



LimmatWealth

World Wide Outlook

3rd quarter 2016



Important Events

- Without any doubt, the main event in the 2nd quarter was the decision of the United Kingdom to leave the European Union (EU) within the next two years (Brexit). Insecurity about leaving or remaining in the EU has been replaced by uncertainty about the actual implementation of the decision. While the exit primarily has negative consequences in the short term, it could have positive effects in the longer term: Thanks to the Brexit, pressure on the EU is building to solve its inherent problems in order not to lose additional members.

Brexit is not leading to any changes of our tactical asset allocation



Growth

- In April 2016, the IMF reduced its forecasts again. The **world economy** is now expected to grow by **3.2% in 2016 and 3.5% in 2017**. The slight acceleration from 2015 (+3.1%) is the result of an improvement of countries currently in economic distress such as Brazil, Russia and some Middle Eastern countries. Major threats according to the IMF are the return of financial turmoil itself, declining potential output and noneconomic threats (e.g. terrorism, rising income inequality, political discussion turning inward).



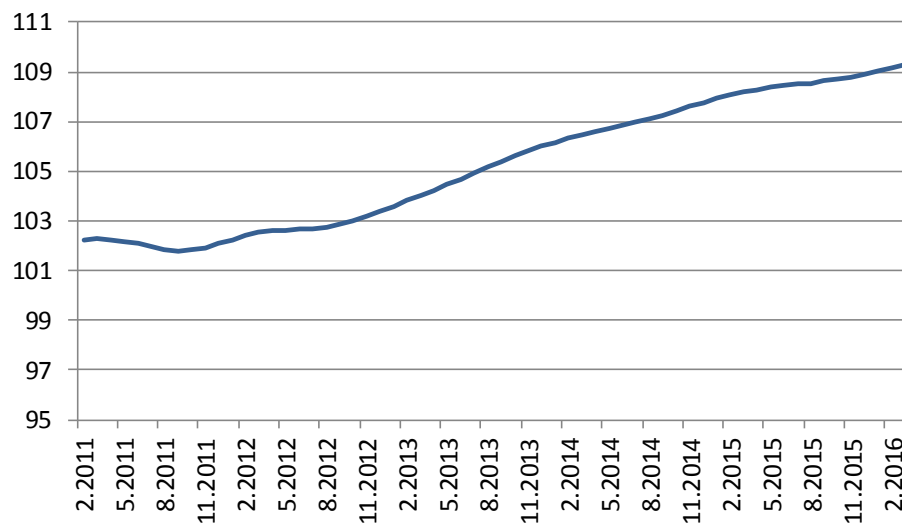
Growth

- In **advanced economies**, the IMF sees more or less constant growth of approximately 2% (2015: 1.9%, **2016: 1.9%**, **2017: 2.0%**). Monetary policy has to remain accommodative. Pressing on with structural reforms remains one of the key necessities for advanced as well as emerging countries.
- Growth in emerging markets is forecasted to rise from 4.0% in 2015 to **4.1% and 4.6% in 2016 and 2017**. The IMF sees exchange rate flexibility as one of the most important means for reducing the impact of potential adverse external shocks.



Growth

- The 'OECD Leading Indicator' points towards slow growth in the quarters ahead:





Growth

LEI (US Leading Indicator) indicates continuing growth in the US*



US Recessions since 1960

Start	End	Months	GDP	Trigger
1960.04	1961.02	10	-1.60%	Monetary policy
1969.12	1970.11	11	-0.60%	Vietnam, monetary & fiscal policy
1973.11	1975.03	16	-3.20%	1st oil crisis
1980.01	1980.07	6	-2.20%	Monetary policy
1981.07	1982.11	16	-2.70%	Iran, 2nd oil crisis
1990.07	1991.03	8	-1.40%	Monetary policy
2001.03	2001.11	8	-0.30%	Dot Com, 9/11
2007.12	2009.06	18	-5.10%	Subprime

* False signals only in 1966 und 1995



Growth

Gross Domestic Product (GDP)

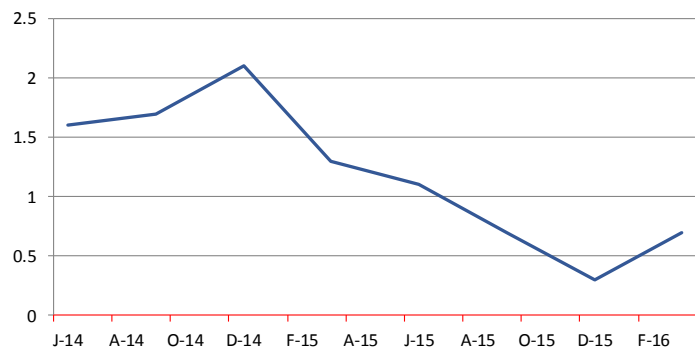
	GDP 13	GDP 14	GDP 15	GDP 16	GDP 17
Switzerland	1.8	1.9	0.9	1.2	1.5
Germany	0.4	1.6	1.5	1.5	1.6
Euro Zone	-0.3	0.9	1.6	1.5	1.6
UK	2.2	2.9	2.2	1.9	2.2
USA	1.5	2.4	2.4	2.4	2.5
Japan	1.4	0.0	0.5	0.5	-0.1
Brazil	3.0	0.1	-3.8	-3.8	0.0
Russia	1.3	0.7	-3.7	-1.8	0.8
India	6.6	7.2	7.3	7.5	7.5
China	7.7	7.0	6.9	6.5	6.2

Source: IMF & Limmat Wealth

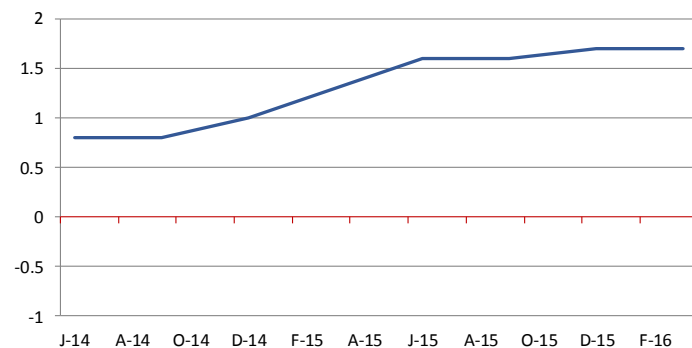


Growth

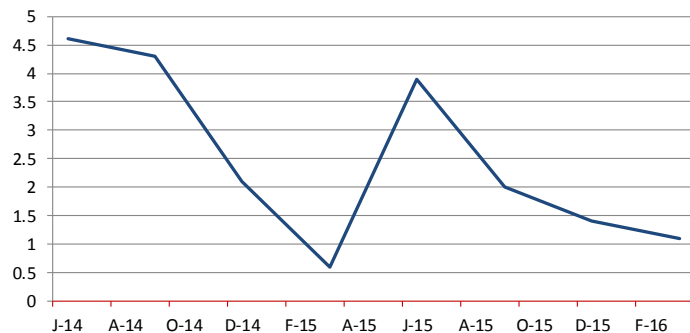
GDP-Growth Switzerland



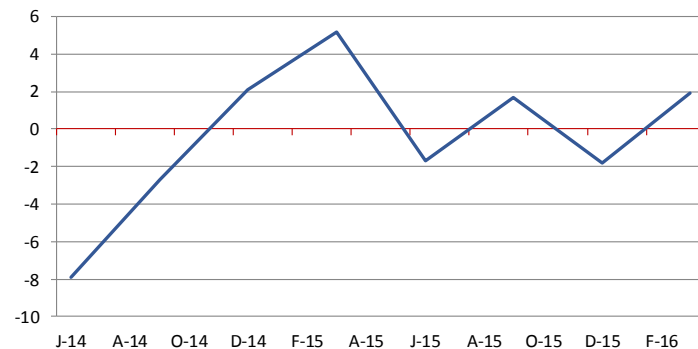
GDP-Growth Euro Zone



GDP-Growth USA



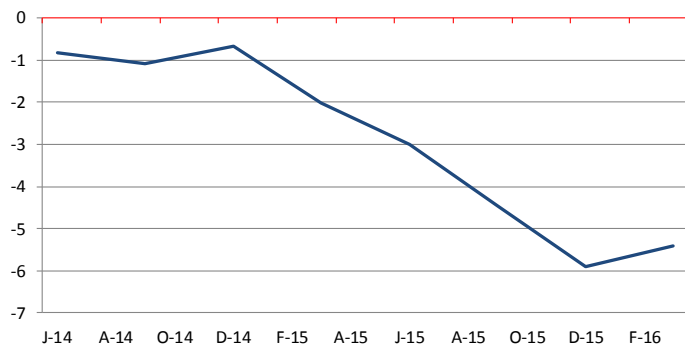
GDP-Growth Japan



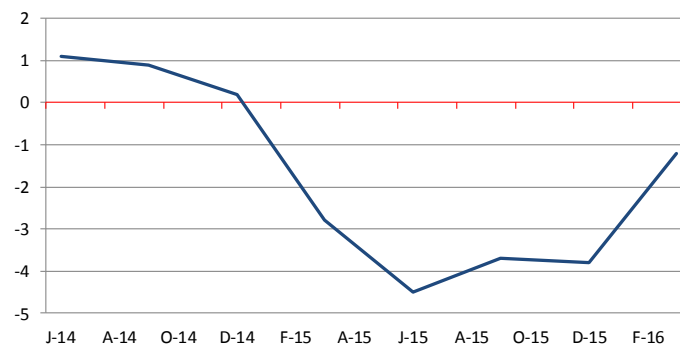


Growth

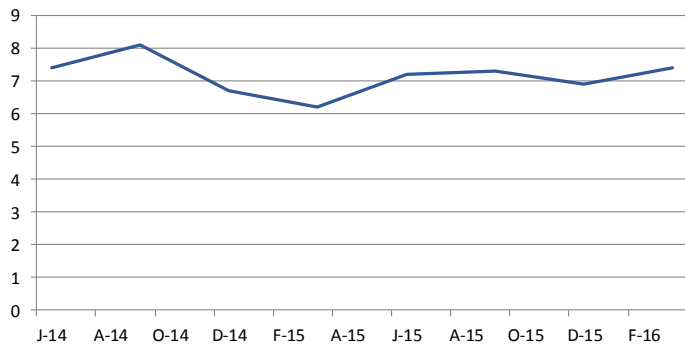
GDP-Growth Brazil



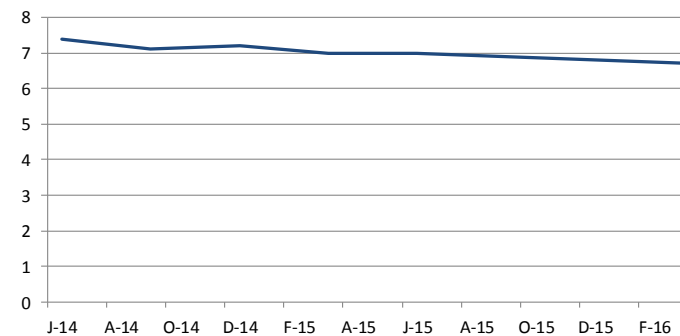
GDP-Growth Russia



GDP-Growth India



GDP-Growth China





Inflation

- By historical standards, inflation will remain low in **advanced economies**: After 0.3% in 2015 the IMF sees an increase to **0.7% in 2016 and 1.5% in 2017**.
- **Emerging and developing countries** are in disinflation: After 4.7% in 2015, inflation will decline to **4.5% (2016)** and **4.2% (2017)**.



Inflation

Consumer Price Inflation (CPI)

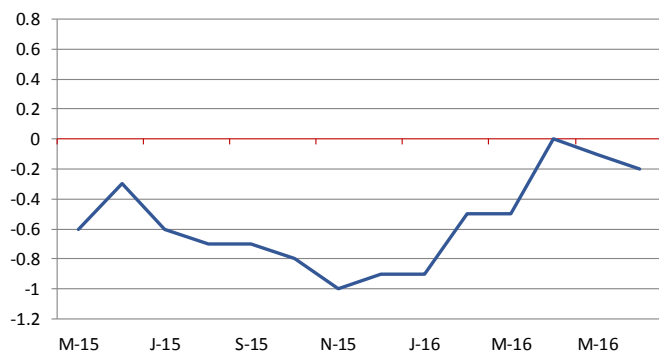
	CPI 13	CPI 14	CPI 15	CPI 16	CPI 17
Switzerland	-0.2	0.0	-1.1	-0.6	-0.1
Germany	1.6	0.8	0.1	0.5	1.4
Euro Zone	1.3	0.4	0.0	0.4	1.1
UK	2.6	1.5	0.1	0.8	1.9
USA	1.4	1.4	0.3	0.7	1.5
Japan	0.4	2.7	0.8	-0.2	1.2
Brazil	6.2	6.3	9.0	8.7	6.1
Russia	6.8	7.8	15.5	8.4	6.5
India	9.4	5.9	4.9	5.3	5.3
China	2.6	2.0	1.4	1.8	2.0

Source: IMF & Limmat Wealth

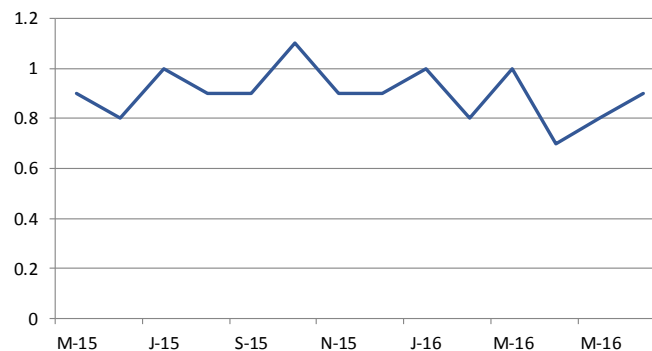


Inflation

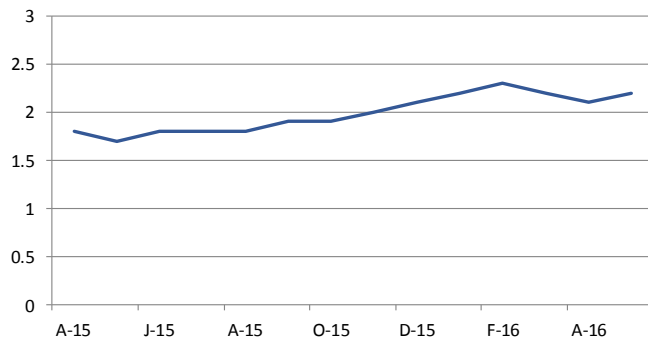
Inflation Switzerland (core)



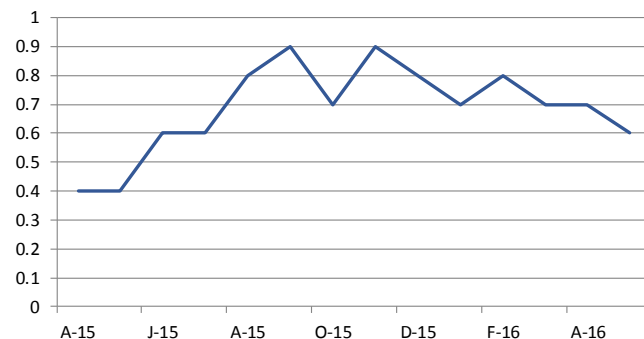
Inflation Euro Zone (core)



Inflation USA (core)



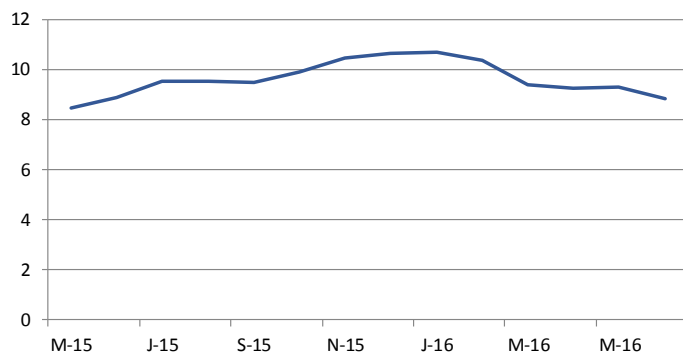
Inflation Japan (core)



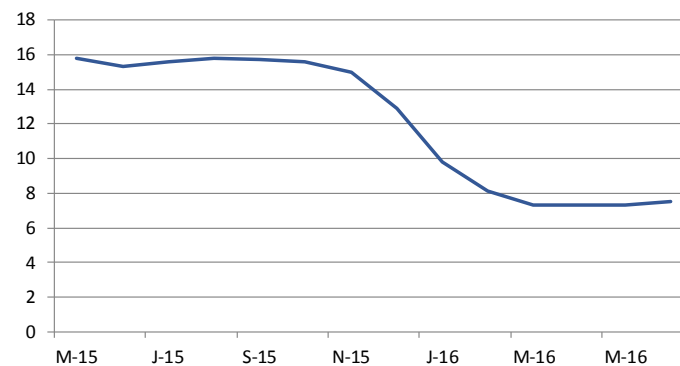


Inflation

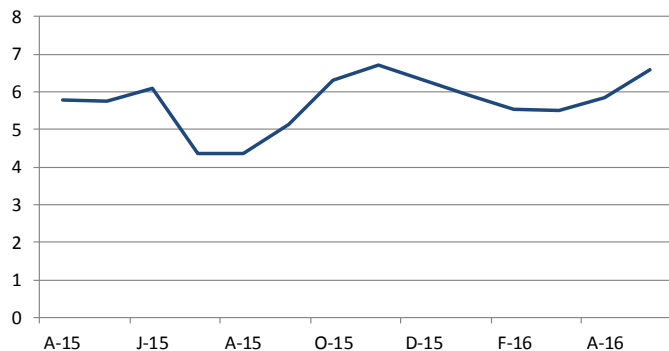
Inflation Brazil



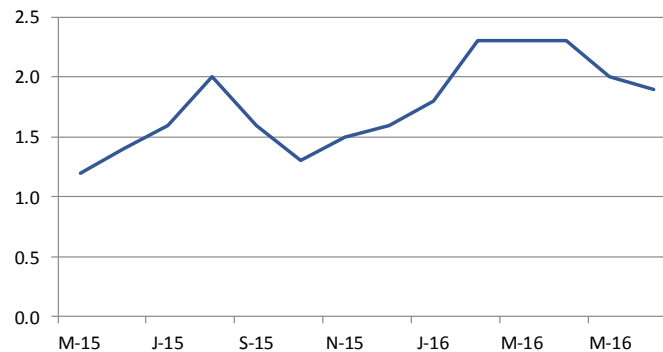
Inflation Russia



Inflation India



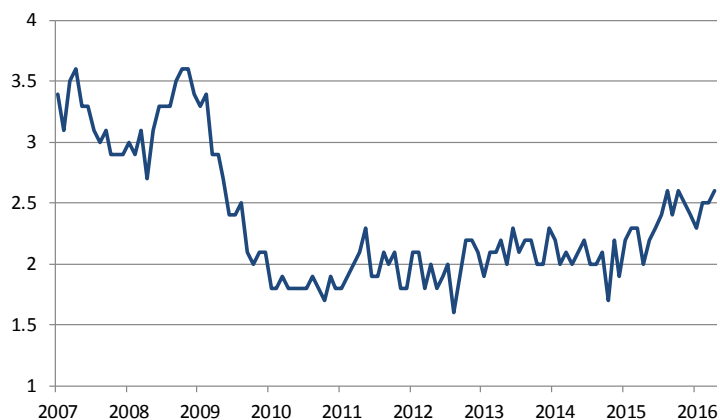
Inflation China





Inflation USA

USA:
Yearly % change average hourly earnings



USA:
Capacity Utilization %



US inflation to remain low as long as hourly earnings and capacity utilization stay at current levels.



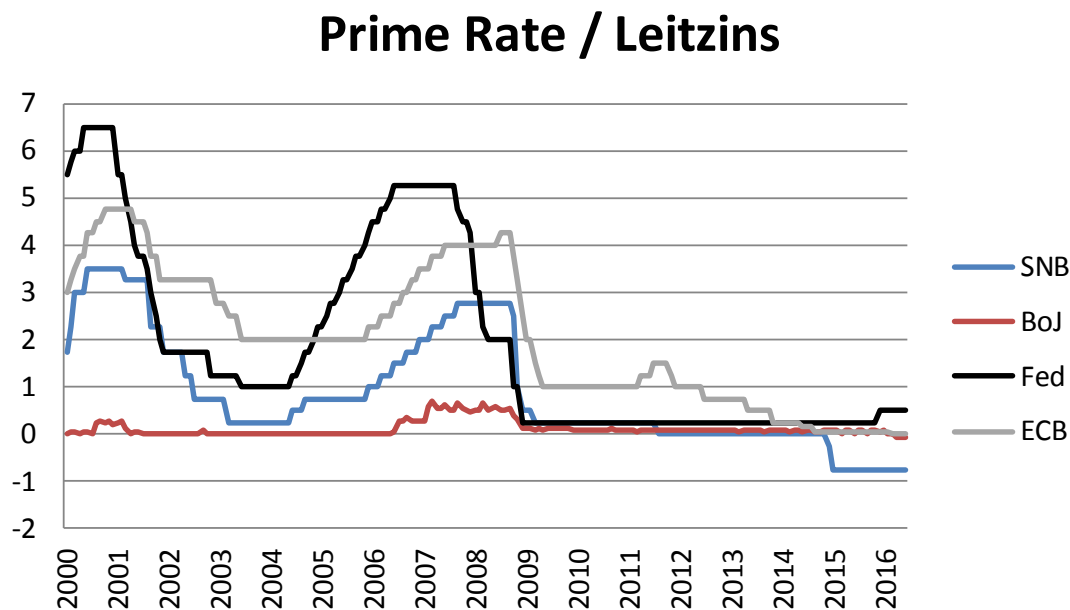
Monetary Policy

- The **European Central Bank** increased its monthly bond purchasing program from Euro 60bn to Euro 80bn and expanded it to investment grade corporate bonds (no banks). Monetary policy will remain very expansionary for the foreseeable future.
- In the **US**, the FOMC hiked the 'Fed Funds Rate' on December 2015 by 25 basis points to 0.25%-0.5%. This constituted the first rise in seven years. The importance of this increase is based on historical experience according to which a first interest hike is usually followed by additional ones. Further interest hikes will occur depending on economic data.



Monetary Policy

- The normalization of the extremely expansionary **conventional** monetary policy ...

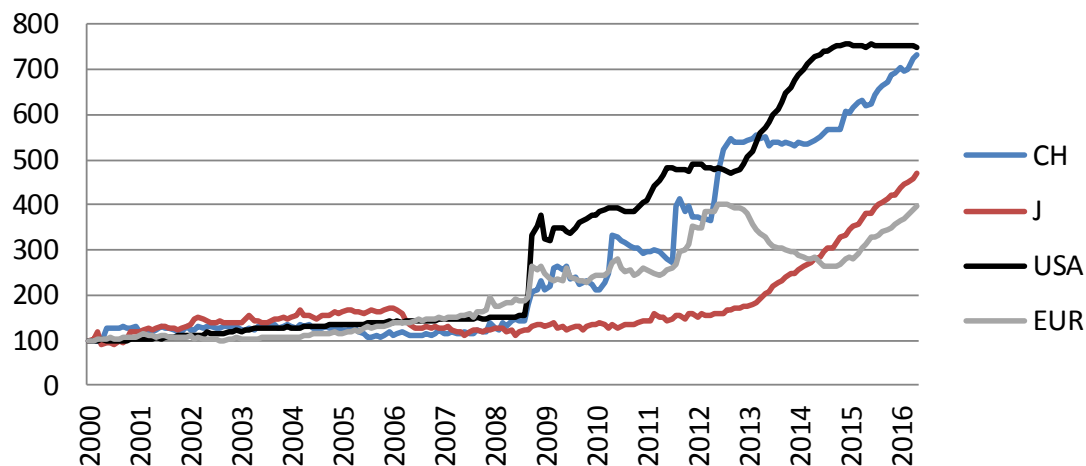




Monetary Policy

... as well as **unconventional** (e.g. bond purchases) monetary policy ...

Central Bank Balance Sheets / Zentralbanken Bilanzen





Monetary Policy

... becomes a tightrope walk between

- **overheating** if central banks normalize too late
(inflation and/or formation of bubbles)
- **recession risk** if central banks normalize too early
- **currency risk**



Indebtedness

Public Debt in % of GDP

Source: Bloomberg

(Government debt held by public)

Russland / Russia	14
China / China	17
Schweiz / Switzerland	34
Neuseeland / New Zealand	34
Norwegen / Norway	39
Australien / Australia	44
Schweden / Sweden	44
Indien / India	52
Finnland / Finland	61
Niederlande / Netherlands	69
Deutschland / Germany	72
USA / United States	74
Grossbritannien / United Kingdom	91
Euro Zone / Eurozone	91
Kanada / Canada	95
Frankreich / France	98
Spanien / Spain	101
Irland / Ireland	101
Singapur / Singapore	106
Belgien / Belgium	106
Portugal / Portugal	129
Italien / Italy	136
Griechenland / Greece	171
Japan / Japan	228



Indebtedness

Budget Deficit / Surplus in % of GDP

Source: Bloomberg

Griechenland / Greece	-7.2
Spanien / Spain	-5.1
Japan / Japan	-5.0
Portugal / Portugal	-4.4
Grossbritannien / United Kingdom	-4.4
Indien / India	-3.9
Frankreich / France	-3.5
China / China	-3.5
Finnland / Finland	-2.7
Belgien / Belgium	-2.6
Italien / Italy	-2.6
USA / United States	-2.5
Irland / Ireland	-2.3
Euro Zone / Eurozone	-2.1
Niederlande / Netherlands	-1.8
Kanada / Canada	-1.3
Australien / Australia	-0.9
Schweiz / Switzerland	-0.2
Schweden / Sweden	0.0
Neuseeland / New Zealand	0.0
Deutschland / Germany	0.7
Russland / Russia	0.8
Norwegen / Norway	5.4
Singapur / Singapore	8.6



Currencies and Gold

- According to the DXY-Index, the USD gained +1.7% during the 2nd quarter but remains in negative territory since the start of the year (-2.5%). As a result of the Brexit, the British Pound lost 7.3% and the Euro shed 2.4%. The Swiss Franc did not profit from the Brexit and weakened (-1.5%) as well versus the USD. The Yen skyrocketed 9% when it became obvious that no additional dovish actions by the Japanese central bank were to be expected.
- Uncertainties with regards to the implementation of Brexit limit the potential of the English Pound and the Euro. As a result, we are expecting a slightly stronger USD. Although the Swiss Franc is strongly overvalued in comparison to the Euro, the alignment to the purchasing power parity will take longer than previously expected because of Brexit. The Yen has appreciated too quickly and we are expecting a technical counter reaction on the downside.



Currencies and Gold

- During the 2nd quarter, gold rose by 7%. We are holding on to our gold position because the yellow metal offers some hedge in light of the current uncertainties. Mainly in the case of currency wars, demand for gold would increase dramatically.
- According to the World Gold Council, 1st quarter gold demand increased by 21% to 1'289,8 tons year-over-year. The boost came mainly from ETFs and similar products. Meanwhile, supply rose only 5% to 1'134.9 tons.



Currencies and Gold

	Currencies / Gold		
	Actual	3 Mo.	12 Mo.
USD/CHF	0.98	1.00	1.02
EUR/USD	1.11	1.10	1.08
USD/Yen	106	105	100
GBP/USD	1.32	1.29	1.30
USD/BRL	3.26	3.50	3.60
USD/Rubel	63.44	65.00	70.00
USD/INR	66.90	67.00	70.00
USD/CNY	6.69	6.70	7.00
EUR/CHF	1.09	1.10	1.10
Gold (USD)	1327	1350	1400



Currencies and Gold

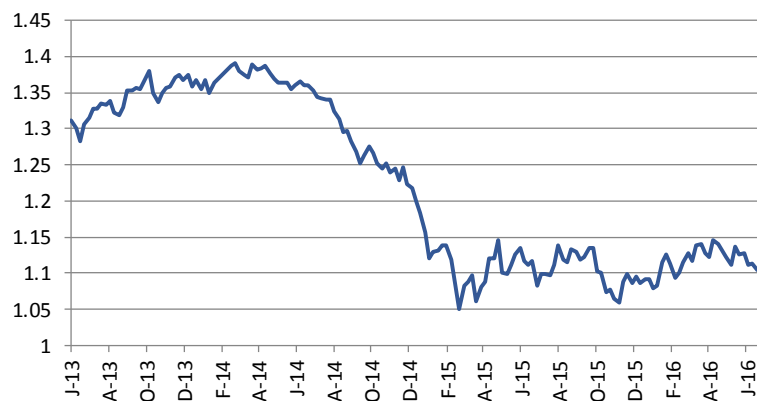
	Current Account in % of GDP
United Kingdom	-5.4
Australia	-4.8
Turkey	-4.4
Latin America	-3.7
Canada	-3.2
Brazil	-3.2
USA	-2.6
Middle East	-1.3
India	-1.1
G10	-0.2
EMEA	0.6
BRICS	1.9
Europe	2.7
China	3.0
Euro Zone	3.2
Japan	3.3
Asia	3.4
Russia	5.3
Sweden	5.7
Norway	6.6
Denmark	7.0
Switzerland	11.4

Current Account =
+ Balance of trade of goods
+ balance of trade of services
+ net factor income
+ net transfer income.

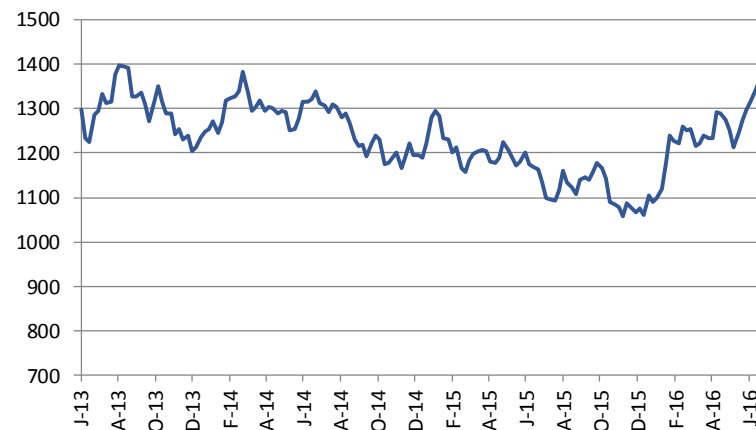


Currencies and Gold

Euro per 1 USD



Gold ounce in USD





Fixed Income

- Prices of high quality government bonds continued to rise during the 2nd quarter and attractive returns were accomplished (Switzerland +0.7%, Germany +1.0%, UK +2.3%, USA +1.3%). Emerging country debt (+5.3%) and high yield bonds (+4.8%) performed even better due to declining quality spreads. Since the start of the year, sovereign bonds (1-10 years) returned low to medium single digit numbers (Switzerland +1.6%, Germany +2.8%, UK +5.3%, USA +3.9%).
- The launch of ETFs (Exchange Traded Funds) on less liquid investments such as leveraged bank loans is a worrying factor in our view. Especially in the 'non-government' segment, liquidity has been disappearing.



Fixed Income

- Under the assumption that the actual yield to maturity of bonds is a good indicator for future returns, bonds do not look attractive. The yield curve of Swiss sovereigns is negative irrespective of the maturity and the German Bund does not reach positive territory before 12 years. The situation is less dire in the USD and GBP area. To make matters worse, the yield curve has flattened worldwide and an additional source for returns is drying out (term spread).

Bonds: Slightly overweighted mainly due to zero or negative yield of cash.



Fixed Income

	Sovereign Bonds (10 yrs.)		
	Actual	3 Mo.	12 Mo.
Switzerland	-0.57	-0.50	0.00
Euro Zone (Germany)	-0.06	0.00	0.50
USA	1.49	1.75	2.25
UK	0.77	1.00	1.50
Japan	-0.26	-0.10	0.00
Brazil	11.97	12.00	12.00
Russia	4.35	4.50	4.50
India	7.29	7.50	7.00
China	2.86	3.00	3.00



Fixed Income: Yield to Maturity Government Bonds (All Maturities)

Switzerland



Euro Zone



USA



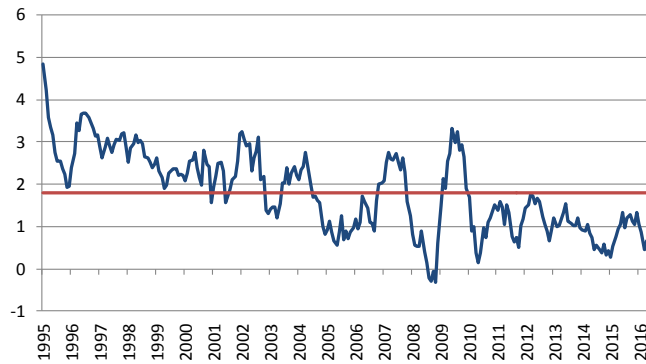
Japan



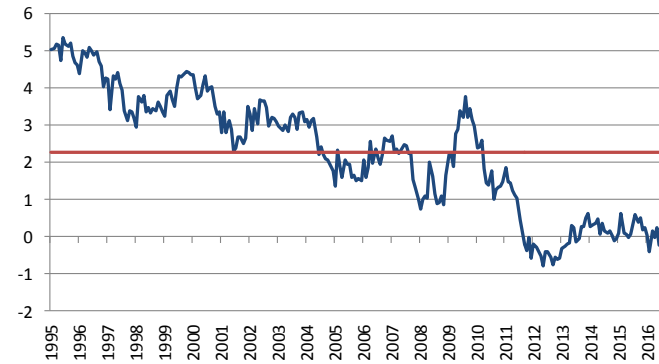


Fixed Income: Government Bonds (All Maturities)

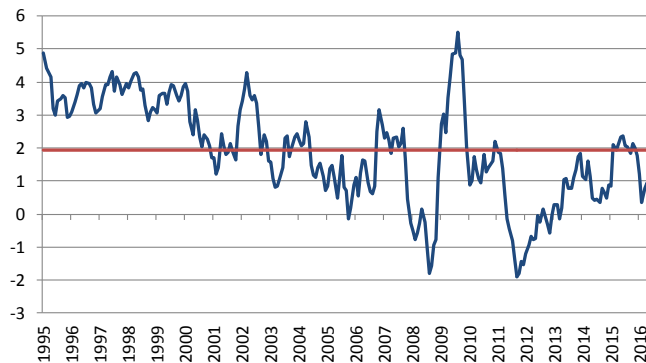
Real Rates Switzerland



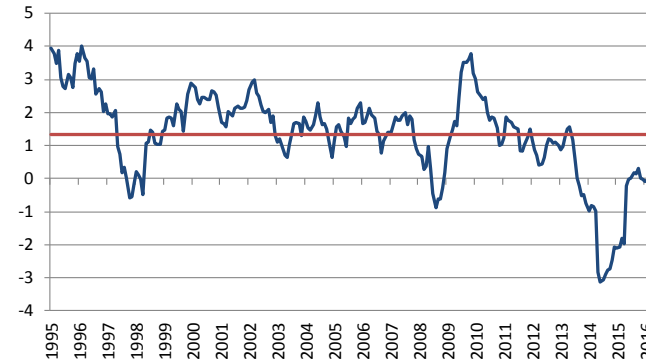
Real Rates Germany



Real Rates USA



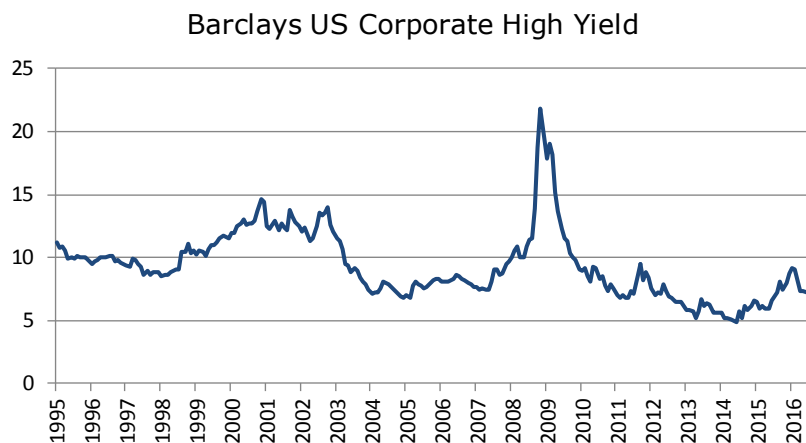
Real Rates Japan



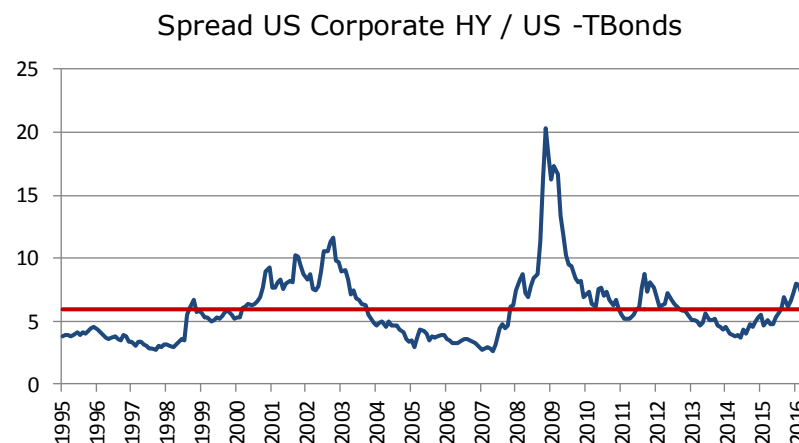


Fixed Income: High Yield

Yield to Maturity



Quality spread

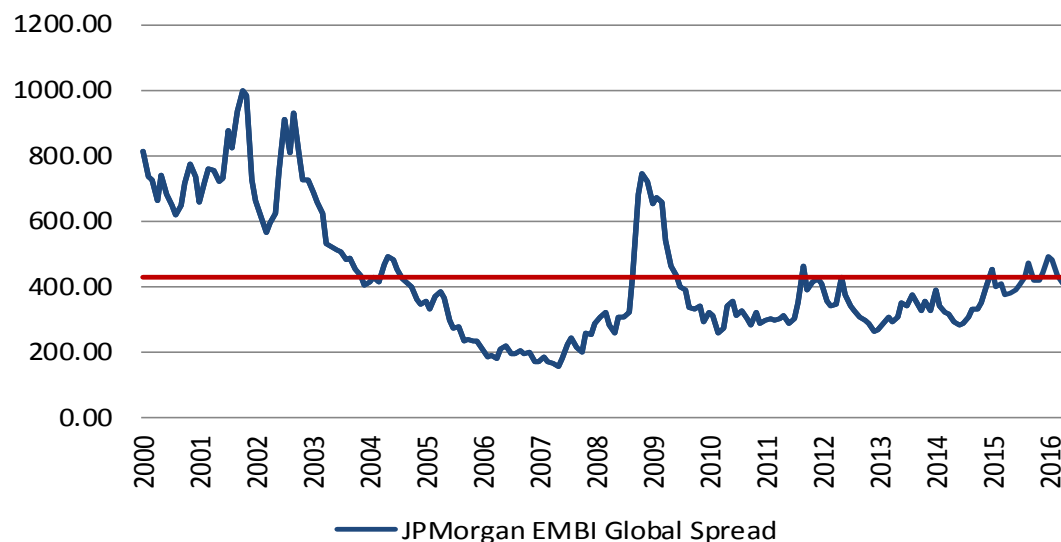


Quality spreads are near their historical average.



Fixed Income: Emerging Market Bonds

Spread of emerging market bonds versus developed markets bonds



Emerging market bond spreads are close to the historical averages.



Alternative Investment Strategies (AIS)

Commodities

- Research shows that fully collateralized commodity futures offered the same returns and Sharpe ratio as equities between July 1959 and December 2004. At the same time, commodity futures returns were negatively correlated with equity and bond returns. In addition, commodity futures are positively correlated with inflation, unexpected inflation and changes in expected inflation.

(Gorton and Rouwenhorst. 2004. 'Facts and Fantasies about Commodity Futures')

- After heavy losses during the last few years and a stabilization during the 1st quarter, commodities underwent a technical counter reaction and surged 13%. Mainly energy (e.g. oil +26%) and precious metals (e.g. gold +7%) lifted the broad commodity index.



Alternative Investment Strategies (AIS)

- Commodity fundamentals have not improved in our view. In light of weak economic growth, we are continuing to underweight this asset class. Within commodities, we are concentrating on gold, which offers some hedge in light of the current uncertainties. Mainly in the case of currency wars, demand for gold would increase dramatically.

Commodities: Slightly underweighted



Alternative Investment Strategies (AIS)

Hedge Funds

- Research shows that hedge funds outperformed equities (years 1995-2009) by 3% per year after adjustments for costs, survivorship bias and backfill bias. At the same time, hedge funds offered interesting diversification advantages.

(Ibbotson, Chen and Zhu. 2011. 'The ABCs of Hedge Funds: Alphas, Betas, and Cots'. Financial Analysts Journal, vol. 67, no.1, 15-25)

- Within our AIS-Quota (Alternative Investment Strategies), hedge funds play the largest role and we are focusing on funds, which follow a market neutral strategy.

Hedge Funds: Overweighted

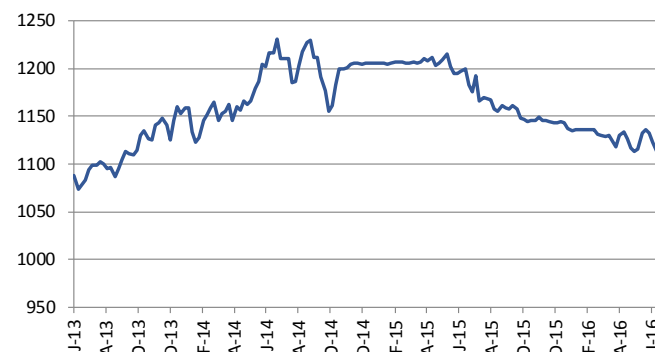


Alternative Investment Strategies (AIS)

Bloomberg Commodity Index Total Return



GS ART (Hedge Funds)



Oil (West Texas Intermediate)





Equities: Overview

- Falling credit spreads and low inflation supported equity markets during the 2nd quarter. The world equity index rose 1.3%. No big differences between developed (+1.2%) and emerging (+1.6%) markets were observable. The strong Yen led to losses in Japanese equities (-7.1%). The Brexit took its toll on European markets (-4.7%) but British equities profited from a weakening Pound (+5.3%). Industry wise, energy (+9.4%), healthcare (+5.8%) and utilities (+5.4%) performed best. Since the start of the year, the world equity market has risen 1.6%. While the US market developed nicely (+4%), Japan (-18%) and Europe (-10%) disappointed. Also Swiss equities (-4%) could not satisfy expectations.
- With regards to risk, we see primarily the following: Rising quality spreads (yield differential of bonds with varying quality), valuation compression due to higher interest rates, pressure on profit margins.



Equities: Overview

- Considering high risks, declining corporate profits on a worldwide basis since September 2014 and rather high absolute valuations of equity markets, we are expecting a range bound market. We see substantial political (Implementation of Brexit, US elections, refugee influx in Europe, rising claim to power of China and Russia etc.) as well as economic (economic activity) risks.
- Significantly higher equity prices – mainly in the US – would need additional extreme measures of central banks. We are not willing to bet on further dovish actions by central banks and are continuing to underweight equities.



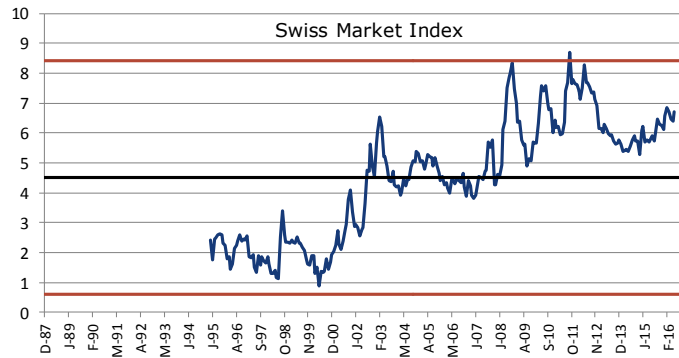
Equities: Overview

- After large setbacks in the order of 30% within the past year, we are of the opinion that biotech companies offer interesting potential. In comparison to 'traditional' pharma companies, biotech offers higher revenue growth (10%-15% vs. 0%-5%) at lower valuations (PE 2017 14x vs. 16x). We are going to invest in a biotech fund within the coming days. As a result, our equity allocation will rise but remain below neutral.

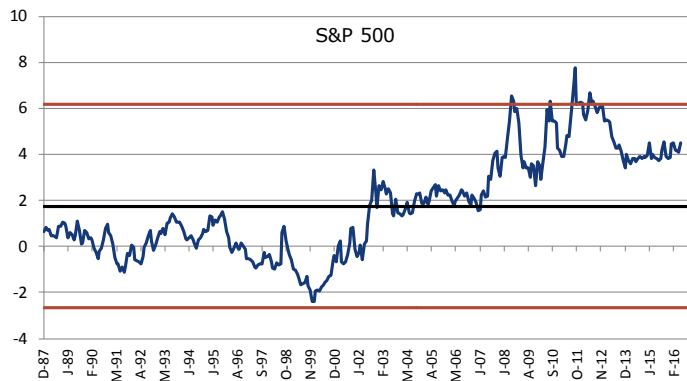
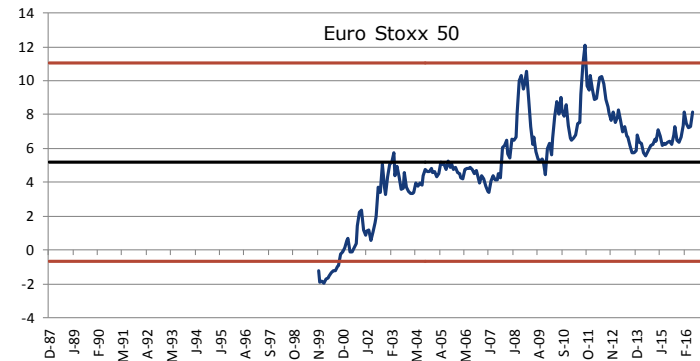
Equities: (Slightly) underweighted



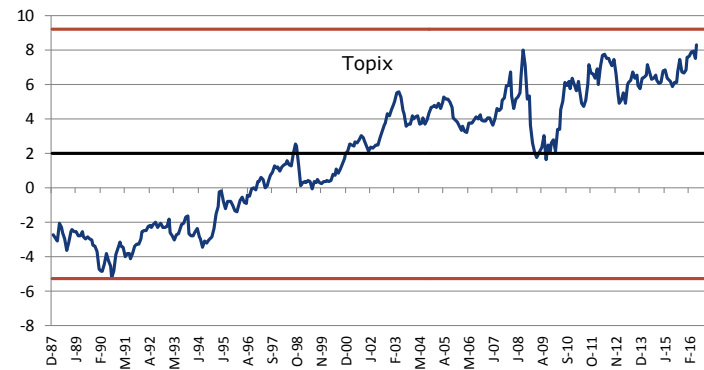
Equities: Valuation According to Fed-Model



cheap
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↓
expensive

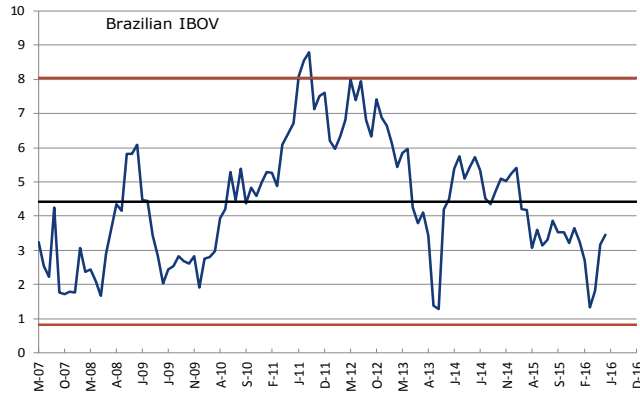


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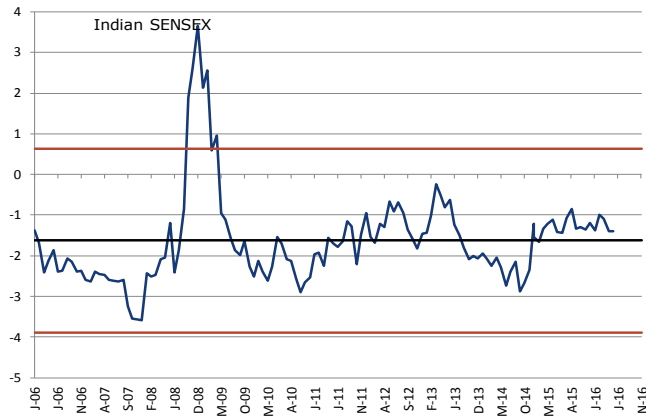
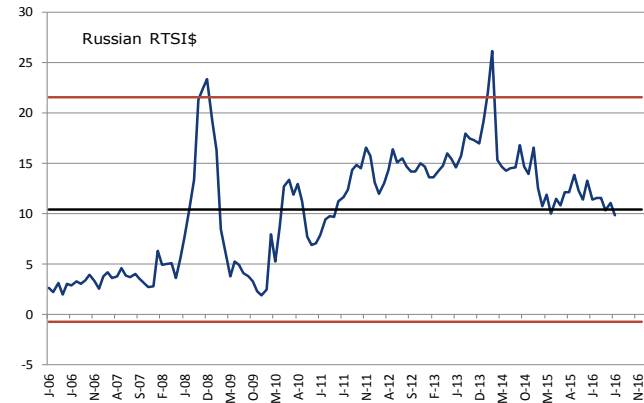




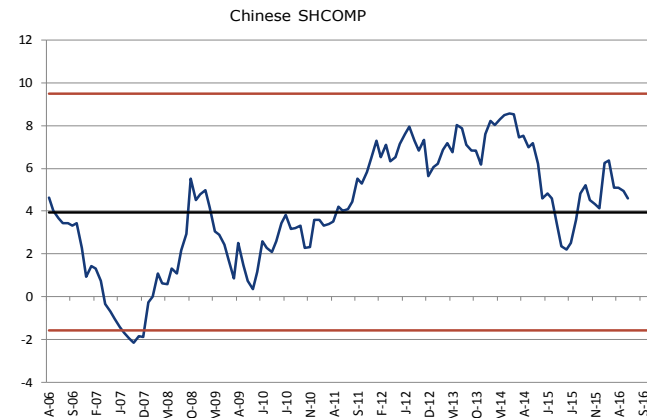
Equities: Valuation According to Fed-Model



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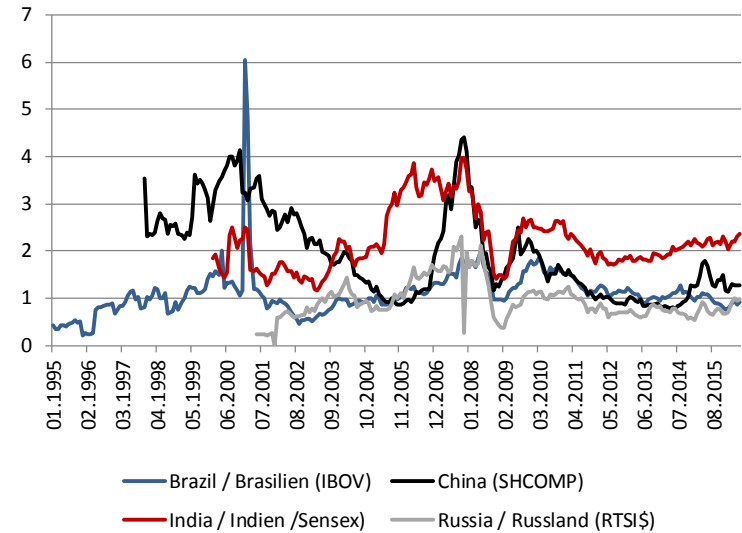
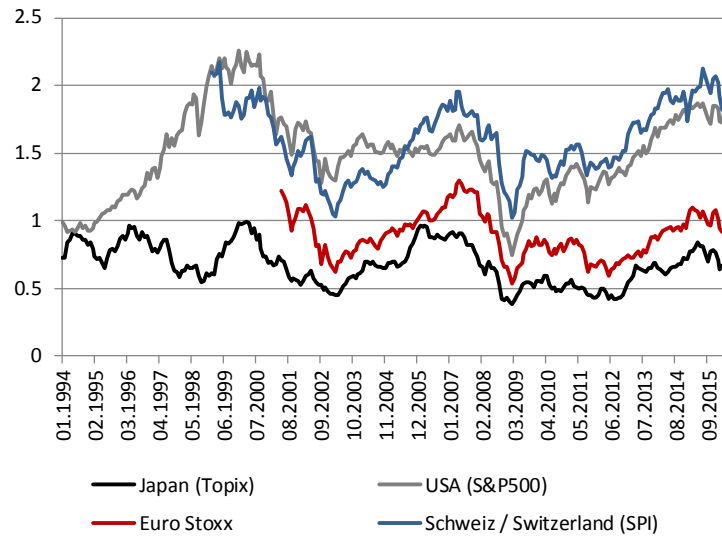


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expensive



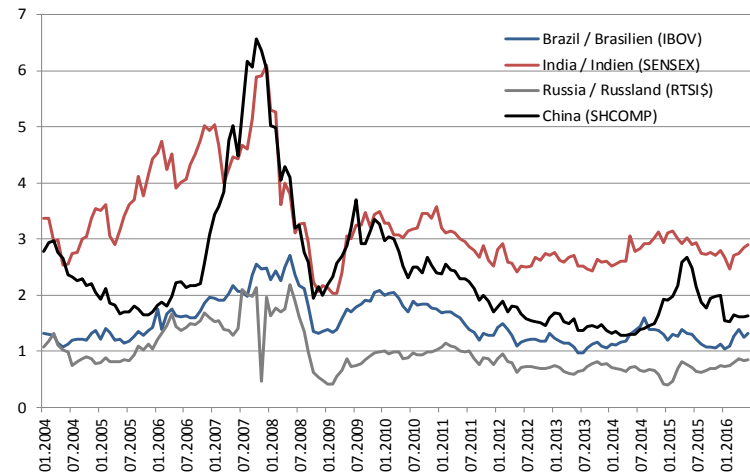
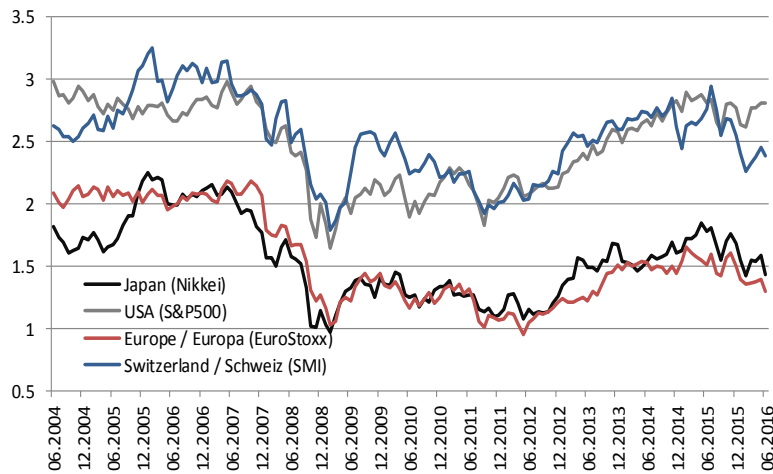


Equities: Valuation by Price/Sales





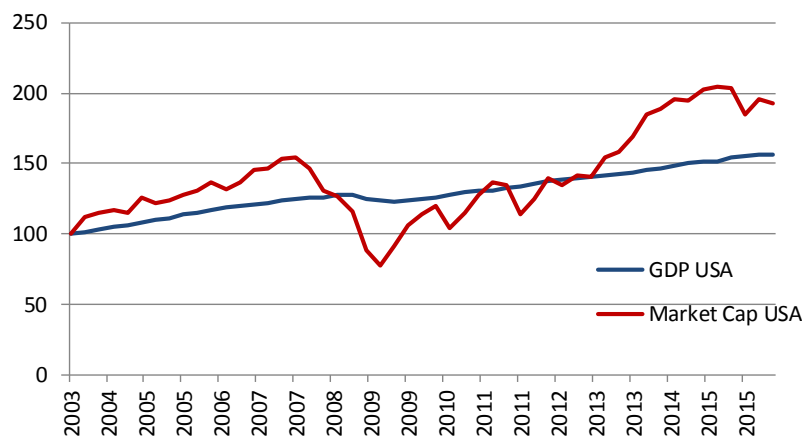
Equities: Valuation by Price/Book



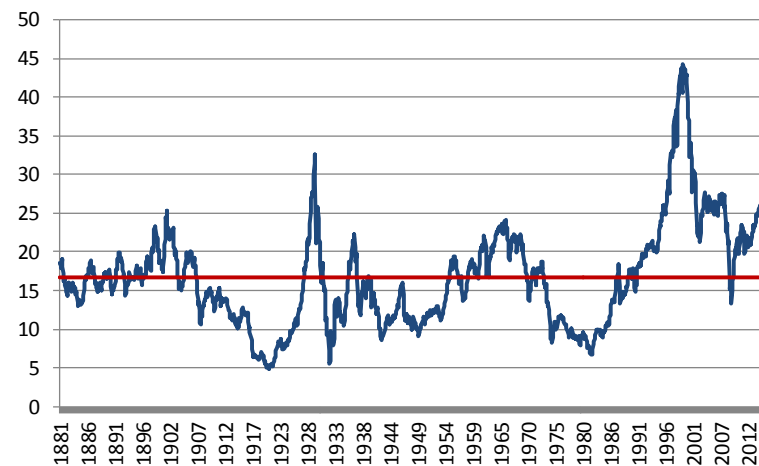


Equities: Valuation of US Market

Market Capitalization and GDP



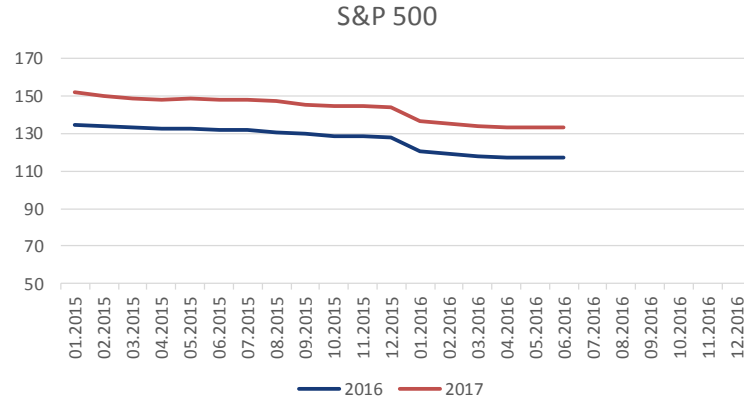
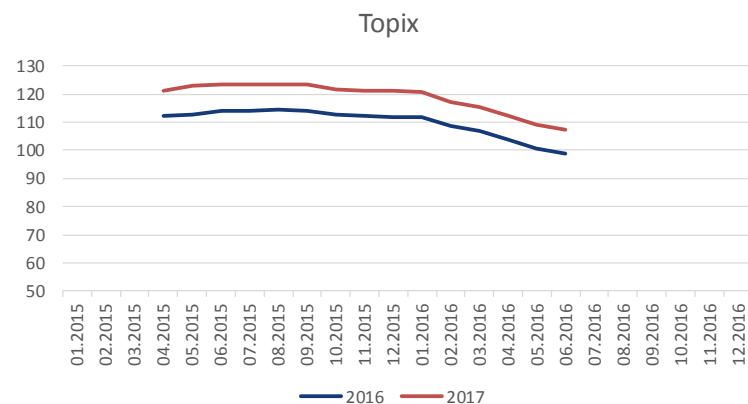
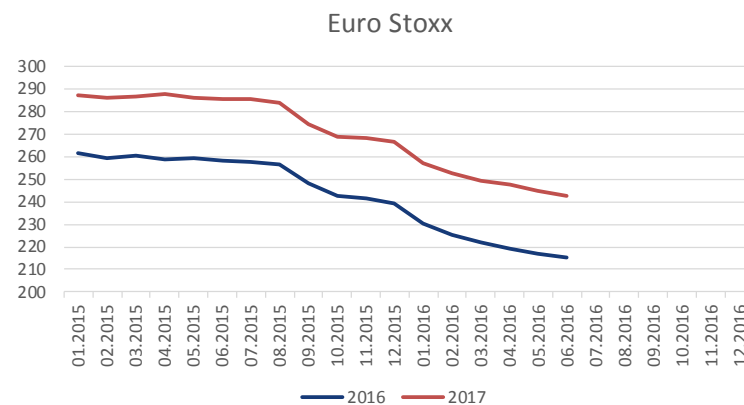
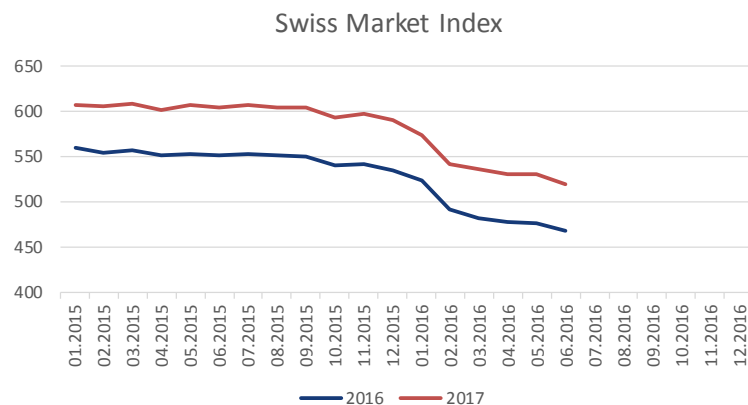
Shiller PE Ratio *



* PE based on real EPS over 10 year period



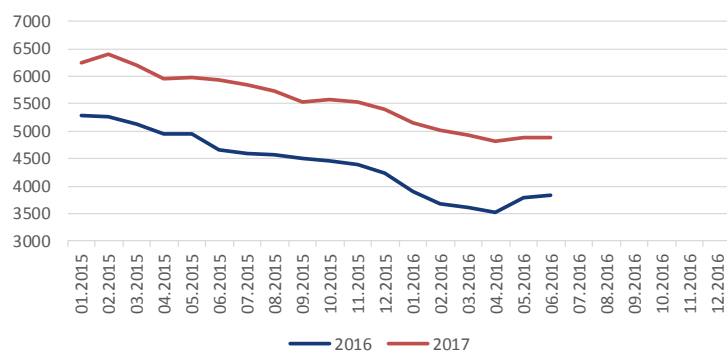
Equities: Earnings-Revisions



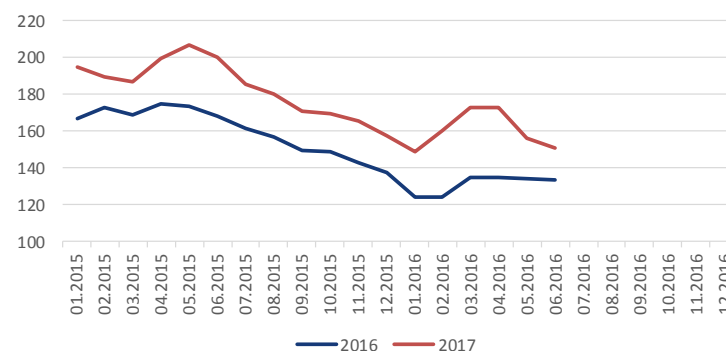


Equities: Earnings-Revisions

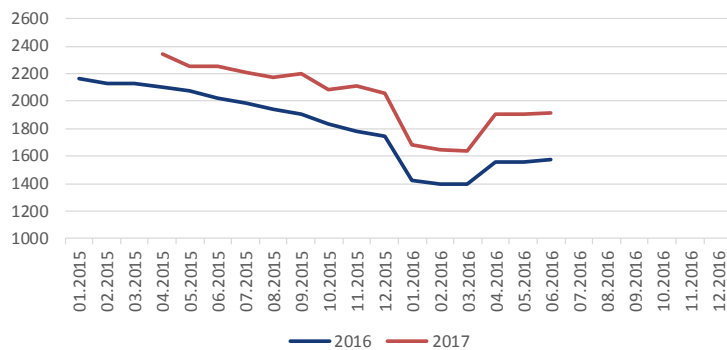
Brazil Bovespa



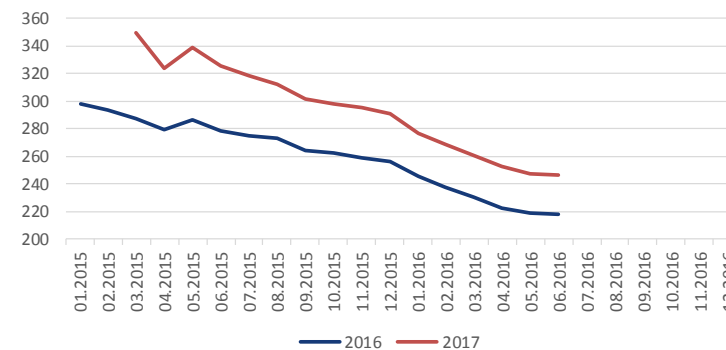
Russian Traded Index \$



Bombay Sensex



Shanghai Composite





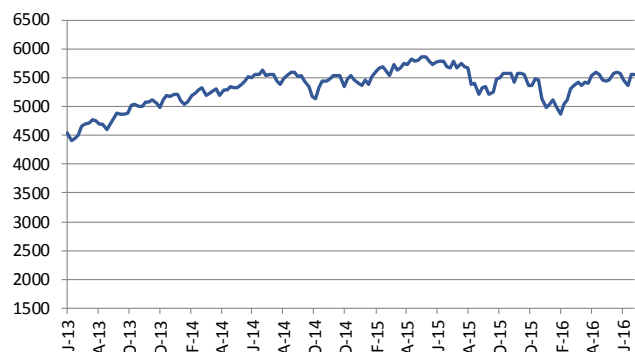
Equities: Forecast

	Equities		
	Actual	3 Mo.	12 Mo.
Switzerland (SPI)	8'841	8'750	9'200
Germany (DAX)	10'065	9'900	10'300
Euro Zone (Euro Stoxx 50)	5'788	5'700	5'900
UK (FTSE 100)	6'723	6'650	6'800
USA (S&P500)	2'152	2'100	2'200
Japan (Topix)	16'386	16'400	16'700
Brazil (Bovespa)	54'598	53'000	55'000
Russia (MSCI Russia)	454	450	470
India (Sensex)	27'891	27'500	29'000
China (CSI Total Return)	2'670	2'650	2'900



Equities: Developed and Emerging Markets

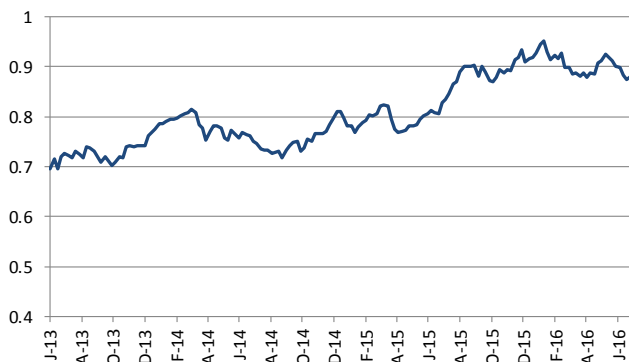
Dow Jones Developed Markets



Dow Jones Emerging Markets



Relative Performance



Outperformance Developed Markets



Outperformance Emerging Markets



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