LimmatWealth

Investment Strategy March 2017

Data & Forecasts

	Growth (%)		Inflation (%)		Currencies (vs. USD)		
	GDP 16	GDP 17	CPI 16	CPI 17	Actual	3 Mo.	12 Mo.
Switzerland	1.0	1.3	-0.4	0.0	1.01	↘	↗
Germany	1.7	1.5	0.4	1.5	-	-	-
Euro Area	1.7	1.6	0.3	1.1	1.05	↗	↘
UK	1.8	1.5	0.7	2.5	1.24	↘	↓
USA	1.6	2.3	1.2	2.3	1.00	→	→
Japan	0.5	0.8	-0.2	0.5	113.50	↘	↗
Brazil	-3.3	0.2	9.0	5.4	3.11	↘	↓
Russia	-0.8	1.1	7.2	5.0	58.34	↘	↓
India	7.6	7.2	5.5	5.2	66.85	↘	↘
China	6.6	6.5	2.1	2.3	6.88	↘	↓

	Bonds (10 yrs.)			Profits (%)		Equities		
	Actual	3 Mo.	12 Mo.	EPS 16	EPS 17	Actual	3 Mo.	12 Mo.
Switzerland	-0.23	0.00	0.25	125	11	9'367	↘	↗
Germany	0.24	0.50	0.75	84	9	11'834	↗	↗
Euro Area	0.00	0.00	0.00	52	10	6'529	↗	↗
UK	2.41	2.50	3.00	137	8	7'263	↘	↗
USA	2.41	2.50	3.00	17	12	2'364	↘	↗
Japan	0.07	0.00	0.25	16	9	19'394	↘	↘
Brazil	10.24	11.00	11.00	699	17	66'662	↗	↗
Russia	4.12	4.25	4.25	73	13	527	↑	↑
India	6.92	6.50	6.50	14	20	28'941	↘	↗
China	3.32	3.25	3.25	24	13	2'876	↘	↗

Positive economic data

The US labor market has been improving further: A strong surge of nonfarm payrolls by 227'000 surprised economists positively. Additionally, average hourly earnings are also on the rise (+2.5% year-over-year). Although unemployment rose slightly from 4.7% to 4.8% this still means full employment by US standards. Meanwhile, the strong labor market has had an impact on the inflation rate: Consumer prices increased by 2.5% and are more or less at the same level as the core rate (2.3%). In light of this situation, further interest rate hikes are almost certain in the coming weeks and months. In the Eurozone, the latest consumer price report, which showed an increase from 1.1% to 1.8%, led to rising inflation fears. We don't share this view, since the surge was primarily caused by soaring oil prices. The core rate of inflation, which excludes volatile components such as food and energy, continues to hover at a low 0.9%. In the United Kingdom, data was in line with previous months (inflation 1.8%, core rate 1.6%) although 4th quarter growth was revised from 2.2% to 2.0%. Japan grew by an annualized 1.0% during the 4th quarter, which constitutes a slight deceleration from the 3rd quarter (1.4%). Weak domestic demand was more than offset by strong exports, which profited from a weak Yen. In all of the discussed economies, the Purchasing Manager Index (PMI Composite) reads more than 50 points, which is a sign of continuing economic expansion. While consumer prices rose slightly from 2.1% to 2.5% in China, inflation declined in Brazil (from 6.7% to 5.4%), Russia (from 5.4% to 5.0%) and India (from 3.4% to 3.2%). During the 4th quarter, India grew by 7.0%, which compares to expectations of 6.1%. In China, foreign exchange reserves declined below USD 3 trillion due to efforts to defend the Yuan. This relatively low level is worrying for some economists.

Interest rates decline

Thanks to falling interest rates at the long end, bonds made up their losses from January to a large extent. With reference to bond indices with maturities from 1 to 10 years, the United Kingdom (+1.25%) and Germany (+1.08%) performed best. Furthermore, high yield (+1.5%) and emerging market bonds (+2.07%) climbed as well. The outlook for IG (investment grade) bonds is murky. In most cases, real yields are in negative territory and below long-term averages. Government bonds are only held for their diversification benefits.

Oil and gold up

Profit taking in the USD stopped in February and the USD-Index recovered by 1.6%. While the Euro lost 2.1%, mainly emerging markets picked up nicely (e.g. Mexican Peso +3.6%). We are forecasting a slightly weaker USD and a stronger Euro in the coming months. We are of the opinion that further interest rate hikes by the Fed are largely reflected in the exchange rate and the market will start to focus on the significant current account deficit of the US.

While the broad commodity index hardly moved (+0.2%) in February, oil prices rose 2.3% despite record high US oil inventories. Gold defied expected interest rate hikes and increased by 3.1%. The World Gold Council reported a decline of worldwide gold demand by 4% to 1'036 tons. Meanwhile, demand collapsed by 15% to 924.5 tons mainly due to financial investors reducing their holdings by 200 tons. The yellow metal is held as a hedge in the case of currency turbulences.

Equity rally continued in February

Positive economic and company data, hopes for pro-business policies in the US (tax reductions, expansionary fiscal policy, less regulation etc.) and a general rise of optimism propelled equity markets even higher. Industrialized countries (+2.7%) and emerging markets (+3.4%) rose in February. In his first address to the Congress, President Trump repeated his campaign promises but didn't deliver useful details on how to implement them into reality. After these heavy gains we saw lately, almost all equity markets are technically overbought and a consolidation is overdue. Additionally, one should keep in mind the various risks such as European elections. Although we don't expect a victory of Marine Le Pen in France and a subsequent exit from the Euro, this risk has to be kept in mind. Furthermore, the Fed could spoil the party by a more restrictive monetary policy. Moreover, the US tax reform plans contain potential for disappointment: Tax reductions could turn out to be lower than expected or their introduction could be delayed.

Thanks to the strong performance of equities our slightly underweighted equity allocation has slowly risen to the neutral position. In our view, the time has not come yet for a general reduction of equity allocations. We let the profits run and advise a neutral allocation. In light of relatively low costs of options, some consultants suggest to hedge equities by using options. We are refraining from this strategy since costs are only low in a historical perspective but not on an absolute level. In February, we realized gains on our certificate on three US asset managers after Fortress was taken over by the Japanese Softbank.