LimmatWealth

Investment Strategy May 2017

Data & Forecasts

	Growth (%)		Inflation (%)		Currencies (vs. USD)		
	GDP 17	GDP 18	CPI 17	CPI 18	Actual	3 Mo.	12 Mo.
Switzerland	1.4	1.6	0.4	0.7	1.00	1.02	0.97
Germany	1.6	1.5	2.0	1.7	-	-	-
Euro Area	1.7	1.6	1.7	1.5	1.09	1.05	1.10
UK	2.0	1.5	2.5	2.6	1.29	1.25	1.30
USA	2.3	2.5	2.7	2.4	1.00	1.00	1.00
Japan	1.2	0.6	1.0	0.6	112.09	110.00	110.00
Brazil	0.2	1.7	4.4	4.3	3.18	3.10	3.25
Russia	1.4	1.4	4.5	4.2	56.99	58.00	60.00
India	7.2	7.7	4.8	5.1	64.21	65.00	67.00
China	6.6	6.2	2.4	2.3	6.90	7.00	7.30

	Bonds (10 yrs.)			Profits (%)		Equities		
	Actual	3 Mo.	12 Mo.	EPS 17	EPS 18	Actual	3 Mo.	12 Mo.
Switzerland	-0.11	0.00	0.25	54	11	9'976	↘	↗
Germany	0.32	0.50	1.00	43	8	12'438	↘	↗
Euro Area				36	10	7'033	↘	↗
UK	1.09	1.09	1.25	157	8	7'204	↘	↗
USA	2.32	2.50	3.00	18	12	2'388	↘	↗
Japan	0.02	0.00	0.25	32	9	19'446	↘	↘
Brazil	10.30	10.00	10.00	64	11	65'403	↘	↘
Russia	4.01	4.25	4.25	35	10	537	↗	↗
India	6.98	7.00	7.00	24	19	29'890	↘	↗
China	3.47	3.25	3.25	0	0	2'783	↗	↑

IMF expects acceleration of economic growth

In its latest World Economic Outlook, the IMF (International Monetary Fund) forecasts a slight acceleration of worldwide output: After 3.1% in 2016, world economic growth will accelerate to 3.5% in 2017 and to 3.6% in 2018. The progress is a result of buoyant financial markets and the long awaited cyclical recovery. Due to structural problems – mainly income inequality and low productivity progress – growth remains below expansion rates observed at the start of this century. With regards to inflation, the IMF remains relaxed: The rise of consumer prices is mainly an effect of higher commodity prices, while core inflation remains tame. Next to geopolitical uncertainties, the IMF sees medium-term risks in the form of protectionism, faster than expected interest hikes in the US, aggressive rollback of financial regulations etc. In the US, the sharp drop of the unemployment rate to 4.5% surprised positively but annualized GDP dropped from 2.1% during the 4th quarter to only +0.7% in the 1st quarter 2017, which constitutes the lowest number in three years. Minutes of the latest Fed meeting revealed that its members expect another two interest hikes during 2017. Furthermore, the reduction of the bond portfolio of the Fed will become a topic in due time. In order to mitigate the effects of the financial crisis the central bank had bought bonds in order to reduce interest rates at the long end and thereby inflated the balance sheet from about USD 1 tn. to USD 4.5 tn. In the Euro Zone, unemployment dropped to 9.5%, which constitutes the lowest number since 2009. In the United Kingdom, 1st quarter growth (+2.1%) and inflation (consumer prices +2.3%, core rate +1.8%) hardly changed. Also in China, economic growth for the 1st quarter (+6.9%) didn't deviate much from the 4th quarter (+6.8%). Inflation remains subdued (+0.9%). In Russia, disinflation continues and consumer prices rose less than 4.5% (core rate +4.3%), which has been unheard of for the last five years.

Bonds unchanged

Bond markets were rather quiet in April. The promising results of the French elections neither had an impact on Swiss (+0%) nor German (-0.03%) government bonds. In contrast, in the UK (+0.26%) and the US (+0.49%) bonds rallied. Also high yield bonds (+0.99%) and emerging market debt (+1.6%) showed appealing results. Towards the end of the year we see first steps of a normalization of the Fed's balance sheet (e.g. no reinvestment of maturing bonds), which will leave its mark on the bond market. The outlook for investment grade bonds remains dire. Nevertheless, high quality bonds are held for their diversification benefits.

Continued correction of the greenback

The USD continued its correction and fell - according to the DXY-Index - another 1.3% in April. Already in the run-up phase to the French elections the Euro started to rise and extended its gains after the victory of the liberal democrat Emmanuel Macron (24% vs. 22% Le Pen) in the 1st ballot. During April, the Euro gained 2.3% vs. the USD. Also the British Pound benefitted from politics: The announcement of snap elections on June 8 led to gains in the order of 3.2% vs. the USD. In light of the large current account deficit of the US, we expect a slightly weaker USD over the coming 12 months. China liberalized the currency market further by allowing banks to execute sell orders of the Yuan without corresponding buy orders for the Chinese currency. Meanwhile, gold profited from rising tensions in Syria and North Korea but closed the month almost unchanged (+1.5%) when French elections did not result in a disaster such as a runoff ballot between Melenchon and Le Pen. We are continuing to hold gold as a hedge in case of currency turbulences. The broad commodity index lost 1.5% in April. Oil rose to almost USD 54 but closed the month at USD 49 (-2.5%).

European equity rally continues

The world equity market rose another 1.6% in April. European stocks benefitted from the promising first ballot in France and soared 1.7% (Euro Stoxx). We are continuing to favor European stocks: On the one hand, monetary policy will remain expansionary at least until German elections in autumn. On the other hand, valuations are less demanding than in the US. Furthermore, operating margins are about one third lower than in the US, which constitutes potential for improvement. According to first extrapolations, American companies have increased their profits by almost 13% during the first quarter, thereby beating expectations of 9% easily. In addition, the US market (S&P500 +0.9%) profited from a slightly more concrete proposal with regards to President Trump's tax plan and his drawback from an immediate termination of the North American Free Trade Agreement (NAFTA). In light of a more restrictive monetary US policy, we are expecting the US market to underperform. Furthermore, we see some kind of disillusion with regards to the quick implementation of Donald Trump's election promises (tax reductions, infrastructure investments, less regulation etc.). We have reservations with regards to the Japanese equity market because we don't see a trigger for higher prices. Our equity allocation remains neutral. Furthermore, we are still of the opinion that investors should keep the manifold problems on their radar screen: Should for example – contrary to our expectations – Marine Le Pen win the second ballot, heavy corrections would result, at least in the short term.