LimmatWealth

Investment Strategy – January 2019

Data & Forecasts

Developed Markets	Growth (%)		Inflation (%)		Equities			Bonds (10 Years)			Currencies (vs CHF)		
	GDP 18	GDP 19	CPI 18	CPI 19	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Switzerland	2.8	1.7	1.0	1.0	10'009	↗	↗	-0.15	0.05	0.30	-	-	-
Germany	1.6	1.6	1.9	1.9	10'800	↗	↗	0.24	0.50	0.80	-	-	-
Eurozone	1.9	1.6	1.8	1.8	3'052	↗	↗	-	-	-	1.12	1.14	1.17
United Kingdom	1.3	1.5	2.5	2.5	6'850	↗	↗	1.28	1.70	2.00	1.25	1.29	1.32
United States	2.9	2.6	2.4	2.4	2'550	↗	↗	2.70	3.20	3.30	0.98	1.01	0.99
Japan	0.9	0.9	1.0	1.0	20'204	↗	↗	0.01	0.10	0.15	111	113	112

Emerging Markets	Growth (%)		Inflation (%)		Equities			Bonds (10 Years)			Currencies (vs USD)		
	GDP 18	GDP 19	CPI 18	CPI 19	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Brazil	1.3	2.5	3.7	3.7	91'699	↗	↗	9.18	10.10	10.40	3.73	3.85	3.75
Russia	1.6	1.5	2.9	2.9	1'117	↗	↗	5.05	6.00	8.00	67.05	67.50	67.00
India	7.4	7.3	3.9	3.9	36'002	↗	↗	7.58	7.90	7.90	70.04	72.00	71.00
China	6.6	6.2	2.2	2.2	2'526	↗	↗	3.15	3.30	3.30	6.85	6.95	6.85

Review – Disillusion and resignation in equity markets at the end of the year

The anticipated year-end rally did not happen. December was characterized by fear and disillusion among investors and naturally this had a negative impact on equities as well as bonds and commodities.

Equity markets worldwide fell significantly in December. While India remained unchanged (-0.3%), Japan (-10.5%), the United States (-9.2%), and Switzerland (-6.7%) fell sharply. Emerging markets on average performed better than their developed counterparts in December and Brazil (+15.0%) and India (+5.9%) even posted positive returns for the full year 2018.

Developed Markets	Q1-3	Q4	Worst Quarter since	2018	Worst Year since
Switzerland	0.5%	-9.0%	Q3 2011	-8.6%	2008
Germany	-5.2%	-13.8%	Q3 2011	-18.3%	2008
Eurozone	-3.0%	-11.7%	Q3 2011	-14.3%	2011
United Kingdom	-2.3%	-10.4%	Q3 2011	-12.5%	2008
United States	9.0%	-14.0%	Q3 2011	-6.2%	2008
Japan	6.0%	-17.0%	Q4 2008	-12.1%	2011

Emerging Markets	Q1-3	Q4	Worst Quarter since	2018	Worst Year since
Brazil	3.8%	10.8%	N/A	15.0%	N/A
Russia	3.3%	-10.6%	Q3 2015	-7.6%	2014
India	6.4%	-0.4%	N/A	5.9%	N/A
China	-14.7%	-11.6%	Q1 2016	-24.6%	2008

Source: Bloomberg, Limmat Wealth

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If you look at the returns of equity markets in 2018 a bit more closely (see table above), one can see that the year can be divided into two phases: we had sideways to slightly negative trending markets during the first three quarters of the year and then sharp drops in most countries in the fourth quarter. The fourth quarter was the worst quarter in most developed markets since the third quarter of 2011 and this led to the worst yearly returns since the global financial crisis in 2008.

In the context of falling equity markets, yields on ten-year government bonds globally decreased as well. While yields decreased only marginally in Germany (-0.07% to 0.24%) and China (-0.07% to 3.31%), they fell significantly in India (-0.24% to 7.37%), the United States (-0.30% to 2.68%), and Brazil (-0.66% to 9.24%). Yields in Switzerland depreciated as well and they are now at the lowest level since November 2016 (-0.15% to -0.25%).

The volatility in currency markets remained within reason despite the turbulences in equity markets last month. The Swiss Franc strengthened against the US Dollar (+1.7% to CHF 0.98) and the British Pound (+1.6% to CHF 1.25) but remained unchanged against the Euro (CHF 1.13). The Euro strengthened against the US Dollar as well (+1.3% to USD 1.15).

Alternative investments performed differently in December. Gold appreciated significantly (+5.1% to USD 1,282 per ounce) while hedge funds dropped quite a bit (-1.9%). The oil price remains under pressure (WTI, -10.8% to USD 45.41 per barrel) and lost more than 40% of its value since reaching a 2018 high at the beginning of October.

Outlook – Trade tensions between the United States and China enters next stage

All of a sudden, the fundamentals are not looking as strong. First it was the technology giant Apple's revenue miss which shed a third off its value last quarter. Then, the focus shifted to US factory activity which dropped to a two-year low and missed every estimate in a survey conducted by Bloomberg. Last year and especially last quarter, investment specialists repeated the same story over and over again: do not panic, the economy and corporate earnings still look strong. The average investor, as measured by the respective equity markets, disagrees and confidence in those assurances has taken a hit. On one hand, there are trade tensions between the United States and China, rate hikes by the FED and relatively high valuations. On the other hand, the United States GDP is expected to grow 2.6% in 2019 while corporate earnings are expected to grow by 8.3%.

We view this correction in equity markets as overdone and we expect slightly upward trending equity markets over the next couple of months. Due to political risks in Europe (Brexit, Italy), we move our focus partially away from Europe to the United States and Asia. We like China, India, and Vietnam as well as the global fishing sector at the moment.

The US central bank hiked interest rates four times last year and is planning to add two more hikes this year. Due to the turbulences in equity markets, investors do not really believe this and therefore the probability for another rate hike during the first half of this year is very low (< 10%). We believe that the FED will hike rates one more time this year and therefore bond markets should only be marginally impacted.

Geopolitical tensions continue to quickly lead to strong moves in currency markets. The Swiss Franc has historically acted as a safe haven in times of trouble; we do not expect this to change going forward.

Hedge funds experienced a disappointing year which ended with the worst yearly performance since 2011. Even though the environment with higher volatility, low correlation, and therefore higher dispersion is beneficial on paper for hedge funds, the sentiment among investors had a negative impact on returns. We still believe that hedge funds can add value as an addition to a traditional portfolio. We maintain our gold position for diversification reasons.

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Limmat Wealth Ltd.