FACTUM

Investment Report

Strategy overview

Further elections are looming in the Old World. A general election will be held in Great Britain on 8 June (after the time of going to press). Elections to the Assemblée Nationale follow on 11 and 18 June in France. It is our assumption that «La République en marche», the movement launched by the freshly-elected President Emmanuel Macron, will win the parliamentary ballot. It is worth noting that political uncertainty has eased substantially since Monsieur Macron's election, and markets responded to this with positive gains. In our view, the biggest political risk is the election in Italy, which has to be held by the spring of 2018 at the latest. Victory could be secured by the Eurosceptical Five Star Movement headed by the comedian Beppe Grillo. We do not see any «political storms» gathering over the next few months – and as a consequence the relative outperformance of the Old World vis-à-vis the United States is likely to continue, including under the aspect of more attractive valuations.

The latest economic indicators show that the global momentum of growth is intact. Europe is particularly worthy of mention in this respect, with indicators in all important countries continuing to rise in May. Over the next few months, central banks around the globe will address further measures to normalise monetary policy. Even if they endeavour to minimise the market-impact of these measures, they are likely to reinforce the trend towards rising yields, and for this reason we are continuing to underweight bonds. Global equity markets are being supported by high earnings growth in the most important regions. For cyclical as well as technical valuation reasons, we see further upside potential for European equity markets. In the United States, the situation is currently looking complicated on account of political turmoil involving possible links between Trump's campaign team and Russia. The possible link is now being investigated by an independent committee. Of greater relevance to us in this conjunction, however, is the question of a possible tax reform in the USA. The fact that actual proposals have yet to be presented suggests that the Republicans have not been able to reach agreement on this. Quick agreement in Congress is anyway unlikely, not least because many Republicans will never agree to a massive worsening of the budget. As pointed out in several previous Investment Reports, sooner or later the Trump administration will need to deliver results, as otherwise markets are likely to respond by discounting assets.

At the portfolio level, we divested the position in European banks that was built up before the first round of voting in France. We secured a double-digit performance on this position within a very short period. Ahead of the second round of voting in France, we no longer considered the yield/risk ratio to be interesting, and for this reason we decided that profit-taking was the best option. This means we have reduced the equity ratio and are currently holding a neutral ratio.

Economy

With quarter-on-quarter GDP growth of 1.2% instead of 0.7%, as had originally been estimated, the momentum of economic expansion in the USA was modest for the first quarter of 2017. It is our assumption, however, that (as discussed in previous Investment Reports) this is a seasonal pattern. The labour market, measured in terms of the unemployment rate, is in outstanding shape in America. The rate fell from 4.4% to

4.3%, which is the lowest figure recorded in 16 years.
The unemployment rate within the Eurozone fell from 9.5% to 9.3%, which is the lowest figure seen since March 2009. A year ago the figure was 10.2%. Before the financial crisis broke out it had been 7.3%.
The economic picture in Brazil has brightened significantly – despite the ongoing political turmoil. The Brazilian economy grew in the first quarter of 2017 for the first time since the final quarter of 2014. The economy has been supported by the Brazilian Central Bank. It stuck resolutely to its loose monetary policies in recent weeks, ignoring the political shenanigans. As anticipated by financial markets, it once again reduced its key lending rate by 100 basis points from 11.25% to 10.25%. The previous Central Bank meeting also cut base rates by 100 points. The sinking inflation rate is likely to enable the Central Bank to go ahead with further interest rate reductions during the course of the year. Markets are expecting base rates to fall to 8.5% by the end of the year.

Equity markets

The most important equity markets around the world continued to perform bullishly last month, as the market overview table shows. Particularly worth mentioning in this conjunction is the SMI in Switzerland, which gained around 2.80% in May, while the Japanese Nikkei also gained approximately 2.40%. For us, what is particularly noticeable about the Swiss market is the extraordinary performance of medium-sized enterprises. The Mid-Cap Index (SMIM) contains the thirty biggest companies after those listed on the SMI. Over the past 12 months the SMIM, once dividends are taken into account, gained 24%, while the SMI recorded a positive performance of 12%. It is also noticeable that the valuation range, for example at the price/earnings ratio level, has widened markedly since the start of 2016. Economic history shows that high valuation differentials tend to narrow once again during correction or consolidation phases. In nervous correction phases, the dearth of liquidity and the low news-flow is often a problem. Within this context, we have decided not to increase our exposure to mid-cap positions. We would also advise private investors to take a critical view of these positions.

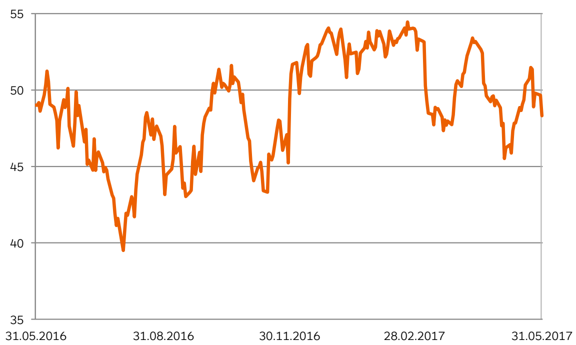
Bond markets

According to the «Fed minutes» published at the end of May, central bankers in the USA are taking a relaxed view of the state of the economy. The majority of members see the slowdown in economic growth recorded during the first three months of the year as merely a temporary phenomenon. In addition, most Federal Reserve members are keen to see the Federal Reserve balance sheet, which ballooned in the wake of the financial crisis, start to shrink toward the end of the year. The US Federal Reserve is likely to continue to pursue a policy of gradual and predictable normalisation of monetary policy. We are expecting the next Fed meeting on 14 June to approve a rate rise of 25 basis points.

Commodities

The financial media paid little attention to the weakness of commodity prices in recent weeks. We would like to take this opportunity to correct this situation. The fact is that oil prices have been jumping all over the place of late. In our view, doubts about the effectiveness of the self-imposed OPEC production cuts appear to have increased, not least in light of burgeoning production in the USA. We are expecting oil prices to recover during the second half of the year, however, and are continuing to see a trading range of USD 55 – 60 for WTI grade crude.

Oil price on a zig-zag-pattern



Source: Bloomberg

It is not just oil prices that have been oscillating markedly of late; the situation has been similar for ores as well as for precious and industrial metals. The price of iron ore, for example, has fallen 30% since February, recently hitting 472 $/ton, having more than doubled in the months prior to this. The price of cobalt, silver, nickel and platinum fell by between 4% and some 6% in recent weeks. Even the price of copper slipped to its lowest level since January.

Currencies

The election of the «pro-European reformer» Emmanuel Macron put paid to the doubts that had been circulation in the months prior to this. Following Donald Trump's election to the American presidency, a political swing to the right also threatened to produce strange economic policy strategies and protectionist tendencies in Europe as well. These would probably have jeopardised growth, would have forced governments and central banks to take extreme measures and would have left markets in a state of heightened jitters. Macron's electoral victory means that the situation has now turned out very differently. We are expecting business-friendly economic policies in Europe, with healthy growth, rising corporate earnings – and ultimately a recovery in eyquity prices. It is not just stockmarkets that have been benefiting, but also the Euro. Since the start of the year the European single currency gained around 1.50% against the Swiss Franc. This has given The Swiss Franc some breathing space. It is no longer in such demand as a safe haven now that worries about a crisis have begun to fade. In addition, in view of these shifting economic circumstances, the European Central Bank has been thinking about pursuing less expansive monetary policies. This means the «interest rate gap» between the USA and Europe would not widen as makedly as some market-watchers bad been expecting. In addition, because of the low level of interest rates, the Swiss Franc offers itself as a refinancing currency for real or portfolio investments within Europe. It is precisely this that could generate capital exports at least over a certain period of time which could weaken the Swiss Franc further.

Market overview 31.05.2017

		1 Mt (%)	YtD (%)
SMI	9'016.64	2.76	13.17
Euro Stoxx 50	3'554.59	1.29	10.56
Dow Jones	21'008.65	0.71	7.47
S&P 500	2'411.80	1.41	8.66
Nikkei 225	19'650.57	2.36	3.65
Gold (USD/fine ounce)	1'268.92	0.05	10.58
WTI oil (USD/barrel)	48.32	-2.05	-10.05
USD 10 years	2.20	-0.08	-0.24
CHF 10 years	-0.17	-0.06	0.02
EUR 10 years	0.30	0.01	0.10
EUR/CHF	1.09	0.36	1.50
USD/CHF	0.97	-2.69	-5.02
EUR/USD	1.12	3.20	6.91
GBP/CHF	1.25	-3.14	-0.84
JPY/CHF	0.87	-2.06	0.33
JPY/USD	0.01	0.69	5.63

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