LimmatWealth

Investment Strategy – November 2017

Data & Forecasts

	Growth (%)		Inflation (%)		Equities		
	GDP 17	GDP 18	CPI 17	CPI 18	Actual	3 Mths	12 Mths
Switzerland	0.9	1.7	0.5	0.6	10'685	↗	↑
Germany	2.1	1.8	1.7	1.7	13'449	↗	↗
Eurozone	2.2	1.8	1.5	1.4	3'678	↗	↗
UK	1.5	1.3	2.7	2.5	7'555	↗	↗
USA	2.2	2.4	2.1	2.1	2'588	↗	↗
Japan	1.5	1.1	0.5	0.8	22'548	↗	↗
Brazil	0.7	2.4	3.5	4.0	73'915	↗	↗
Russia	1.8	1.8	3.9	3.9	1'109	↗	↑
India	7.1	6.8	4.5	3.5	33'731	↗	↗
China	6.8	6.4	1.6	2.2	3'388	↗	↗

	Bonds (10 Years)			Currencies (vs USD)		
	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Switzerland	-0.11	0.00	0.25	1.00	0.99	1.00
Germany	0.34	0.60	1.00	-	-	-
Eurozone	-	-	-	1.16	1.16	1.17
UK	1.25	1.50	1.50	1.31	1.30	1.30
USA	2.32	2.50	2.75	-	-	-
Japan	0.02	0.00	0.00	114	113	114
China	3.88	3.60	3.50	6.63	6.65	6.70

Review – Positive month for equities and hedge funds

Equity markets in developed and emerging markets ended yet another month in positive territory. All major markets printed positive numbers led by Japan (+8.1%), Germany (+3.1%), and the US (+2.2%) but also the UK (+1.6%) and Switzerland (+1.5%) added to their performance year-to-date. Emerging markets as a whole advanced substantially (+3.5%), mainly driven by positive numbers in India (+6.2%) and China (+1.3%). Russia finished the month down (-2.1%) and is year-to-date one of the worst performing markets we follow (+1.4%).

Yields on ten-year government bonds were unchanged in developed markets in October. Ten-year government bond yields in the US increased slightly (+0.05% to 2.38%) while they decreased in Europe (-0.10% to 0.36%) and the UK (-0.03% to 1.33%). Swiss ten-year government bonds remained negative (-0.08%). Yields in emerging markets increased substantially, especially in India (+0.20% to 6.86%) and China (+0.27% to 3.89%).

Currency markets were calm in October. The US Dollar appreciated against most developed currencies, most importantly against the Swiss Franc (+3.0% to CHF 1.00), Euro (+1.5% to EUR 1.16), British Pound (+0.8% to GBP 1.33), and Japanese Yen (+1.0% to JPY 114).

Alternative investments such as hedge funds and gold showed a mixed picture in October. While hedge funds printed yet another positive month (+0.7%), gold fell slightly to USD 1,271 per ounce (-0.7%).

Outlook – Constructive on equities, UK expected to lag

While valuations are certainly not cheap in a historical context, we remain constructive on equities supported by very strong activity numbers (PMIs), and solid earnings delivery.

The majority of companies have now reported Q3 earnings and the bulk of the remaining results will come out this and next week. The numbers reported are generally robust and better than expected with double-digit earnings per share (EPS) growth year over year (YoY) in Europe and Japan, and high single-digit growth in the US and UK.

Country/Region	% of Companies Reported	% that Beat Estimate	EPS Growth YoY	Dividend Yield
US (S&P 500)	83%	77%	+6.9%	1.9%
Europe (Euro Stoxx 50)	67%	52%	+12.5%	3.3%
Switzerland (SMI)	86%	50%	-7.7%	3.3%
UK (FTSE 100)	70%	69%	+7.0%	4.1%
Japan (Nikkei 225)	59%	62%	+17.3%	1.7%

Source: Bloomberg, Limmat Wealth (as of November 6th, 2017)

This is the first year since 2010 where the bulk of the equity rally can be explained by strong earnings delivery rather than by valuation expansions (as measured by the price/earnings ratio). This is a healthy development.

Even though companies from the UK are printing good numbers, we expect the UK to be the biggest laggard regionally mainly due to four reasons:

- The UK appears to be entering a challenging growth-policy tradeoff phase. On one hand activity indicators such as PMI, retails sales and construction are softening but at the same time, the Bank of England (BoE) is tightening rates given a move up in inflation. This is not a good combination.

- Historically, the UK has lagged in regimes of rising rates given that it is the highest dividend-yielding market in the world (see table above). If our forecast for ten-year

UK government bonds materializes (see table on page 1), UK equities are likely to lag.

- UK consumer and business confidence as well as fixed asset investments could be under pressure for a while given the uncertainty over the ongoing Brexit negotiations.

- The British Pound is the big unknown here as there are credible forces pulling in opposite directions. On one hand, the BoE tightening is calling for a stronger GBP but at the same time, the possibility that talks between the UK and EU deteriorate or if there is a significant deterioration in the UK activity could mean GBP gaps lower. We are currently forecasting a stable GBP/USD exchange rate (see table on page 1) however, this could change quickly given the political risk mentioned above.

There are more and more promising signs that lead us to believe that the rally in equity markets is not going to end soon. While valuations are certainly on the higher end of the historical range, we currently do not see any fundamental signs that could negatively affect the markets. At the same time, we remain cautiously optimistic given the still looming political issues and the changing environment as central banks are transitioning away from monetary and fiscal easing to a more restrictive monetary policy on the other hand. Yields and inflation expectations have begun to rise and recent political change is creating a more event-rich environment. Such events will not always be positive. We are positive on all major markets over the next twelve months and we believe developed markets will outperform Emerging markets. We still like European banks due to increasing interest rates.

The probability of a further interest rate hike by the FED before year-end is over 90 percent now. This hike should be fully priced in and therefore not lead to any negative surprises. We still do expect only gradually higher interest rates in developed markets in the mid-term, and accordingly, this should not lead to large price changes in bond markets.

We do not expect a lot of volatility in the currency markets short-term.

As mentioned in earlier investment strategies, the current environment with higher volatility and lower correlations is ideal for most hedge fund strategies*. We maintain our Gold position for diversification reasons.

* We recently put together a two-page question and answer flyer about hedge funds with the title "Hedge Funds – A Good Time to Invest". If you are interested in getting a copy, please let us know.

November 7th, 2017
Limmat Wealth Ltd.