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INVESTMENT OUTLOOK 10.2015

12 October 2015

It is a great pleasure to introduce the first IMT Investment Outlook. On 1 October I joined IMT Asset Management AG in Vaduz, Liechtenstein, which is part of IMT Group. IMT Group is a well-established group of companies, providing trust, legal, and asset management services. IMT is currently celebrating its 30th anniversary.

Many of you formerly received Blue Horizon's Wealth Management Review, which has now been discontinued and replaced by the IMT Investment Outlook. The concept, however, remains very similar; we have merely introduced a fresh layout and made a few changes. We hope you will like the result.

Unfortunately, recent market movements cloud my latest career move. A very negative August was followed by a very choppy September. Nevertheless, we still believe that markets will rebound and we are holding on to our current positioning.

We hope you enjoy our first IMT Investment Outlook and – as always – we appreciate any feedback.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

NERVOUS MARKETS AND RISING RECESSION RISK

Financial markets

In September markets were very volatile with unusually wide fluctuations, though by and large equity markets moved sideways. The major damage to equity markets occurred within only a few trading days, basically between August 19 and August 25, when the S&P500 lost more than 10%, while emerging markets and the EuroStoxx50 lost more than 6%.

This volatility translated into negative performance in September for most equity markets. The Nikkei lost 8.0%, the EuroStoxx50 index 5.2%, the S&P500 2.6%, and emerging markets 3.3%. Meanwhile, government bonds rallied. German 10Y Bund yields fell 21 basis points and US 10Y treasury yields fell 18 basis points.

The major event in September was the Fed's decision on the 17th of the month to keep interest rates unchanged. On the back of continuing low inflation and great uncertainties about the economic outlook for China and the emerging markets in general, this looks today like the right decision. Recent PMI and labor market data for the US (see below for more details) also suggest that a September rate hike may have been too early. Like most market observers, we continue to be preoccupied with the question of when the Fed will hike rates for the first time after more than nine years. The last Fed rate hike happened in June 2006. A rate hike in October of this year has become very unlikely. Markets still price only a 40% probability of a December rate hike. In our opinion, a December rate hike cannot be excluded but would warrant more encouraging US growth and labor market data in October and November.

What does this mean for other central banks? In our view, it is likely that the Bank of Japan will announce another round of quantitative easing (QE), possibly as early as end of October. There is also speculation that the ECB will announce further QE measures. We tend to believe, however, that the ECB will stay with its current program with no additional acceleration.

Bond yields fell in August and September as safe-haven assets were in high demand. 10Y treasury yields fell 21 basis points in September, while 10Y bunds dropped 18 basis points. Especially US inflation expectations dropped markedly. The US 10Y break-even inflation fell from 1.9% at the end of June to merely 1.4%. In the meantime credit spreads widened. Consistent with the risk-off environment, high-yields and emerging markets spreads widened to a distinctly greater extent than high-grade spreads.

Currency markets did not suffer from any pronounced rise in volatility. While the EUR gained 2.1% vis-à-vis the USD in August, it gave back some of the gains in September and lost 0.3%. The Swiss franc continued its gradual weakening path and fell 0.3% against the EUR.

Heightened growth fears naturally had a negative impact on industrial metals, down 1.3% in September, and on energy prices, which fell 9.9%. Gold, despite its safe-haven characteristics, fell 1.7%.

Macroeconomics

At the origin of the current market environment lie fears relating to Chinese growth and the potential contagion effects on the rest of the world. We have argued that such effects on the developed world should be rather muted. However, a reading of most leading indicators for September, which by and large were disappointing, could lead one to conclude otherwise.

The US ISM manufacturing index fell further to 50.2 from 51.1 in August. Non-farm payrolls rose by only 142,000 against expectations of about 200,000. In addition, August payroll figures were revised down to merely 136,000. The US unemployment rate remained, however, at 5.1%.

The Markit European composite PMI was also down, falling to 53.6 from 54.3 in August. While the decline disappointed, the absolute level still points towards robust growth figures in the coming quarters. Another positive forward-looking indicator was that European order books improved further.

The Chinese Caixin manufacturing PMI fell slightly to 47.2 from 47.3 in August and thus remains in the contraction zone below a level of 50.

This also holds true for the Swiss PMI, which fell back to 49.5 from 52.2 in August. The Swiss PMI however, tends to be very volatile and we should try to identify the overall PMI trend, which seems to be slightly up. Given continued Swiss franc strength, the outlook remains bleak, in our view.

Outlook

We conclude that the most pronounced deterioration of leading indicators has occurred in the US and China. Unfortunately, precisely those economies are supposed to be the growth engines for the world economy.

As a result, we do see heightened recession risks. Furthermore, deflationary forces still persist, a fact reflected not least in falling inflation expectations, apparent, for example, in break-even inflation rates (see Fig. 9). Deflation fears are being further fueled by persistently falling commodity prices.

While acknowledging recession risks, our main scenario remains a slow growth recovery. We believe that a hard landing in China can be avoided since the Chinese services sector is growing healthily and accounts for almost half of Chinese GDP. Also, lower commodity prices are a net positive for China, as they are for most developed economies.

The weakness of the US economy in the third quarter comes as a surprise but may partly be explained by the significant strengthening of the USD. In our view, the US economy should be able to overcome this weakness and continue to grow going forward. It also looks as if the slow European recovery path will prove to be sustainable.

What does this mean for markets? Equities are in a bull market, which has lasted for six years now. We see the recent market moves as a correction and not as a turning point leading into a bear market. Despite this, the bull market has certainly matured and we expect lower equity market returns as a result.

Based on our macro outlook, we expect that the Fed might possibly hike rates as early as December but is more likely to do so in the first half of 2016. In the meantime, the USD may not move much vis-à-vis the EUR. A Fed rate hike or alternatively a further acceleration of ECB's QE program is, however, likely to trigger another appreciation of the USD. Similarly, US government bond yields may stay low for some time but the risk is certainly to the upside. A Fed rate hike is, in our view, likely to trigger a repricing of the USD yield curve.

In our opinion gold is in a structural bear market, and when rates eventually start to rise gold is likely to experience another down leg. Based on valuations, we like non-commodity-producing emerging markets and see some value in high-yield bonds after the recent sell-off. Among equities we favor Europe and Japan.

ECONOMICS

Leading indicators worsened across the board. The Swiss PMI even fell below 50. US labor market data were very weak. Non-farm payrolls rose only 142,000 in September against an expected 201,000. Inflation remained subdued at around 0% in most advanced economies. Swiss inflation even fell to -1.4%.

Fig. 1: PMIs

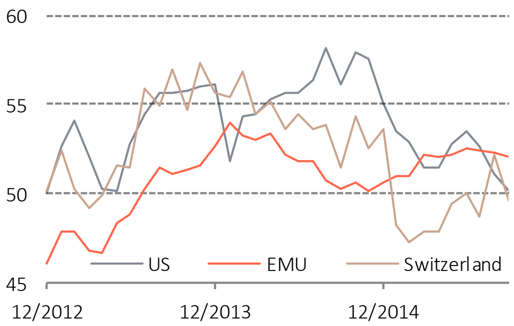


Fig. 2: PMIs

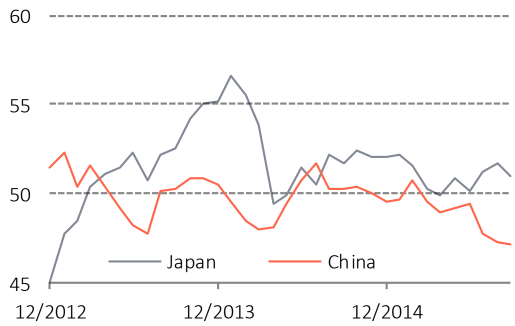


Fig 3: Consumer price inflation, in % YoY

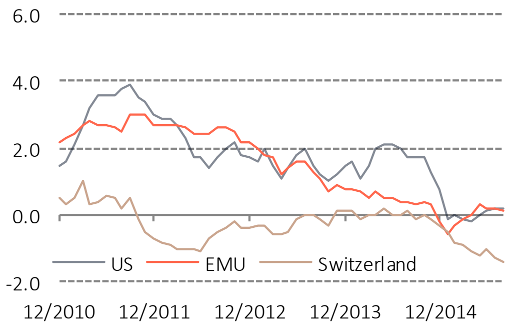


Fig. 4: Consumer price inflation, in % YoY

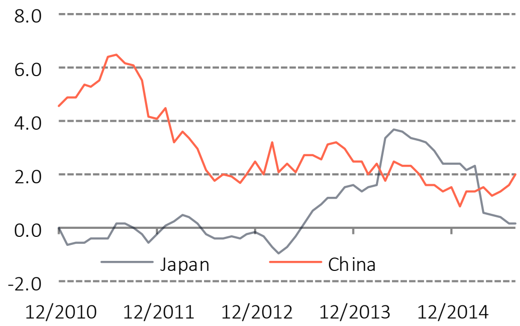


Fig 5: Unemployment rates, in %

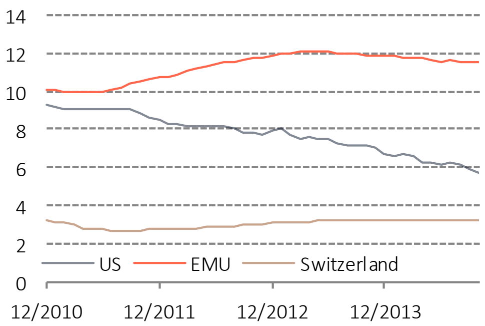
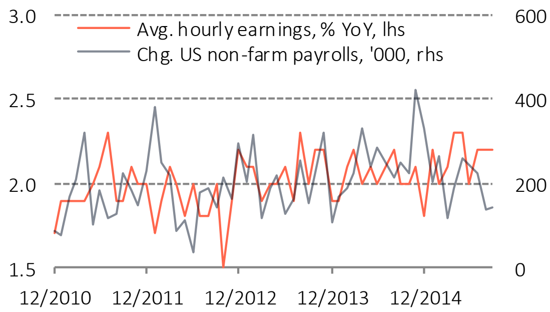


Fig 6: US labor market



FIXED INCOME

Government bond yields fell as safe-haven assets have been in high demand. US 10Y treasury yields briefly dipped below 2%. Especially in the US we observed a pronounced drop in inflation expectations. Meanwhile spread products sold off, especially high-yield and emerging-market bonds.

Fig.7: 2Y government bond yields

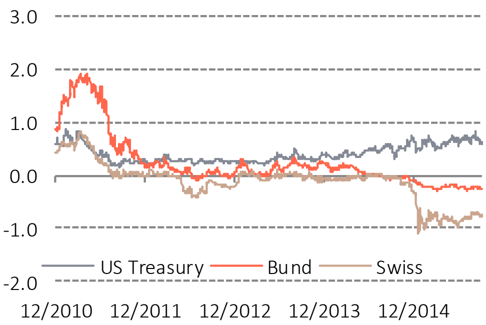


Fig. 8: 10Y government bond yields

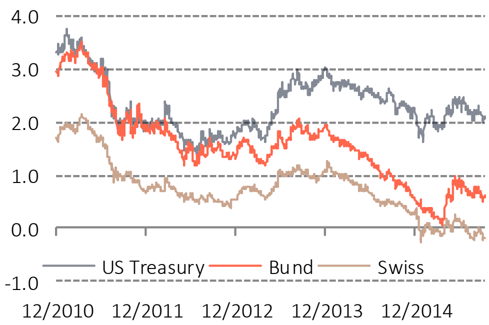


Fig 9: 10Y break-even inflation

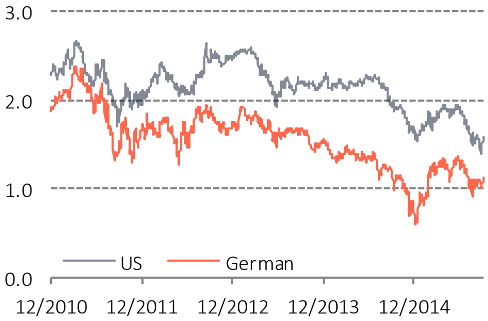


Fig. 10: Credit spreads, 5Y credit default swaps

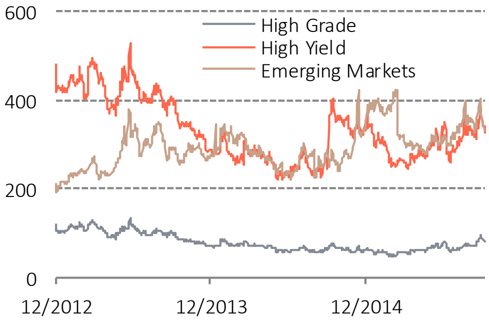


Fig 11: Money market spreads (3M-2Y)

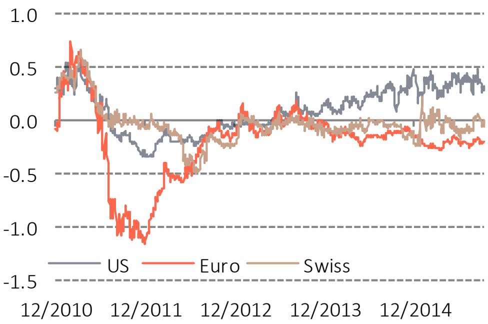
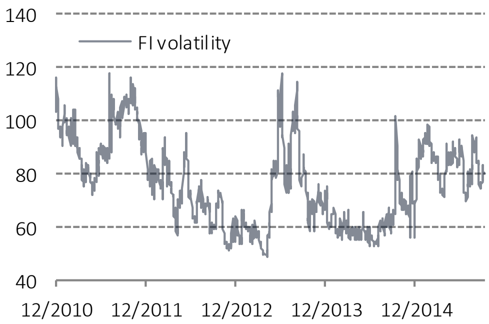


Fig 12: Merrill Lynch volatility index



EQUITIES

August and September drove most equity indices into negative YTD performance. Not surprisingly in such a market environment, implied volatility spiked to levels last seen in 2010. The major losses happened within only a few trading days in mid-August, followed by very choppy market conditions. Since the beginning of the year, the most unattractive sectors have been energy, materials and utilities.

Fig. 13: MSCI equity indices – major regions

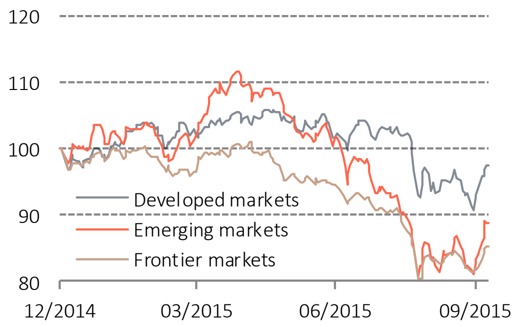


Fig.14: Equity indices – major developed markets

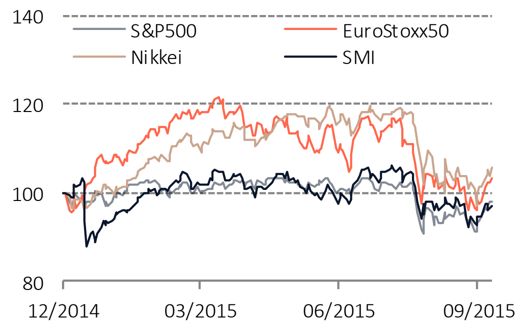


Fig 15: Equity indices – major emerging markets

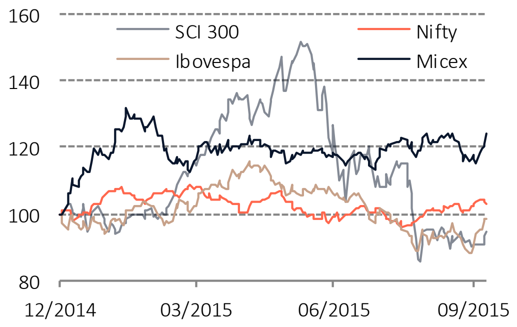


Fig. 16: Sector performance, MSCI Europe, YTD

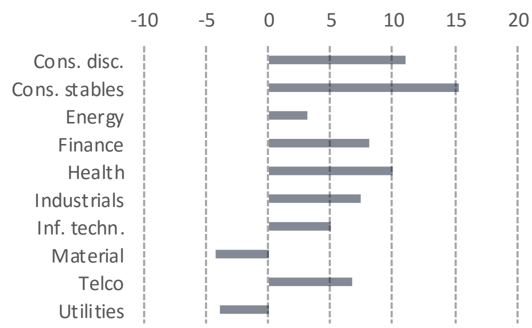


Fig 17: Price-earnings ratios

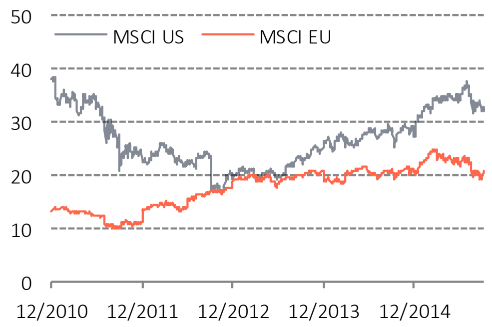
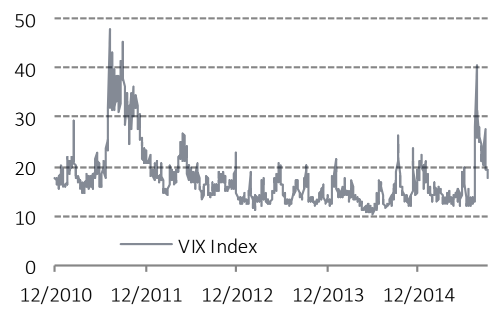


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

The recent market environment was negative for most alternative investments. Especially commodities fell markedly while gold, as a safe-haven asset, could not benefit much from the uncertainties. REITS, hedge funds, and listed private equity indices decreased in value from the end of July.

Fig. 19: Gold price, USD/oz

Fig.20: Oil price, USD/bl

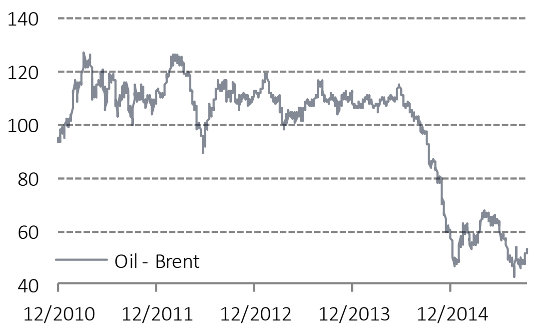


Fig 21: Bloomberg commodity indices

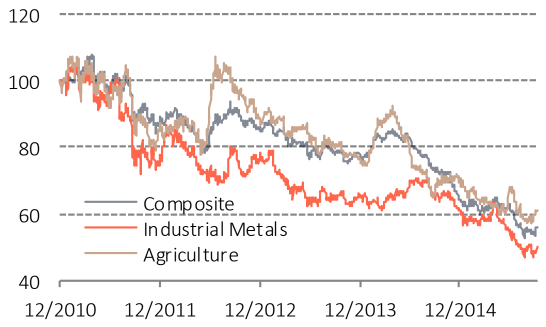


Fig. 22: HFRI hedge fund indices

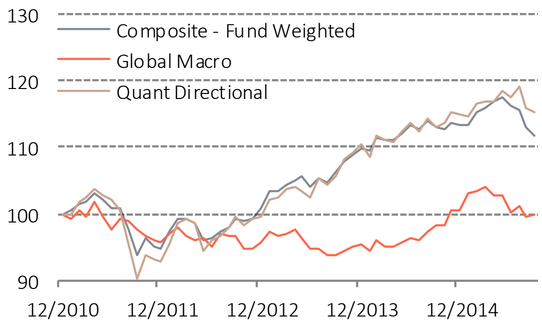


Fig 23: FTSE EPRA/NAREIT global index

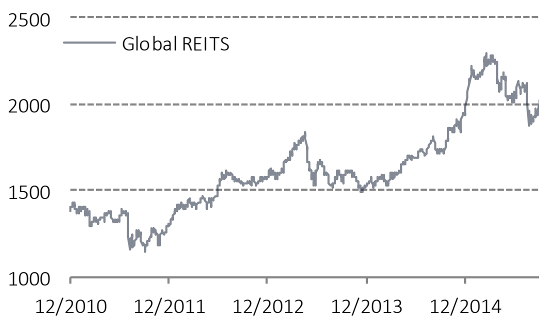
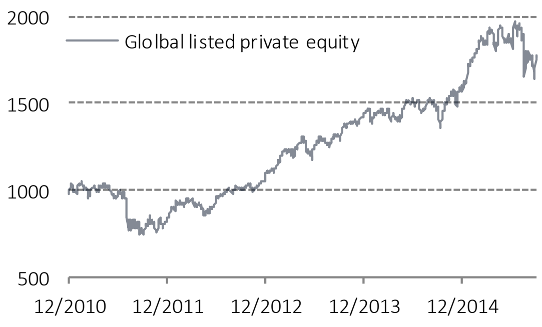


Fig 24: LPX global listed private equity



CURRENCIES

Surprisingly, equity market volatility did not spill over into heightened currency market volatility. In September the EUR kept up well, while the USD weakened somewhat. The initial market reaction after the Fed decision not to hike rates was USD weakening. Since then, though, the USD strengthened somewhat. The EUR-CHF exchange rate stabilized between 1.085 and 1.10.

Fig. 25: EUR-USD exchange rate

Fig. 26: GBP-USD exchange rate

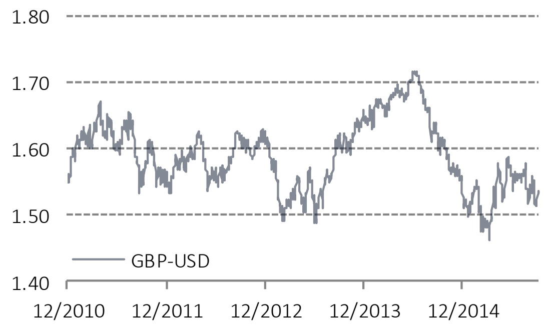


Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

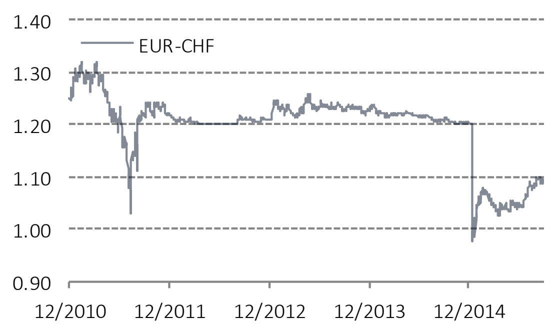
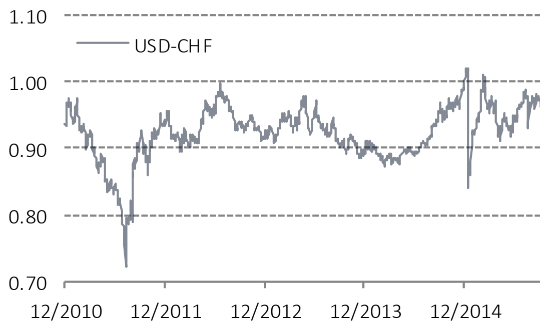


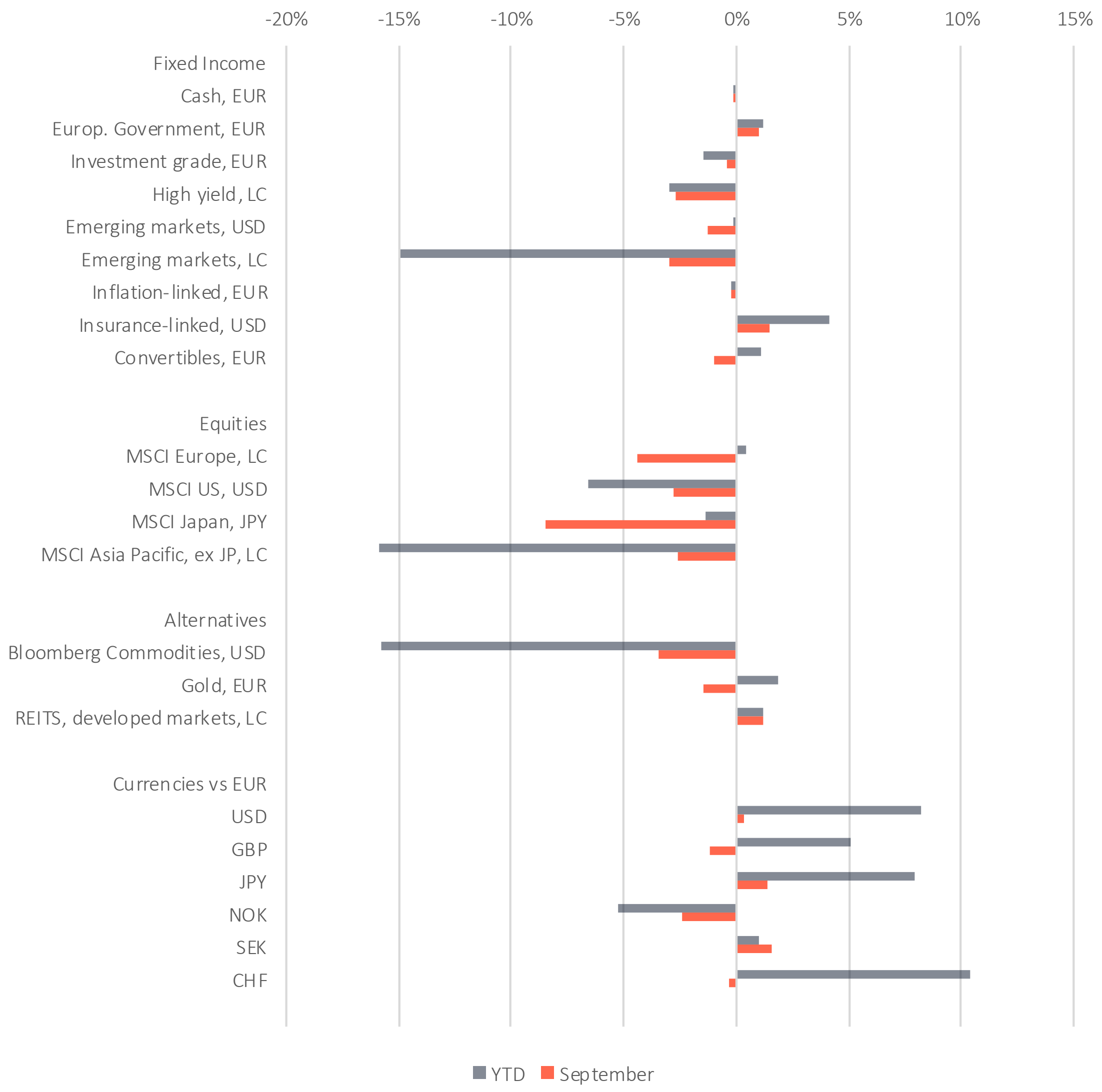
Fig 30: USD-CHF exchange rate



ASSET ALLOCATION

From the beginning of the year, the EUR weakened against most major currencies. As a result foreign-currency exposure was a positive performance driver. Underperforming asset classes were Asia Pacific equities and commodities.

Fig. 31: Performance of major asset classes, based on our EUR portfolio strategy



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