

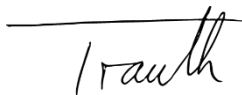
# INVESTMENT OUTLOOK

## 11.2016

10 November 2016

October started on a positive note after strong September growth indicators were published and Mrs. Clinton was leading the polls with a seemingly clear lead. As the outcome of the election became more uncertain markets sold-off and remained volatile around Election Day. After the result became clear, markets recovered noticeably. It remains to be seen how Trump's presidency will impact the global economy and financial markets. For us the big question is whether Trump will work constructively together with a qualified administration or whether he is going to continue with ill-tempered rhetoric and inconclusive, erratic policy ideas. We hope for the first outcome and it seems to us that markets are giving this possibility a fair chance.

Separately from the political events which dominated markets in October and early November, macro indicators were very positive, confirming that most economies are growing at a moderate but stable pace.

A handwritten signature in black ink, appearing to read 'Trauth', with a horizontal line above it.

**Thomas Trauth**

CEO – IMT Asset Management AG



# THE SUN WILL RISE IN THE MORNING

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## What can we expect from Trump's presidency?

The US elections caused major market volatility around Election Day. It looked to us as though whenever the odds of a Trump victory rose, equity markets sold off, suggesting that market participants feared a Trump presidency. But after the Trump presidency became a fact, markets calmed almost instantly, recovering most of the pre-election losses. There are, however, a few exceptions, like the Mexican Peso, which has remained under selling pressure and reached historic lows.

It is as if market participants reminded themselves of President Obama's words the night before the election, that whatever the election result might be "the sun will rise in the morning". In our view, the first market reaction seems to confirm Obama's words and the notion that a Trump presidency will not turn out as bad as many expect.

In our opinion, the major question is whether we will see a tamed and constructive President Trump or a continuation of the campaigning Mr. Trump. In the first case, Mr. Trump will be able to calm his temper and surround himself with enough competency to implement a liberal but sensible economic policy. It will be crucial for the Republican party, which struggled to cope with Trump during the campaign, and which has the majority in Congress and Senate, to be able to integrate Mr. Trump in a constructive way. This could prove to be positive for the economy and financial markets, as deregulation and lower taxes will boost economic activities.

If, however, Mr. Trump should continue with inconclusive policy ideas and were to, for example, run

large fiscal deficits, implement protectionist measures, and provoke social unrest in the US, this could turn out to be very negative for economic growth in both the USA and globally, creating serious uncertainties and downside risks for financial markets.

We give the constructive Trump outcome a fair chance but remain aware of elevated political risks associated with the Trump presidency.

## Financial markets

October started on a positive note after strong September growth indicators were published and Mrs. Clinton was leading the polls with a clear lead. However, on 28 October investors' sentiment was hit hard when FBI director James Comey announced in a letter to Congress that additional emails had come to light, which appeared to be pertinent to the Hilary Clinton investigation. Clinton's lead melted as fast as equity markets sold-off in the days to follow. European equity indices, for example, lost about 4% between 28 October and 6 November. On 6 November Mr. James Comey wrote another letter to Congress, and confirmed the result of the first FBI investigation that Mrs. Clinton's email usage would not warrant an indictment. As a result, markets recovered most of their losses in a matter of days and the polls swung back in favor of Mrs. Clinton.

On Election Day, markets were extremely volatile with risky assets, the USD, and the MXN (Mexican Peso) selling off significantly. When the result became clear markets calmed and most markets recovered the majority of their prior losses.

Until 28 October, equity markets diverged somewhat with European equity markets up by 2.6% (EuroStoxx50), the Japanese Nikkei225 up by 6.1% and the Chinese CSI 300 up by 2.7%. The US S&P500 was, however, down by 1.9%. Gold prices fell 3.1% and the price for Brent oil was almost unchanged. Then, on 28 October, when FBI director James Comey shocked the US public and – as it appeared – global market participants, market volatility increased significantly and calmed only after the election.

The major post-election beneficiaries were global bank stocks, on the back of expected deregulation, pharma stocks, since it was feared that Clinton would introduce more stringent rules on drug pricing, and industrial metals, on the back of an expected major US infrastructure program.

### Macroeconomics

The US elections clouded a significant rebound of growth indicators. The growth path for the US, Europe, Japan and China (see page 5) has clearly improved and seems to be stabilizing on a solid footing.

In October we observed another round of strong growth indicators. The US ISM manufacturing index climbed to 51.9 after 51.5. Also, the European manufacturing PMI rose to 53.5 after 52.6. US labor costs rose more strongly than in previous months. Average hourly earnings increased by 2.8% year-on-year. US non-farm payrolls rose by 161,000, which is a decline vs. the previous month but nevertheless a confirmation that the US economy is still creating new jobs.

Inflation expectations continued to rise. The US 10-year break-even inflation rate rose by almost 0.1% points after the US elections to 1.91%. This was probably also the result of expected aggressive reflationary policy measures by the Trump administration.

Another underappreciated development was that the US reporting season turned out to be quiet posi-

tive. A majority of about 70% of the S&P500 companies managed to beat their EPS estimates.

### Central Banks

At its meeting on 2 November the Fed came out broadly in line with expectations. It stated, though, that the case for a hike “has continued to strengthen”. The market-implied probability of a December hike currently stands at 85%.

Unlike the Fed, the Bank of England (BoE) surprised us with more hawkish comments. While the BoE has indicated a higher likelihood of a rate cut, in its recent announcement it told the public that the next rate move could be either up or down.

### IMT Risk Monitor

On 5 November, when markets were very concerned about the uncertain outcome of the US elections, we observed a spike of implied volatilities, especially in equity and fixed income markets. Currency and commodities markets remained well behaved. Other than that, our risk indicators did not move much compared to last month. The equity valuation risk declined slightly, due to the market correction. Also the market became somewhat more relaxed about systemic, i.e. banking, risks.

### Outlook

We see the recent policy-induced market volatility as only temporary, and when looking through the policy induced clouds we observe increasingly encouraging signs of better economic growth. This does not mean that we can be relaxed about the risk environment. There is still a fragile European Union in general and the uncertain Brexit situation in particular. The US elections have revealed a deeply divided political landscape with severe tensions within the US population. There are also potential risks related to Russia, the Middle East, and the Far East. We also see risks for bond and equity markets, if central banks should become less accommodative.

Nevertheless, we continue to be cautiously optimistic since our base case remains a slow-growth scenario and a very gradual tightening path for the US Fed.

Considering Trump's announcements during the campaign, we expect positive economic impulses from lower taxes, infrastructure spending, and deregulation. However, a more protectionist US would potentially also reduce international trade and the associated economic benefits for all involved trading partners.

Industrial commodities could benefit from increased infrastructure spending, while the impact on oil prices is not so clear. Trump wants to support the domestic oil industry, which would lead to higher

production and lower oil prices. At the same time, the US may impose additional sanctions on Iran, which could limit Iran's ability to supply world oil markets.

The outlook for the gold market is not clear-cut to us either. On the one hand, gold would be supported by further political uncertainties – not least related to the new Trump presidency. On the other hand, stronger growth and rising interest rates are clearly negative for gold prices. On balance, we continue to see larger downside risks for gold.

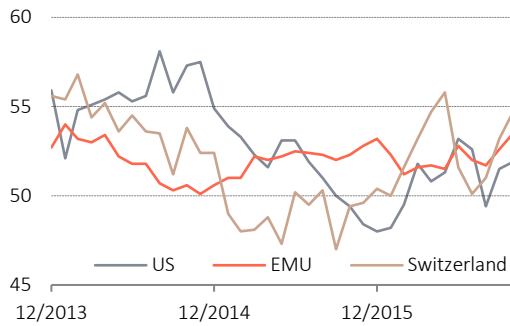
We remain positive for the USD and continue to see downside risks for the GBP, since a hard Brexit scenario remains our base case.

# ECONOMICS

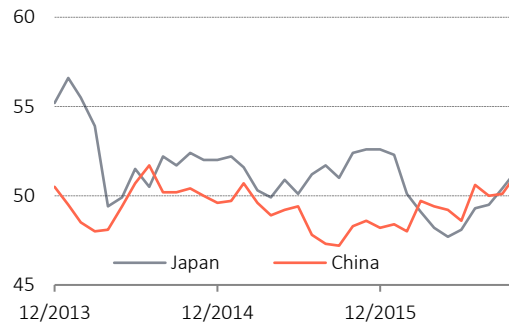
In October, we saw confirmation of the positive September growth indicators. Almost all PMIs improved clearly in October. Also, inflation rates increased somewhat and are expected to increase even more when in early 2017 base effects from oil

prices will kick in. US labor costs even rose 2.8% YoY in October, which makes a December Fed rate hike more likely. US non-farm payrolls rose by 161,000, which is a bit weaker than in previous months but can still be considered a robust reading.

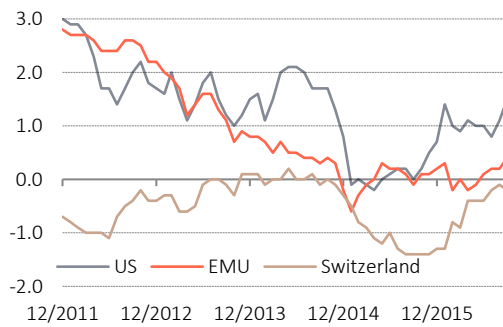
**Fig. 1: PMIs**



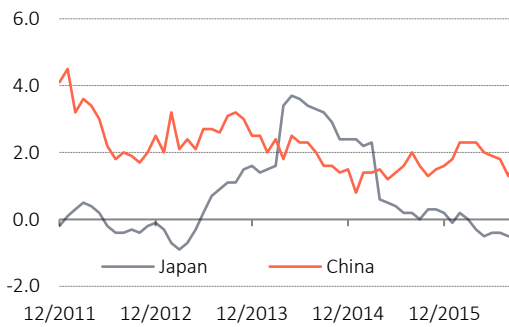
**Fig. 2: PMIs**



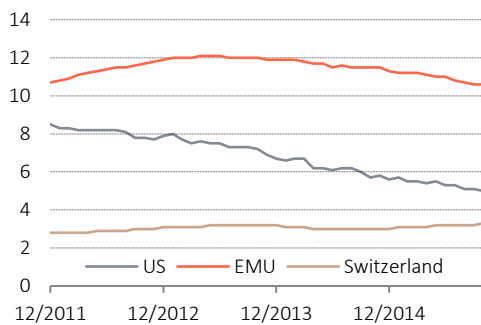
**Fig 3: Consumer price inflation, in % YoY**



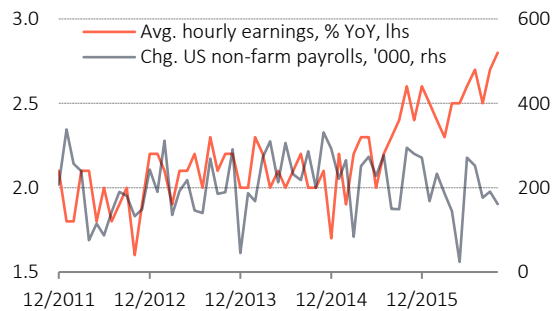
**Fig. 4: Consumer price inflation, in % YoY**



**Fig 5: Unemployment rates, in %**



**Fig 6: US labor market**

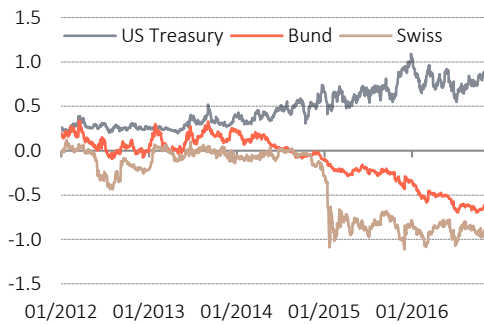


# FIXED INCOME

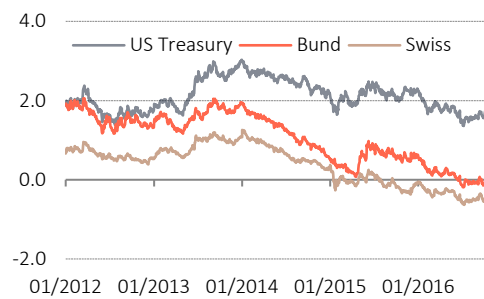
In October bond yields increased especially at the long end of the curve, which may reflect the improving macro-economic outlook. The pick-up of headline inflation resulted in higher expected inflation rates; break-even inflation rose, especially in the US.

Credit spreads remained relatively stable despite the uncertainties surrounding the US elections. Money market spreads, however, did not move much, since market turmoil cast doubt on a Fed rate hike by the end of the year.

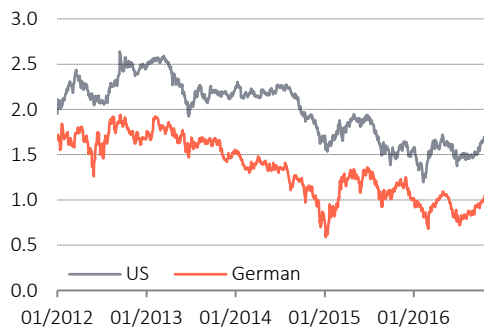
**Fig.7: 2Y government bond yields**



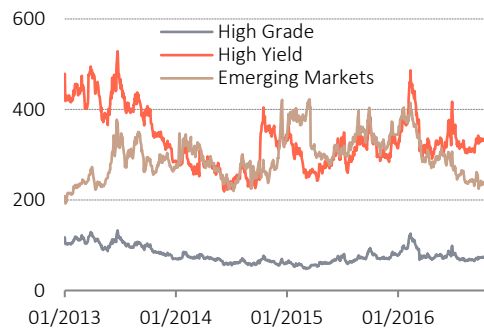
**Fig. 8: 10Y government bond yields**



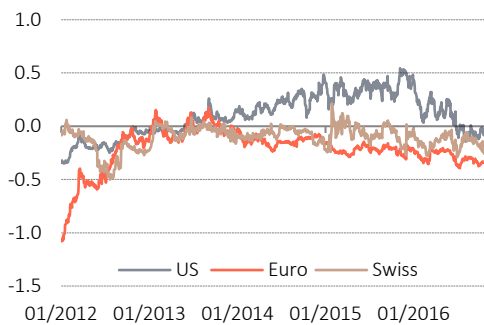
**Fig 9: 10Y break-even inflation**



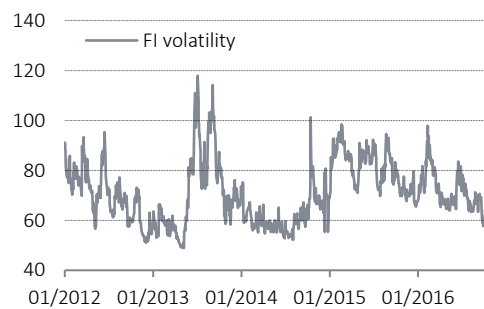
**Fig. 10: Credit spreads, 5Y credit default swaps**



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



**Fig 12: Merrill Lynch volatility index**

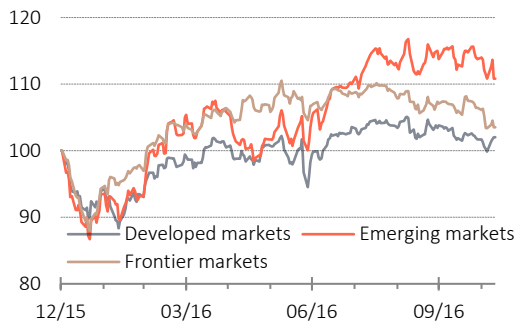


# EQUITIES

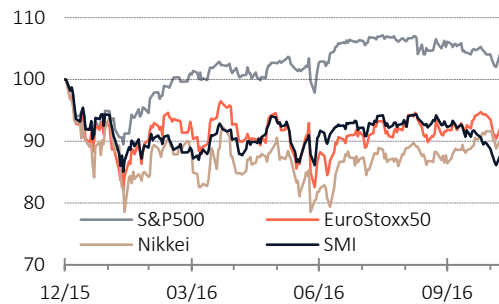
In October equity markets were mixed. The US S&P500 index was down 1.9%. The EuroStoxx50 index was up 1.8%, despite the fact that during the pre-election sell-off European equities underperformed the US market. The Emerging Markets index was slightly up, by 0.2%. The Japanese Nikkei 225

index performed strongly and climbed by 5.9%. The Brazilian Bovespa index continued to outperform and was up 11.2% in October. While year-to-date the financial sector suffered, financials enjoyed a strong performance in October. The MSCI Europe financial sector was up about 6%.

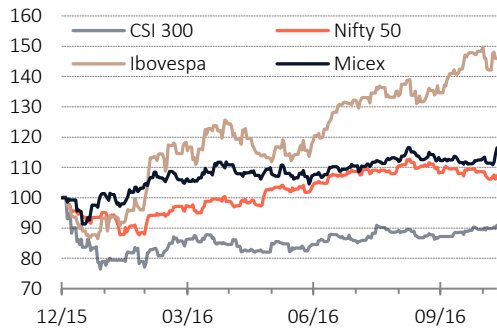
**Fig. 13: MSCI equity indices – major regions**



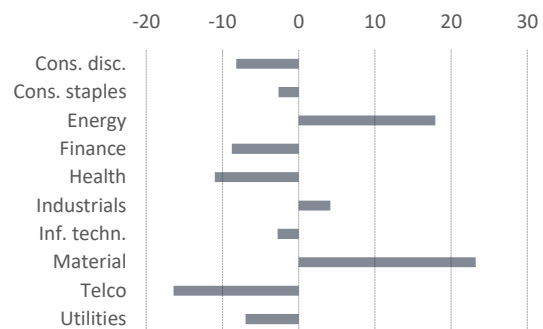
**Fig.14: Equity indices – major developed markets**



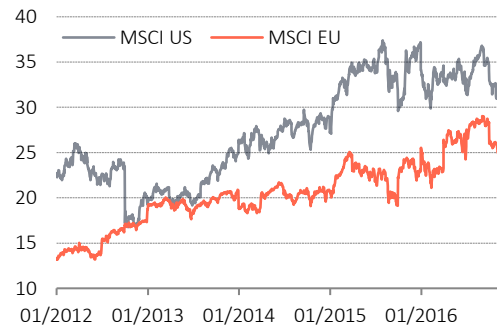
**Fig 15: Equity indices – major emerging markets**



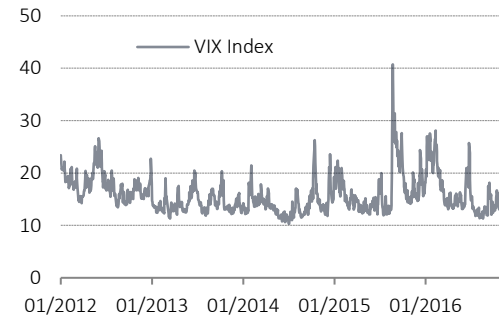
**Fig. 16: Sector performance, MSCI Europe, 2016**



**Fig 17: Price-earnings ratios**



**Fig 18: Equity volatility – S&P500 VIX index**



# ALTERNATIVE INVESTMENTS

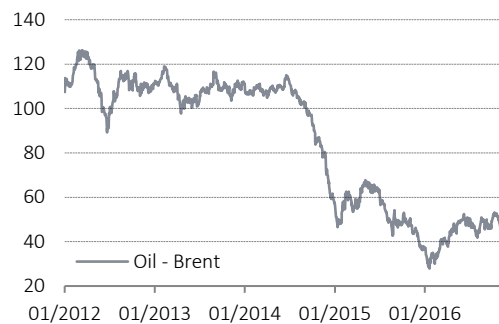
The oil price increase was only short-lived. Brent oil fell 4% in October and currently trades around 45 USD/bl. Gold sold off in early October but recovered somewhat during the market turmoil around election day. Industrial metals rose 1.3% in October and

rallied strongly in early November, rising almost 10% within a couple of days. Global REITs remained under selling pressure.

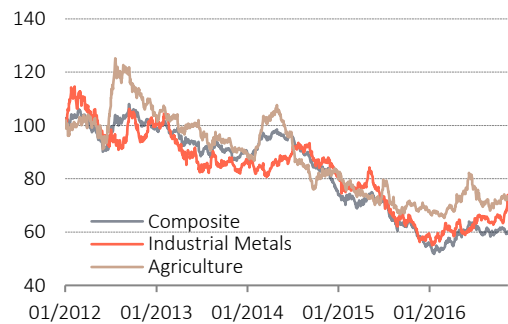
**Fig. 19: Gold price, USD/oz**



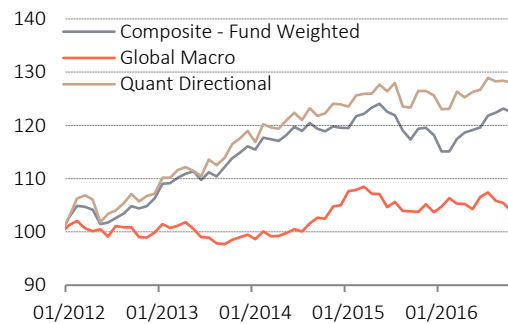
**Fig.20: Oil price, USD/bl**



**Fig 21: Bloomberg commodity indices**



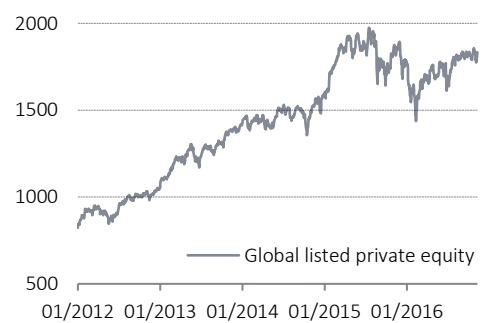
**Fig. 22: HFRI hedge fund indices**



**Fig 23: FTSE EPRA/NAREIT global index**



**Fig 24: LPX global listed private equity**



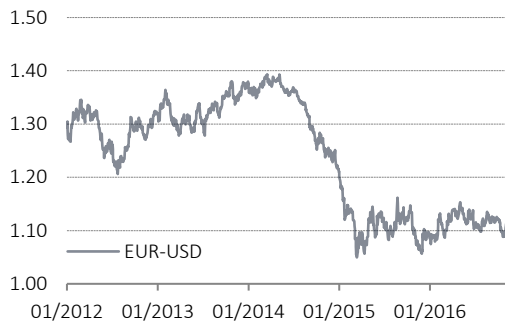


# CURRENCIES

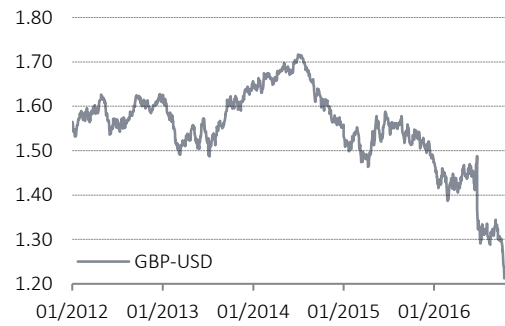
The USD appreciated in October and continued its ascent in early November, only interrupted by a brief but significant sell-off in the days before the US election. The US election and the vote for Mr.

Trump was clearly supportive for the CHF, which causes concerns for the SNB. The GBP recovered somewhat from its recent sell-off. The Chinese CNY continued to weaken.

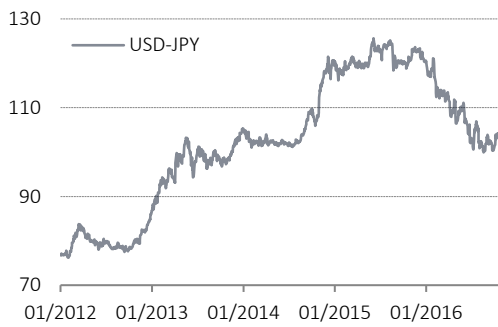
**Fig. 25: EUR-USD exchange rate**



**Fig. 26: GBP-USD exchange rate**



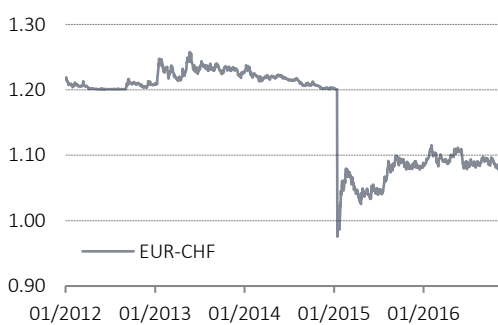
**Fig. 27: USD-JPY exchange rate**



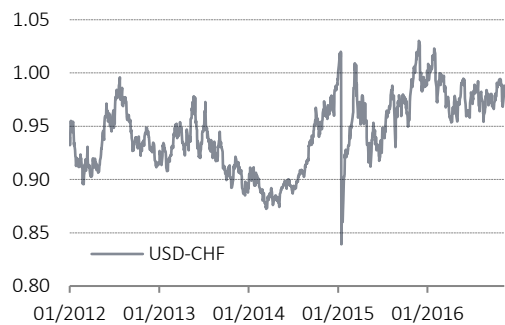
**Fig. 28: USD-CNY exchange rate**



**Fig. 29: EUR-CHF exchange rate**



**Fig. 30: USD-CHF exchange rate**

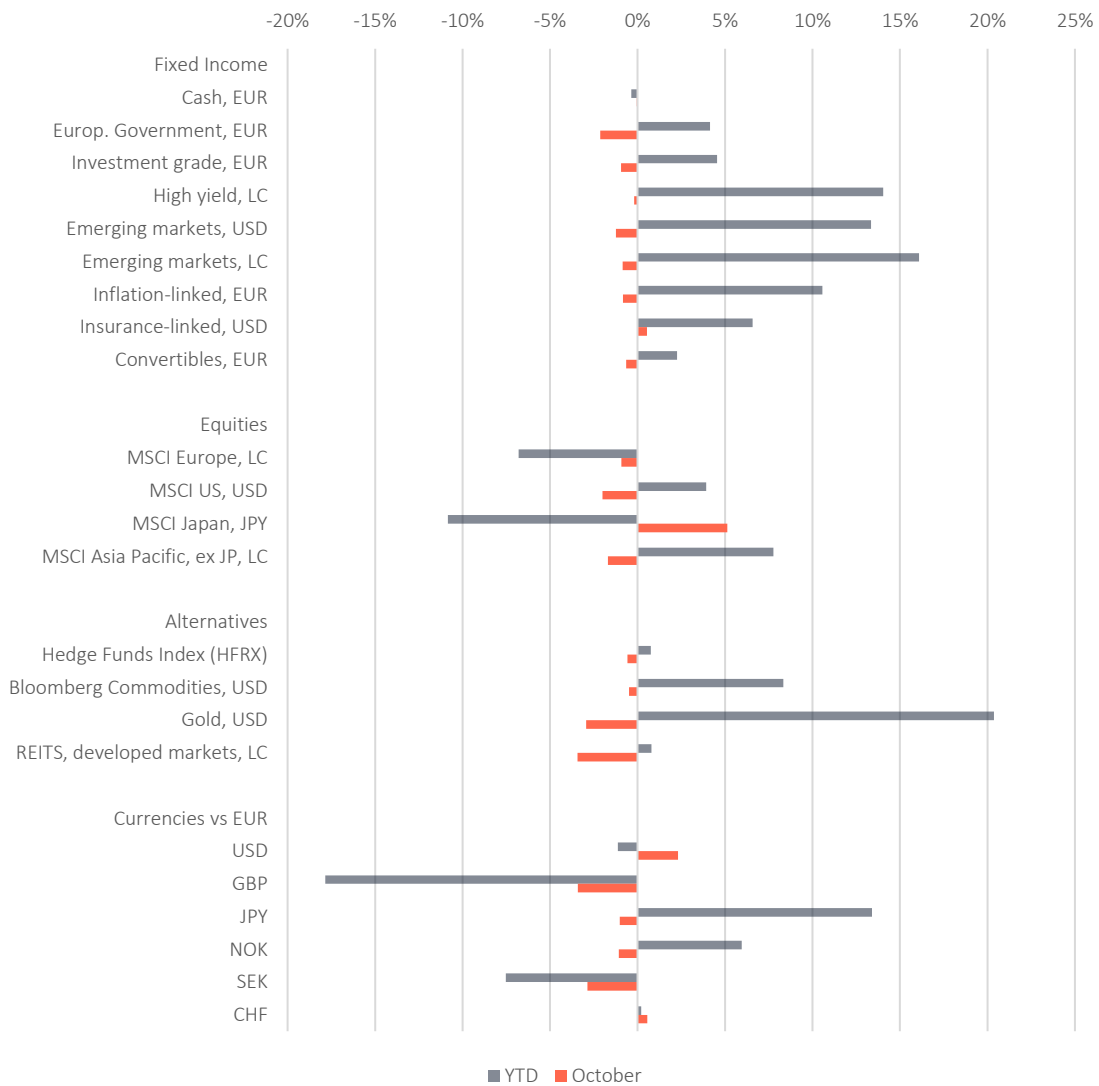


# ASSET ALLOCATION

For a EUR investor, the best-performing asset classes in October were Japanese equities, which recovered somewhat from a severe sell-off earlier this year. In addition, the USD was able to cover

some ground vs. the EUR. Most other asset classes suffered in October. The MSCI Europe index was, in contrast to the EuroStoxx50 index, down in October.

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

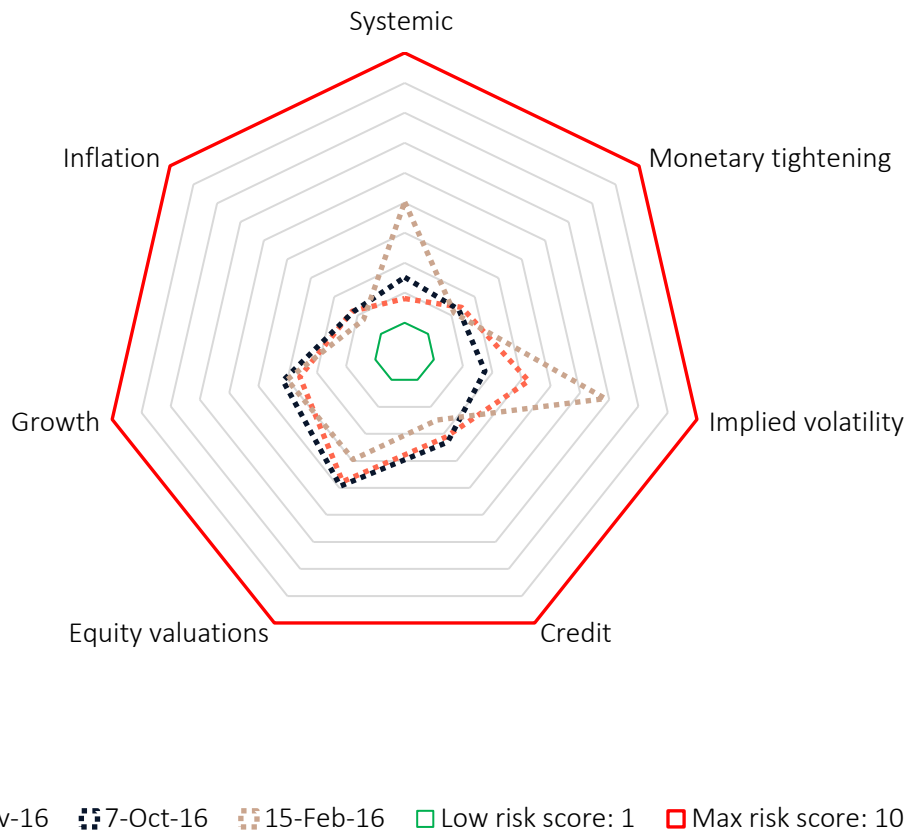


# RISK MONITOR

On 4 November, when markets were very concerned about the uncertain outcome of the US elections, we observed a spike of implied volatilities, especially in equity and fixed-income markets. Volatilities in currency and commodities

markets remained moderate. Other than that, our risk indicators did not move much, compared to last month, while equity valuation risk declined slightly. The market became somewhat more relaxed about systemic, i.e. banking, risk.

Fig. 32: IMT Risk Monitor



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