LimmatWealth

Investment Strategy December 2016

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	1.02	1.00
Germany	1.7	1.4	0.4	1.5	-	-	-
Euro Area	1.7	1.5	0.3	1.1	1.06	1.08	1.10
UK	1.5	1.1	0.7	2.5	1.25	1.25	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	114	110	100
Brazil	-3.3	0.5	9.0	5.4	3.39	3.25	3.60
Russia	-0.8	1.1	7.2	5.0	63.56	65.00	70.00
India	7.6	7.6	5.5	5.2	68.36	67.00	70.00
China	6.6	6.2	2.1	2.3	6.89	6.80	7.10

	Bonds (10 yrs.)			Profits (%)		Equities		
	Actual	3 Mo.	12 Mo.	EPS 16	EPS 17	Actual	3 Mo.	12 Mo.
Switzerland	-0.13	-0.25	0.00	113	8	8'623	8'700	9'200
Germany	0.28	0.25	0.50	72	7	10'640	10'700	11'400
Euro Area				37	11	5'984	6'000	6'400
UK	2.38	2.00	2.50	99	17	6'784	7'000	7'400
USA	2.38	2.00	2.50	7	12	2'199	2'200	2'250
Japan	0.03	0.00	0.00	10	9	18'513	18'000	18'000
Brazil	11.83	12.00	12.00	496	22	61'906	62'000	63'000
Russia	4.52	4.50	4.25	42	11	501	490	520
India	6.22	6.50	6.50	16	24	26'630	26'500	27'500
China	2.95	2.75	2.75	11	13	2'874	2'850	3'050

India abolishes bills with the largest face value

In the US, published economic data hardly surprised: Inflation remained at 1.6%, while the core rate of 2.1% surpassed its target of 2% again. Furthermore, the core rate of Personal Consumer Expenditures (PCE), which rose by 1.7%, is getting close to its target of 2%. An interest hike in the order of 25 basis points in December is all but certain. In the Eurozone, inflation remains low (consumer prices +0.5%, core rate +0.8%). Although the unemployment rate remained at a relatively high 10%, this represents the lowest level since Spring 2011. In the United Kingdom inflation also remained subdued (consumer prices +0.9%, core rate +1.2). The Japanese economy surprised positively with an expansion of 2.2% (annualized) in the 3rd quarter due to strong exports. Inflation remains close to zero (consumer prices +0.1%, core rate +0.2%) and unemployment stays at 3%. The Brazilian economy has continued to shrink (3rd quarter -2.9%) and the Purchasing Manager Index (44.9 points) is not pointing towards an imminent improvement. On the other hand, with a small contraction of only 0.4% in the 3rd quarter, the likelihood that Russia will come out of recession soon has risen substantially. Inflation (consumer prices 6.1%, core rate 6.4%) remains high and also unemployment of 5.4% offers potential for improvement. In India, Prime Minister Modi announced the annulment of the two bills with the largest face value (500 and 1000 Rupiah) in order to fight corruption and tax evasion. Meanwhile, the Indian economy, which relies heavily on cash transactions, came almost to a standstill and a negative effect on 4th quarter growth has to be expected. Nevertheless, during the 3rd quarter, India grew with 7.3%. Chinese inflation continues to hover around 2% (2.1%).

US elections surprise

Contrary to most forecasts, the Republican Donald Trump won the US elections. In a first reaction, investors dumped equities, industrial commodities and the Mexican Peso and fled into safe havens like bonds and gold. Markets stabilized relatively quickly and they started to price in the topics, which Trump had mentioned during his campaign: Lower taxes, less regulation and higher government spending financed by debt. Consequently, equities profited from the expectations of lower taxes and the finance sector outperformed heavily in anticipation of less regulation. Higher government spending and more debt led to higher inflation and interest rate expectations and consequently investors dumped bonds.

Rising bond yields

In the aftermath of the US elections, 10 year government bonds rose by 56 basis points in November. Since July, US rates have skyrocketed from 1.36% to 2.39%. Also international bond markets could not decorrelate totally although the ascent was more muted (Switzerland +27 bp (basis points), Germany +11 bp, UK +17 bp, Japan +7 bp). While high yield bonds (-0.4%) hardly moved, expectations of a more protectionist attitude by Trump led to losses in emerging market debt bonds (-4.3%). With the exception of Switzerland, 10year government bonds are back in positive territory. The strong rise of the last few weeks looks overdone and a correction would not come as a surprise to us. Nevertheless, within 12 months, we forecast higher rates and as a result, expected returns on bonds are not attractive. Bonds are only held for their diversification benefits.

Continued dollar strength

Rising interest rates propelled the USD higher and the DXY-Index rose 3.1% in November. With the exception of the British Pound (+2.5%), practically all currencies weakened (Swiss Franc -2.6%, Euro -3.3%, Yen -8%). After this strong performance during the last few weeks, the USD is technically overbought and we expect it to trade sideways.

An agreement to reduce petroleum production by OPEC and Russia lifted the oil price by 5.5%. As soon as a victory of Donald Trump became likely, gold surpassed USD 1’300 but declined continuously afterwards (-8% in November). Gold is held as a hedge in the case of currency wars.

Emerging markets equities dive

In expectations of more protectionism due to Trump’s election, emerging markets equities dived by 4.8% in November. Meanwhile, developed equities rose by 1.7%. We are of the opinion that especially US equities are ahead of their fundamentals and consequently see a sideways market in the coming months. In our view, markets have priced in a rejection of the Italian referendum to a large degree over the last few weeks (weakish Euro, strong pick up in Italian bond yields, underperformance of Italian stocks). Worldwide, we see the main challenges not on the earnings side but primarily in politics (European elections in 2017 with potentially rising populism and rising protectionism) and with regards to more restrictive monetary policies (interest rate hikes in the US, tapering in Europe starting mid of 2017 etc.). Consequently, we remain slightly underweighted in equities.