Ltd.