LimmatWealth

Investment Strategy January 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	1.02	1.02	0.97
Germany	1.7	1.4	0.4	1.5	-	-	-
Euro Area	1.7	1.5	0.3	1.1	1.05	1.05	1.10
UK	1.5	1.1	0.7	2.5	1.23	1.23	1.30
USA	1.6	2.2	1.2	2.3	1.00	1.00	1.00
Japan	0.5	0.6	-0.2	0.5	118	115	110
Brazil	-3.3	0.5	9.0	5.4	3.29	3.25	3.50
Russia	-0.8	1.1	7.2	5.0	61.08	65.00	70.00
India	7.6	7.6	5.5	5.2	68.16	67.00	70.00
China	6.6	6.2	2.1	2.3	6.96	7.00	7.30

	Bonds (10 yrs.)			Profits (%)		Equities		
	Actual	3 Mo.	12 Mo.	EPS 16	EPS 17	Actual	3 Mo.	12 Mo.
Switzerland	-0.19	0.00	0.25	130	13	8'966	8'900	9'350
Germany	0.19	0.50	0.75	82	9	11'598	11'500	12'000
Euro Area				51	10	6'493	6'450	6'700
UK	2.44	2.50	3.00	135	10	7'143	7'100	7'400
USA	2.44	2.50	3.00	17	12	2'239	2'225	2'250
Japan	0.05	0.00	0.25	12	10	19'114	19'000	19'000
Brazil	11.24	12.00	12.00	660	21	59'589	57'500	60'000
Russia	4.46	4.50	4.25	65	14	564	560	580
India	6.35	6.50	6.50	16	24	26'667	26'600	28'000
China	3.06	3.25	3.25	25	14	2'774	2'775	2'900

Fed hikes rates by 0.25%

As expected, the US central bank hiked rates by 0.25% to the new target range of 0.5%-0.75%. 178’000 new jobs in November, a continued decline of the unemployment rate to 4.6% and a reading of 54.9 for the purchasing manager index might have persuaded the central bankers to this step. In 2017, another three steps of 0.25% each have to be expected, which would result in a level of about 1.5% in one years’ time. Inflation remains close to its target rate of 2% (consumer prices +1.7%, core rate +2.1%, core rate of personal consumption expenditures +1.7%). In the Euro Zone, the Italian referendum took center stage. The rejection led to the resignation of Minister President Matteo Renzi. The European Central bank announced the extension of its asset-purchase scheme through the end of 2017 but reduced monthly purchases from Euro 80bn to Euro 60bn starting in April. Unemployment fell from 10% to 9.8% but inflation remained below its target of 2% (consumer prices +0.6%, core rate +0.8%). Economic data from the United Kingdom did not surprise (inflation 1.2%, core rate 1.4%). Meanwhile, Japan shocked with a downward revision of annualized 3rd quarter growth from 2.3% to 1.3%. Main reason was a drawdown of inventories by enterprises. Also the unemployment rate worsened slightly (from 3.0% to 3.1%). Inflation remains inexistent (consumer prices +0.5%, core rate +0.1%). China’s economic dynamics remain moderate (Purchasing manager index 52.9, inflation 2.3%) but, the country has been experiencing capital outflows. The Brazilian economy probably has seen its lows: The purchasing manager index rose from 44.9 to 45.3, inflation has dropped below 7%, and the current account deficit has declined significantly.

Consolidation of government bonds

While 10-year US government bonds slowed their yield-ascent to 6 basis points (bp) to 2.47%, yields declined in Switzerland (-6 bp), Germany (-7 bp), and the United Kingdom (-18 bp) in December. Emerging markets bonds recovered some of their losses (+1.4%), which they had occurred in November. As usual, high yield bonds showed a high correlation to equities and returned 1.9%. In the US, we forecast rising real interest rates and consequently increase our forecast for 10year government bonds yields. As of the end of 2017 we see 3% at the long end. The yield difference of the US to Europe has already reached a very high level by historical standards. Therefore, we don't expect a further widening of these yield-spreads. This means that the increase of interest rates in Europe will be similar in size to the US. Accordingly, our interest rate expectations for Europe also rise (Switzerland 0.25%, Germany 0.75%, UK 1.75% etc.). The outlook for bonds remains murky and investments are mainly based on diversification reasons. In the meantime, USD short-term investments have – although small – positive returns, which leads us to reduce bonds in USD portfolios in favor of cash holdings.

Continued USD-Strength

The green back continued its ascent in December and advanced another 0.7% according to the DXY-Index. The strength was broad-based and most currencies lost in comparison to the USD (Swiss Franc –0.6%, Euro –0.9%, Yen –1.8%). After a strong gain of more than 10% since early May 2016 (DXY-Index), we see a consolidation phase. Afterwards, a slightly weaker green back is anticipated in comparison to the Euro, as the American currency is rather expensive based on its purchasing power parity and the current account remains negative. This slight weakness will also occur versus the Swiss Franc, since we expect the Swiss Franc to Euro relation to remain unchanged.

The commodity index (+1.8%) profited from stronger oil prices (+8.7%), while gold (-1.8%) was not in favor. We are holding on to gold due to its stabilizing effect on portfolios in the event of an unexpected currency war.

Year-end rally of developed markets

Developed markets advanced by 2.4% in December. Especially Euro Zone equities (Euro Stoxx 50 +7.9%) performed well and reached positive territory for the year 2017 (+3.7% including dividends). Currently, we see a lack of concern by investors (low volatility, bullish investor sentiment, major US markets at all-time highs), which makes us wary. In addition to the usual political (e.g. Middle East) and economic (e.g. Chinese debt and growth) risks, elections will be held in Holland, France and Germany this year. If populist parties gain share, this would be negative for equities mainly due to rising fears of protectionism. In the US, monetary policy will become more restrictive, which in the past was followed by low returns. During the first quarter, investors will find out that even Donald Trump is not able to elude the economic and political realities. The 'Trump euphoria' will give way to more realistic expectations, which will result in lower equity prices. On the positive side, we see rising earnings in 2017. Earnings have declined since September 2014 and this turnaround will support equity markets. In a nutshell, we are of the opinion that currently equity allocations should not be increased. Holding some cash makes sense in order to be able to increase the equity allocation after a correction. We remain slightly underweighted in equities.