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INVESTMENT OUTLOOK 04.2017

20 April 2017

In March, equity markets continued to rally. Emerging markets outperformed developed markets, and Europe outperformed the US. European government bond markets sold off while US government bonds remained almost unchanged month-on-month. Commodity prices fell, led by a sharp decline of oil prices. The gold price was almost unchanged.

On 9 March the ECB kept rates unchanged but made clear that further stimulus measures have become less likely.

On 15 March the US Fed raised the Federal Funds Target by 25 basis points, which had been widely expected. The comments by Fed chairwoman Janet Yellen suggest that two more rate hikes can be expected this year.

We continue to see a favorable environment for risky assets, although markets have recently taken a breather. We have become more positive on European equity markets and increased our exposure somewhat, as the time may have come for European equities to start closing the valuation gap vis-à-vis the US.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

ROTATION INTO EUROPEAN EQUITIES

Financial markets

Equity markets continued to perform well in March. Emerging markets gained 2.3%, and developed equity markets 0.8%. The EuroStoxx50 index was up by 5.5% and clearly outperformed the US S&P500 index, which was flat month-on-month. Among emerging markets, the Mexican IPC index was up 3.6% and the Indian Nifty index 2.2%. At the same time, the Brazilian Bovespa index fell 2.5%.

The market for European government bonds sold off with 2-year yields rising 16 basis points and 10-year yields 12 basis-points. Meanwhile, US government bonds remained almost unchanged month-on-month.

The performance of high-yield bonds was flat in March, while local emerging markets bonds returned 2.3%.

Overall, commodity prices fell in March, led by a sharp decline of oil prices. The price of Brent oil fell by 6.7%. The gold price, however, was almost unchanged in March.

REITS continued to be very volatile. In March the global REITS index fell by 2.6%, pushing down the year-to-date performance to zero. In the last couple of weeks, the index recovered its March losses.

Macro economics

In recent months, we have experienced a high number of positive surprises from macro indicators. This has been true primarily for soft indicators like consumer and business sentiment. Increasingly, so-called hard indicators, like actual consumption and production data, have also improved. While this is a good development as it confirms the positive growth dynamics, it will become harder to beat expectations going forward.

The European PMI climbed to 56.2 after 55.4. The US PMI declined slightly to 57.2 after 57.7 in February. Since the level is still far above the 50-mark, which divides the growth from the contracting zone, it remains a very strong reading.

The US unemployment rate fell further to 4.5%. US non-farm payrolls rose by only 98,000 in March vs. 219,000 in February. While the figure was clearly below expectations, it may signal a more normal job growth as the labor market moves towards full employment. US average hourly earnings rose 2.7% year-on-year and show a steady growth without rapid pickup.

Headline inflation in the US declined somewhat to 2.4% after 2.7% year-on-year and to 1.5% in the Eurozone after 2.0%. This is a result of the reduced base effect from energy prices. In China inflation fell markedly, from 2.5% year-on-year in January to 0.8% in February and 0.9% in March. This is the result of declining food prices.

US inflation expectations, as measured by 10-year break-even rates dropped somewhat to about 1.9% and the European equivalent dropped by about the same amount to 1.15%.

Central banks

On 9 March the ECB kept rates unchanged, as expected, and made clear that further stimulus measures have become less likely. Financial analysts are debating when the ECB is likely to taper, especially since growth is picking up and headline inflation reached almost 2% earlier this year. However, headline inflation was mostly driven by base effects with energy prices. We do not foresee inflation rising strongly in the foreseeable future, which will allow the ECB to announce tapering of its asset purchases in September. In our view, this will be accompanied by dovish statements and the tapering pace will be rather modest.

On 15 March the US Fed decided to raise the Federal Funds Target by 25 basis points, as expected. The Fed sees risks as balanced and the general policy stance as still accommodative. We expect two more rate hikes this year.

Outlook

We continue to see a positive outlook with stable growth, moderate inflation and rising earnings. This bodes well for equity and credit markets, despite more challenging valuations.

We have reduced our overweight for high-yield bonds, since rich valuations make the risk-return look less favorable.

Among equities we have shifted to a higher allocation of European stocks , since the general perception seems to be that political risk in Europe has just about vanished. This may lead to European equities starting to close the current valuation gap between Europe and the US . European equities trade at a 22% discount to the US, compared to the five-year average of 17%. The devaluation of the EUR, despite some recent EUR strength, should continue to provide tailwinds for European exporters. Since Mid-2014, the EUR has devalued by 23% versus the USD. We also observe margin improvements for European companies, and the growth and earnings pick-up in Europe seems to have become more dynamic compared to the US.

While Japanese equities have underperformed since the beginning of the year, we maintain our overweight position, as monetary support should eventually lift equities higher.

Looking for risks which have the potential to cause market disruptions, we would see especially the following four. Firstly, President Trump could decide on further military interventions in the Middle East and potentially also in North Korea. Secondly, US debt is rising and may reach the debt ceiling within the next couple of months. Since powerful parts of the Republican party are strongly against lifting the debt ceiling, this may lead to fierce debates in the US Congress. Thirdly, the French could – surprisingly – elect an anti-European president. Fourthly, despite all efforts to stabilize the economy before the Communist Party conference in October, the Chinese economy could slow down and send ripple-on effects through global financial markets.

ECONOMICS

Growth data remained strong in March. Headline inflation fell slightly since base effects from commodity prices declined in that month. US non-farm payrolls rose by only 98,000 in March vs. 219,000 in February. While the figure was clearly below expectations, it may signal a more normal job growth as the labor market moves towards full employment. The unemployment rate fell to 4.5%. US average hourly earnings rose 2.7% year-on-year and show a steady growth without rapid pickup.

Fig. 1: PMIs

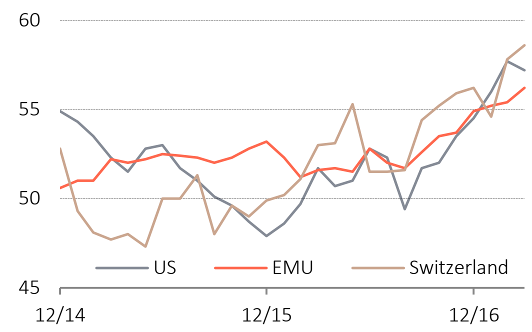


Fig. 2: PMIs

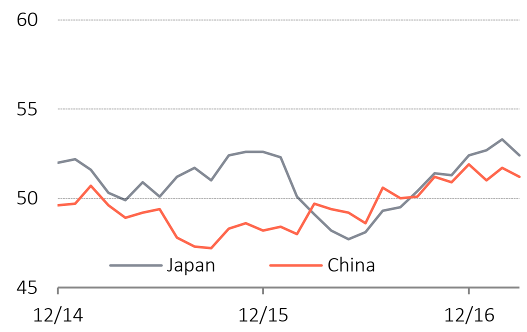


Fig 3: Consumer price inflation, in % YoY

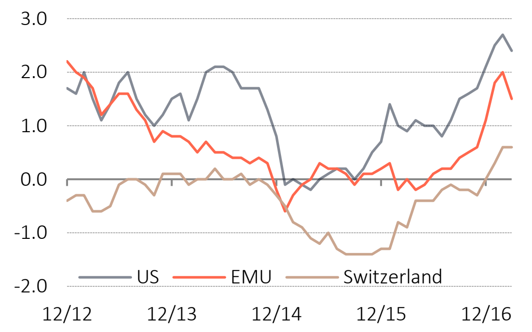


Fig. 4: Consumer price inflation, in % YoY

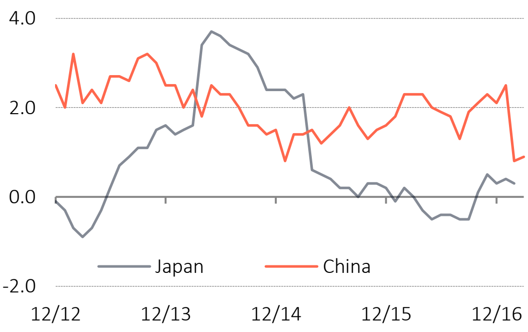


Fig 5: Unemployment rates, in %

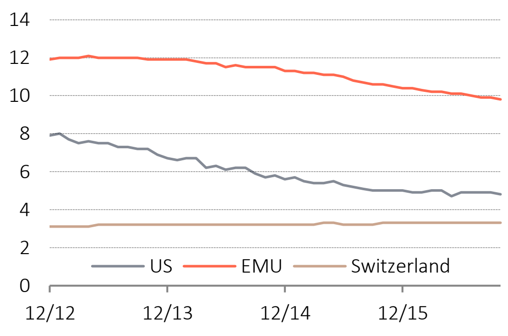
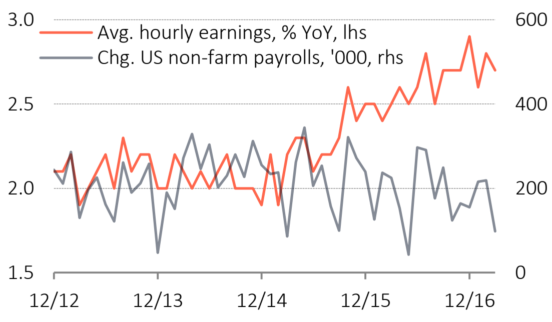


Fig 6: US labor market



FIXED INCOME

The European government bond market sold off in March, while US government bonds remained flat month-on-month. The European yield curve flattened, since the short-term yields rose more strongly than long-term yields. Break-even inflation retreated somewhat from recent highs. High-yield and emerging markets spreads remained stable.

Fig.7: 2Y government bond yields

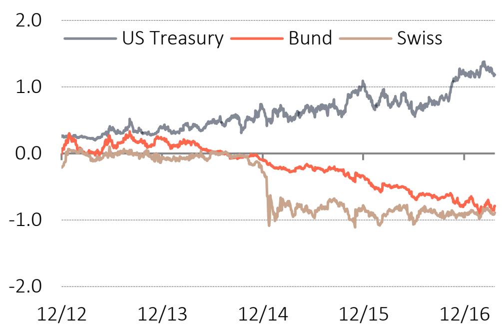


Fig. 8: 10Y government bond yields

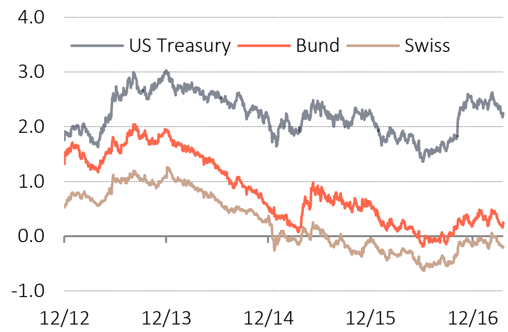


Fig 9: 10Y break-even inflation

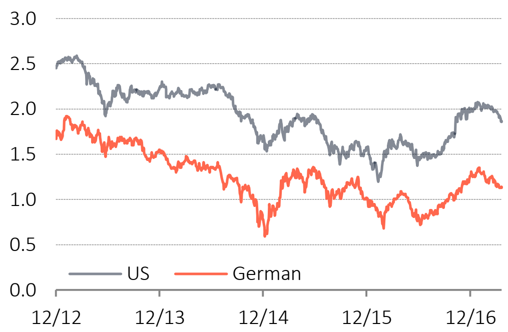


Fig. 10: Credit spreads, 5Y credit default swaps

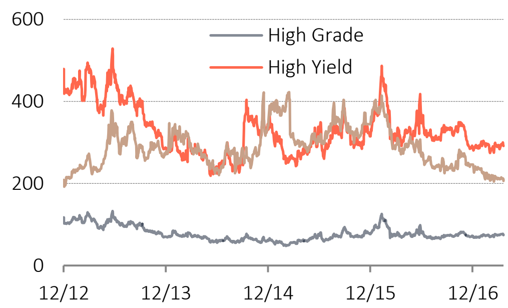


Fig 11: Money market spreads (3M-2Y)

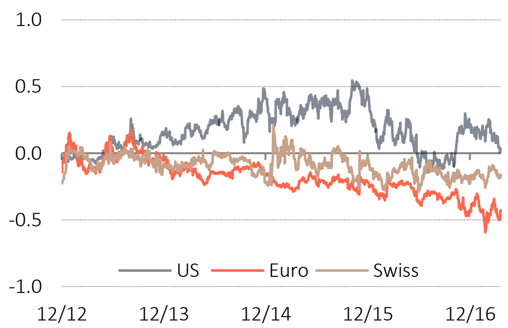
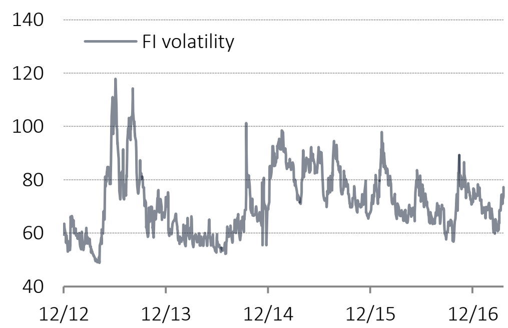


Fig 12: Merrill Lynch volatility index



EQUITIES

In March equity markets performed well. Emerging markets continued to outperform, and within developed markets the Nikkei225 clearly underperformed. In March the European EuroStoxx 50 equity index climbed by 5.5% and managed to catch up with the year-to-date performance of the S&P500 index. The S&P500 index was flat in March. The energy sector has clearly underperformed year-to-date, suffering from falling oil prices. Information technology and industrials have performed best so far.

Fig. 13: MSCI equity indices – major regions

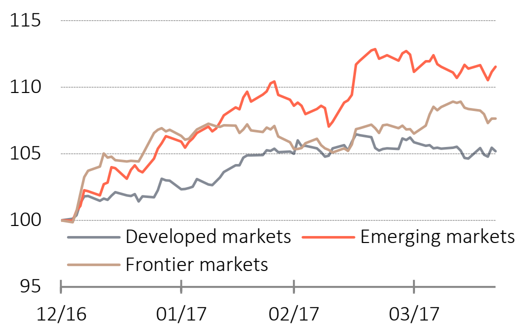


Fig.14: Equity indices – major developed markets

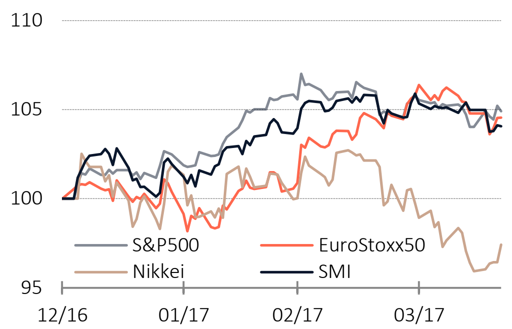


Fig 15: Equity indices – major emerging markets

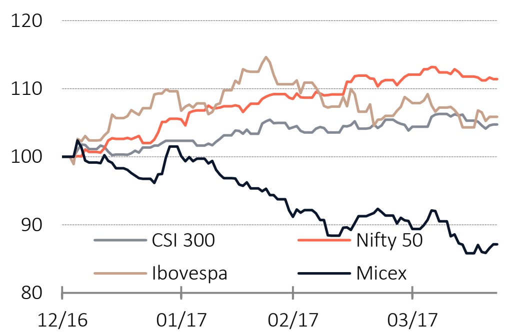


Fig. 16: Sector performance, MSCI Europe, 2017

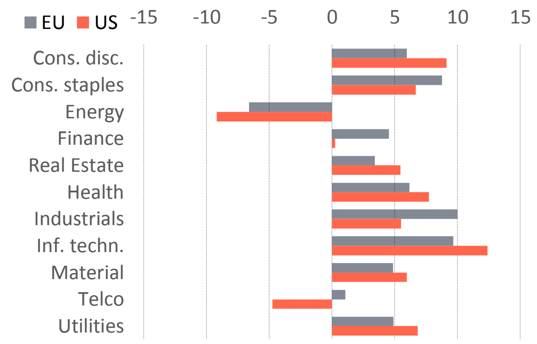


Fig 17: Price-earnings ratios

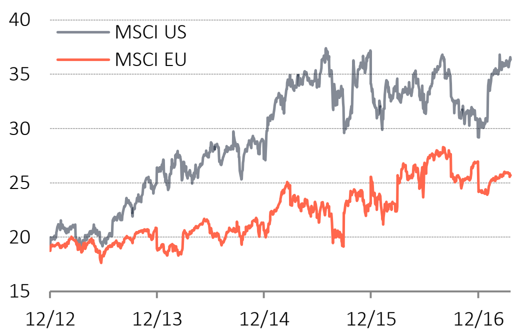
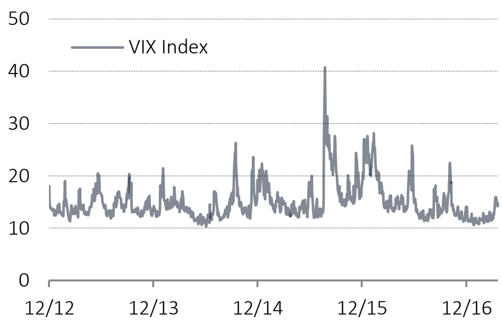


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

The Brent oil price fell by 6.7% in March, while the broad commodity index declined 2.7%. Gold was flat month-on-month. REITS have been very volatile in recent months. The global REITS index fell 2.6% in March, wiping out all year-to-date gains, but recovered strongly in April. Listed private equity continued to rally and performed 5.7% between January and the end of March.

Fig. 19: Gold price, USD/oz

Fig.20: Oil price, USD/bl

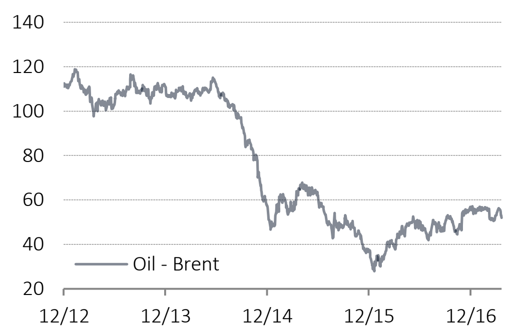


Fig 21: Bloomberg commodity indices

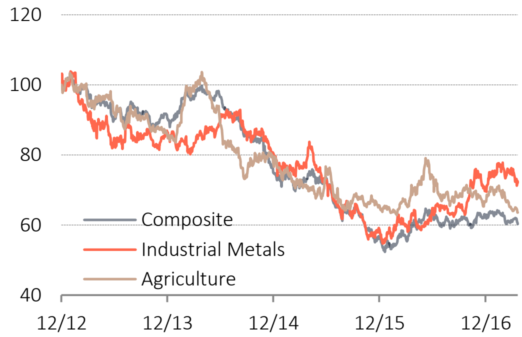


Fig. 22: HFRI hedge fund indices

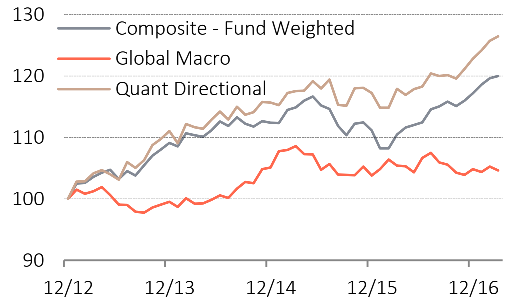


Fig 23: FTSE EPRA/NAREIT global index

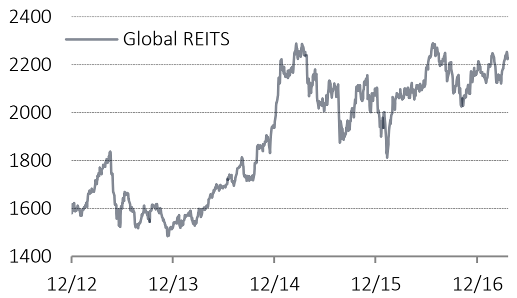
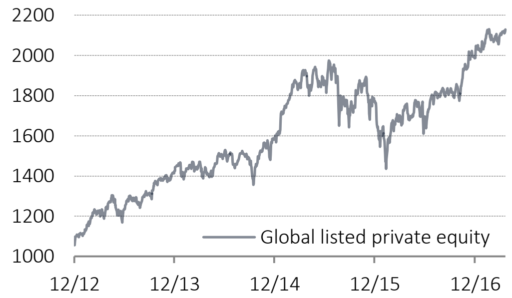


Fig 24: LPX global listed private equity



CURRENCIES

EUR-USD continues to be in a trading range. The GBP strengthened after Theresa May announced snap general elections on June 8. The JPY and the CHF continue to remain on the strong side. The Chinese CNY has stabilized recently, after it devalued by about 7% in 2016.

Fig. 25: EUR-USD exchange rate

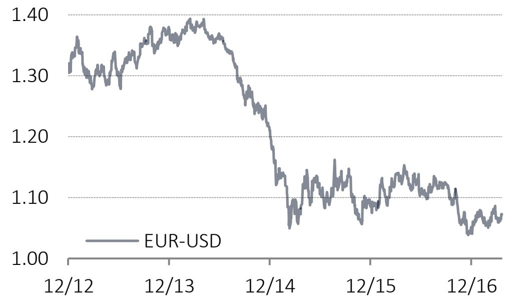


Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

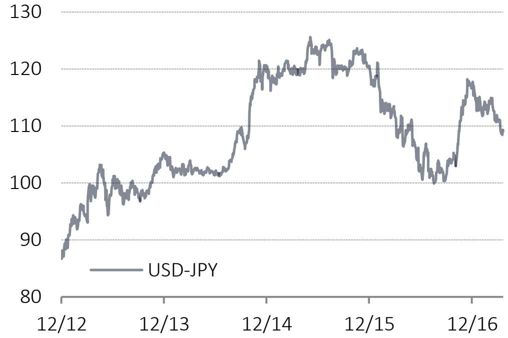


Fig. 28: USD-CNY exchange rate

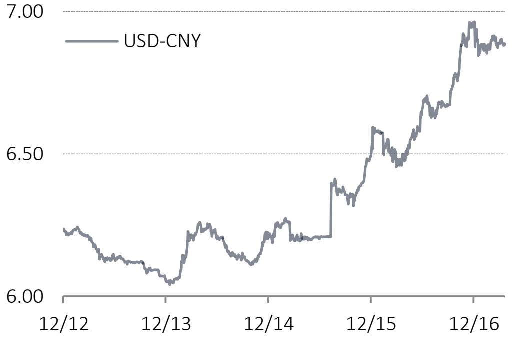


Fig 29: EUR-CHF exchange rate

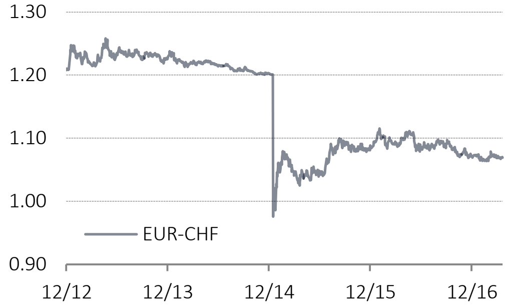
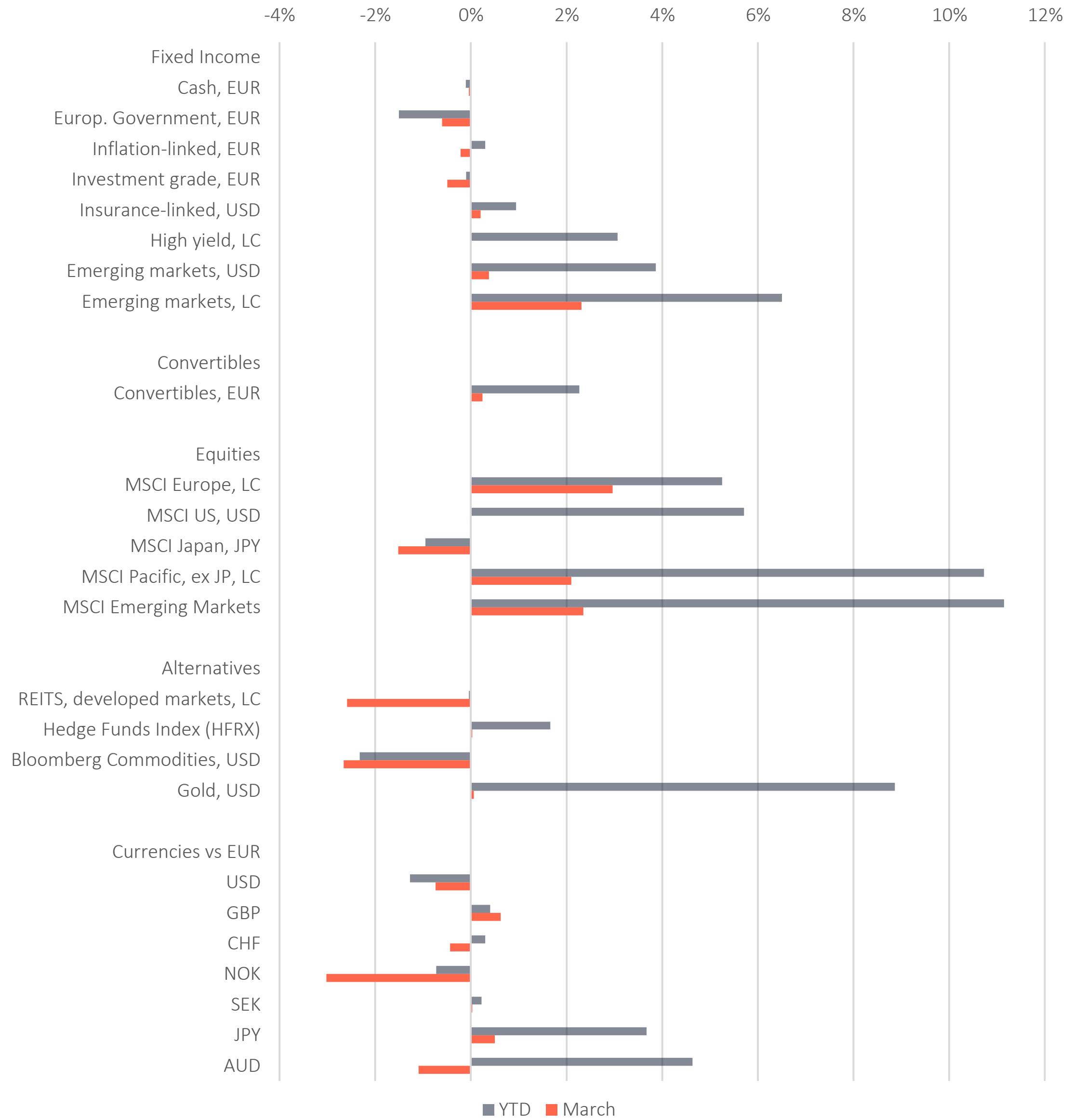


Fig 30: USD-CHF exchange rate

ASSET ALLOCATION

During the first quarter the market environment was favorable for multi-asset class portfolios. Especially equity markets contributed to a positive performance. Also, the risky part of the bond universe performed strongly. Taking risks has been rewarded. Commodities, except for gold, had a bad first quarter. In March REITS gave back all their gains of January and February.

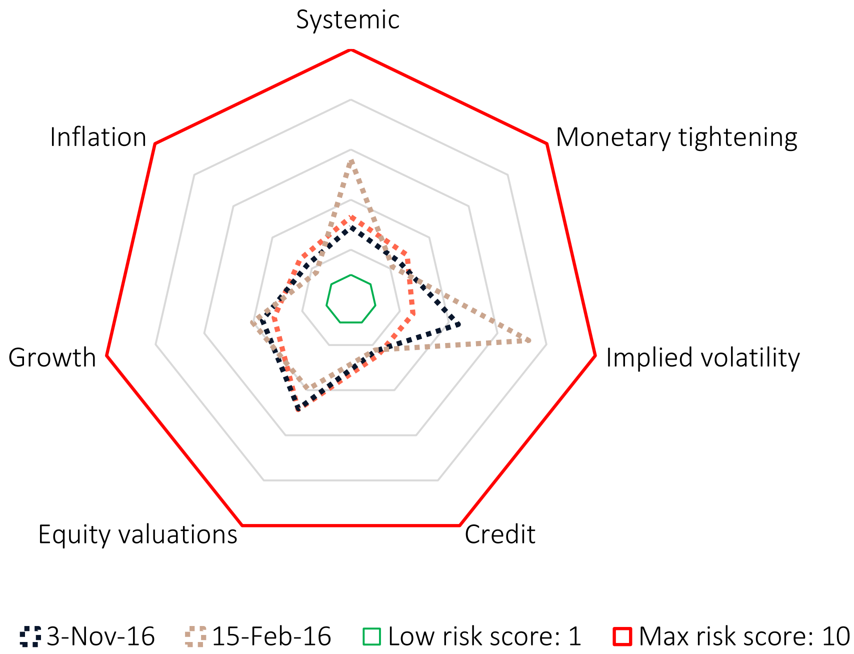
Fig. 31: Performance of major asset classes, based on our EUR portfolio strategy



RISK MONITOR

The risk monitor exhibits no major changes. The market risk environment remains benign. Equity valuations continue to be somewhat elevated. In our risk assessment, we believe that geo-political risks are not sufficiently reflected in the risk monitor, but in our base case scenario we remain confident that overall risks have declined in recent months.

Fig. 32: IMT Risk Monitor



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