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INVESTMENT OUTLOOK 03.2017

15 March 2017

In February, risky assets continued to perform strongly. Optimism after the US election coupled with stronger economic indicators fueled the positive investor sentiment. Developed equity markets were up 2.6% in February and emerging markets even 3.0%. At the same time bond markets rebounded and recovered some of their losses of previous months. As a result, multi-asset-class portfolios performed very favorably.

The Trump administration continued to dominate the news. It seems, however, that the speed of policy implementation, which appeared to be very high in the first two weeks of the new presidency, has fallen significantly. The discussion around the health insurance reform is expected to go on for quite some time, especially since the topic is highly controversial within the Republican party. As a result, we expect that the promised tax cuts will be delayed.

In addition, markets have been focused on central bank policies. The ECB kept rates low in order not to undermine the recovery, while the Fed, as expected, hiked rates in mid March.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

THE GOLDILOCK ENVIRONMENT CONTINUES

Financial markets

Market sentiment continued to improve in February. We observed a broad-based rally of risky assets. Emerging markets rose 8.6% between the beginning of the year and the end of February. Strongest performers have been India (8.5%), Brazil (10.7%) and also Mexico (6.5%), while the Russian equity market fell by 8.8%. Equity markets in Asia Pacific enjoyed a strong rally as well. In particular, the Hang Seng rose 11.7%. The US equity market continued to outperform other developed equity markets. The S&P500 index climbed 5.6%, followed by the MSCI Europe with 2.2%, and the Japanese Nikkei 225, which was flat. The equity volatility index, VIX, which measures the price of insurance against a fall of the S&P50 index, remained at historically low levels around 11. This could very well indicate a certain degree of complacency among investors.

Also bond markets rallied in February. US 10-year government bond yields declined 6 basis points and German Bund yields even 23 basis points. As a result, the US-European yield spread widened further to about 200 basis points. Also, credit spreads continued to tighten in February, both for high yield and emerging market bonds.

Macro economics

The European PMI climbed further to 55.4 after 55.2. Output growth was driven by the manufacturing sector with strong new orders and new export business. The US PMI rose as high as 57.7 in February after 56.0. The US non-farm payrolls for February rose 235,000 after 238,000 and signal continued job creation.

Headline inflation in the US rose to 2.7% year-on-year and to 2.0% in the Eurozone. US inflation expectations, as measured by 10-year break-even rates stabilized around 2.0%, while the European inflation expectations fell slightly to a level of 1.25%.

Central banks

As expected, on 15 March US Fed decided to raise the Federal Funds Target by 25 basis points to be within 0.75% and 1.00%. The Fed sees risks as balanced and the general policy stance as still accommodative. The comments by Fed chairwoman Janet Yellen suggest that two more rate hikes can be expected this year.

Meanwhile the ECB, on 9 March, kept rates unchanged. ECB's chairman, Mario Draghi, however, made clear that further stimulus measures have become less likely. While the ECB seems to be committed to maintain its QE program for longer, there is a sense that the ECB may announce first steps to exit its ultra-accommodative policy stance during the course of the year.

Outlook

Better growth, strong earnings and still accommodative central banks, keep us positive on risky assets. Especially because, in addition, government bonds, particularly in Europe, remain highly unattractive.

We kept our high-yield bond allocation unchanged, despite somewhat stretched valuations.

The yield differential between US and European short-term rates is about 200 basis points and may increase even further. Therefore, being short, the USD is very expensive and we expect the USD to remain on the strong side.

ECONOMICS

PMIs and inflation continued to rise in February. The headline inflation, however, also reflects rising oil prices. US non-farm payrolls rose by 235,000 in February vs. 238,000 in January, confirming continued robust job creation in the US. Average hourly earnings rose 2.8% year-on-year.

Fig. 1: PMIs

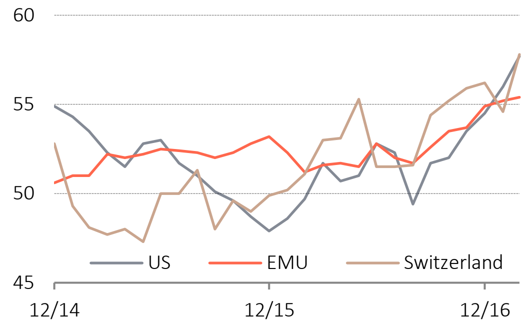


Fig. 2: PMIs

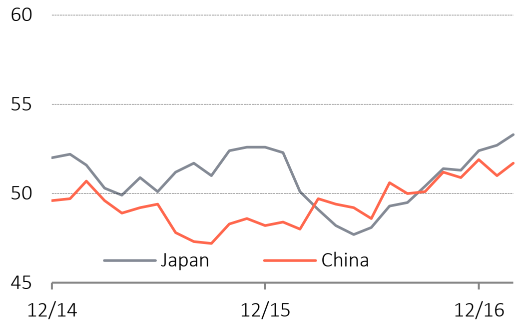


Fig 3: Consumer price inflation, in % YoY

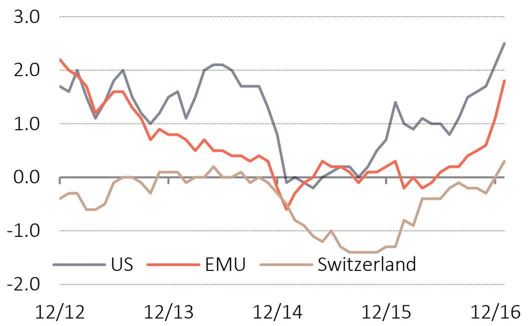


Fig. 4: Consumer price inflation, in % YoY

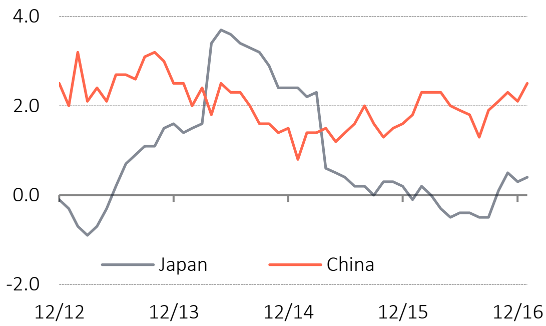


Fig 5: Unemployment rates, in %

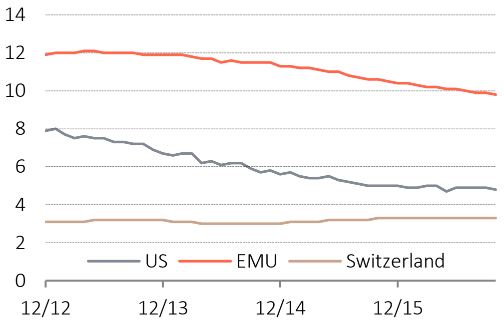
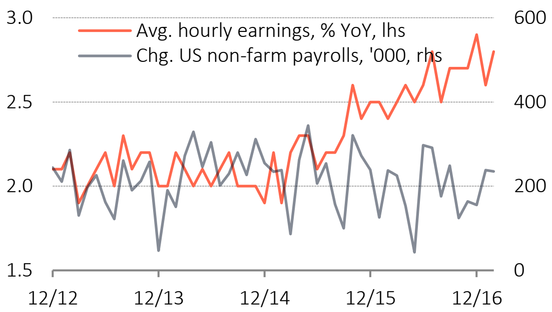


Fig 6: US labor market



FIXED INCOME

Bond markets performed well in February, driving yields down again. The exception was the short end of the US yield curve, as investors increasingly anticipated further Fed rate hikes. US break-even inflation rates stabilized while European inflation expectations fell somewhat after the strong rise recently. Credit spreads tightened further in February.

Fig.7: 2Y government bond yields

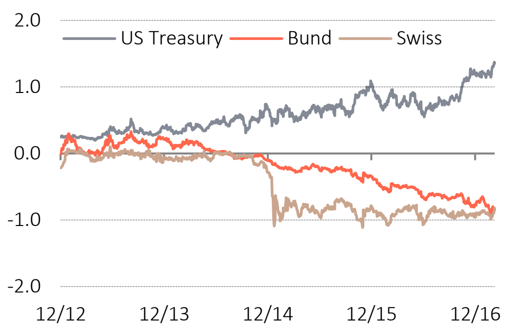


Fig. 8: 10Y government bond yields

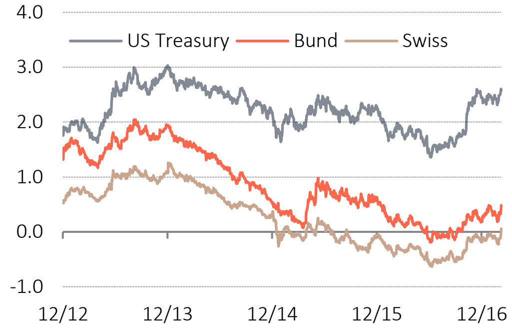


Fig 9: 10Y break-even inflation

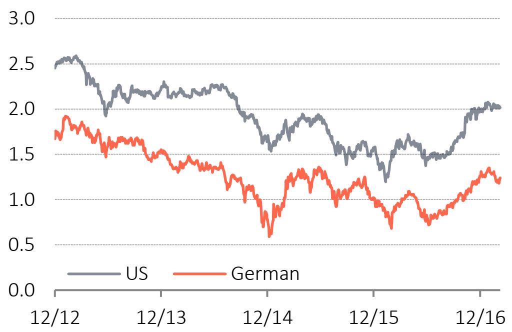


Fig. 10: Credit spreads, 5Y credit default swaps

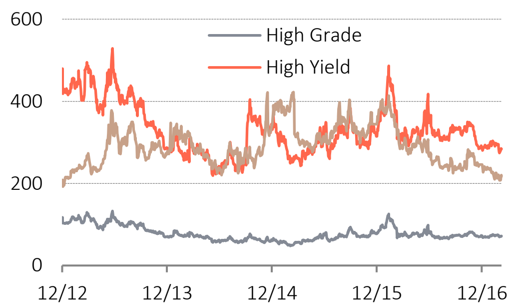


Fig 11: Money market spreads (3M-2Y)

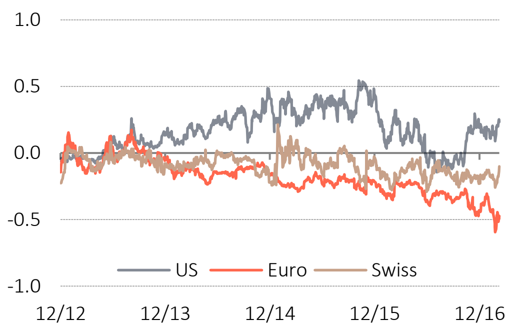
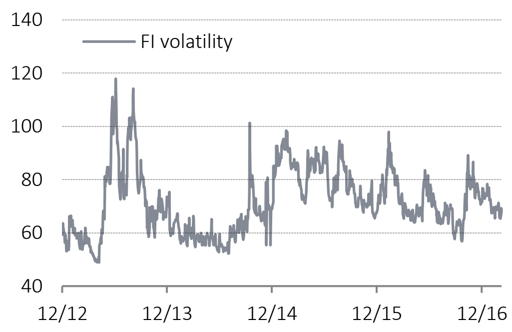


Fig 12: Merrill Lynch volatility index



EQUITIES

February was another strong month for equities in general. Emerging markets continued to outperform. US equities continued to outperform European equities. The S&P500 index climbed by 3.7% as compared to the MSCI Europe, which rose 2.6%. Despite very expansive monetary policies in Japan, the Nikkei225 was only slightly up, by 0.4%. The best performing European sectors have been information technology, consumer stables and health.

Fig. 13: MSCI equity indices – major regions

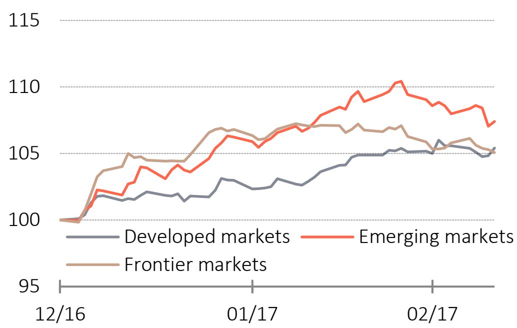


Fig.14: Equity indices – major developed markets

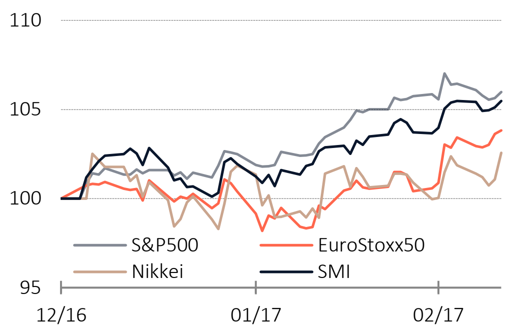


Fig 15: Equity indices – major emerging markets

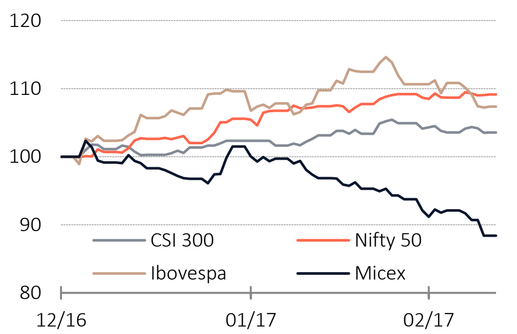


Fig. 16: Sector performance, MSCI Europe, 2017

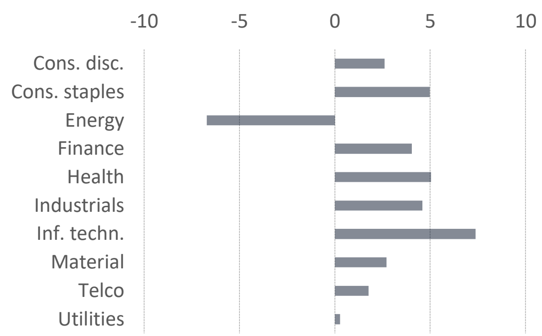


Fig 17: Price-earnings ratios

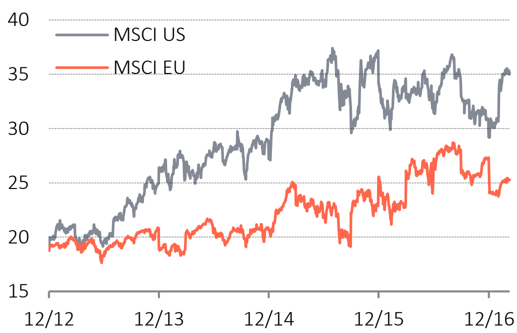
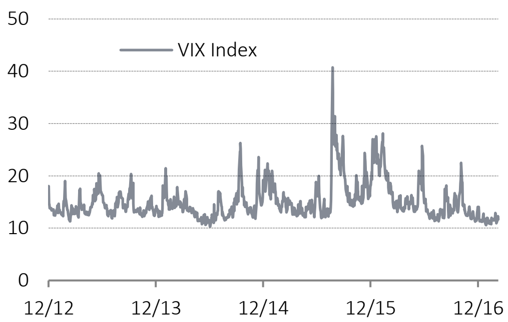


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

Gold prices managed to rise, despite the risk-on environment. Oil prices were slightly up in February, but corrected sharply in March. Global REITS had a good month. Hedge funds enjoyed a good start to the year, driven especially by directional quant strategies, which benefit from clear and lasting trends in financial markets.

Fig. 19: Gold price, USD/oz

Fig.20: Oil price, USD/bl

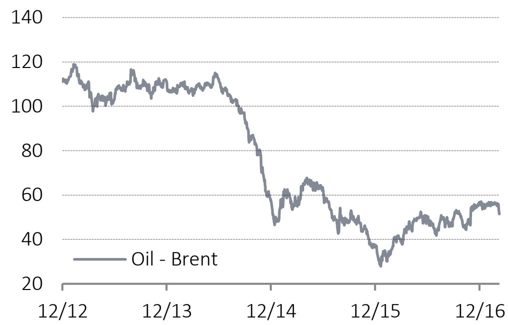


Fig 21: Bloomberg commodity indices

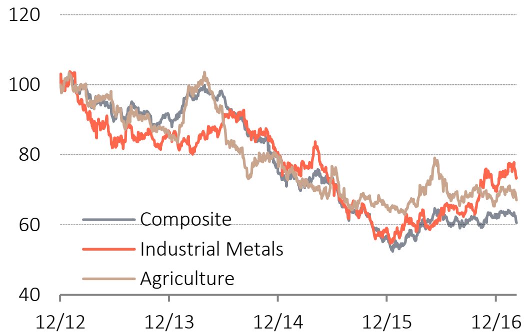


Fig. 22: HFRI hedge fund indices

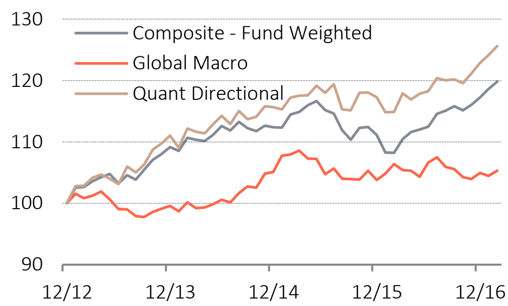


Fig 23: FTSE EPRA/NAREIT global index

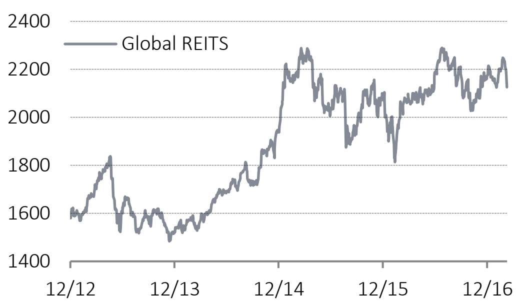
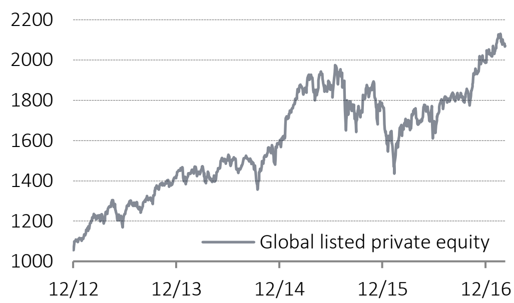


Fig 24: LPX global listed private equity



CURRENCIES

EUR-USD is fluctuating between 1.05 and 1.08. The EUR strengthened vis-à-vis the USD by about 0.6%, between end of February and the beginning of the year. The GBP stabilized around 1.24 to the USD, held down by uncertainties around the implementation of Brexit. The CHF continued to appreciate, though the SNB seems to have intervened to prevent it from rising too much.

Fig. 25: EUR-USD exchange rate

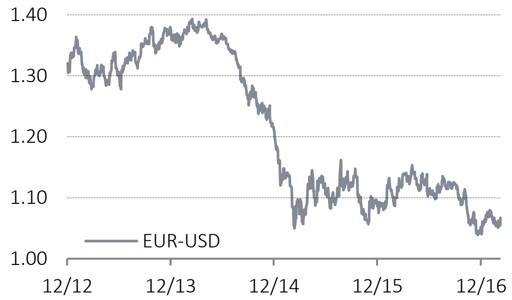


Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

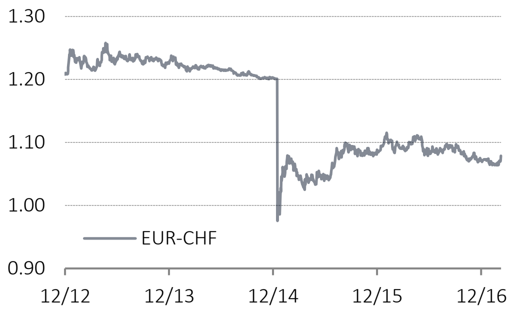
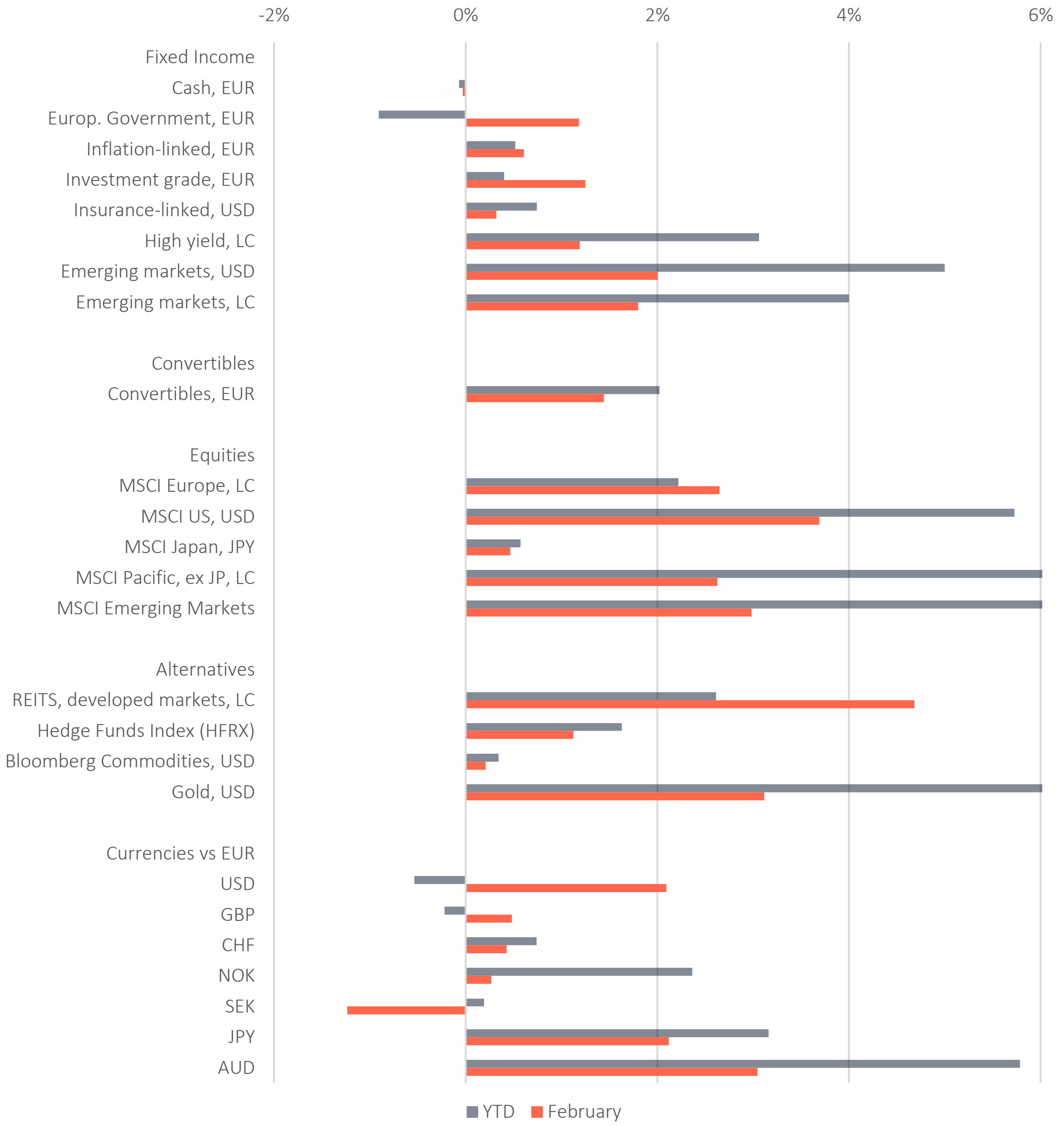


Fig 30: USD-CHF exchange rate

ASSET ALLOCATION

The chart below shows the broad-based positive performance of most asset classes. Taking risks has been rewarded since the start of the year. Strongest year-to-date performers have been emerging markets and Asia Pacific equities, as well as Gold, while government bonds lost some value. The EUR has been stronger vis-à-vis most currencies, with the exception of the USD and the GBP.

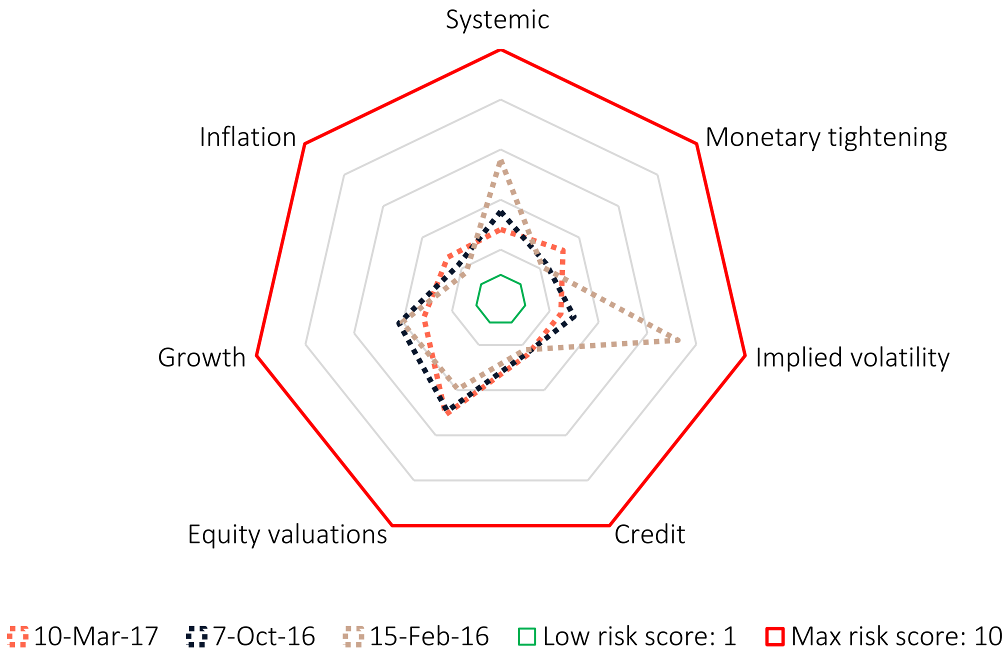
Fig. 31: Performance of major asset classes, based on our EUR portfolio strategy



RISK MONITOR

The risk monitor continues to indicate moderate market risks, and shows minor changes compared to last month. The most pronounced risk comes from equity valuations. However, we believe that equity valuations do not impose an immediate threat, given the pick-up of growth and still accommodative monetary policies.

Fig. 32: IMT Risk Monitor



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