Für Ihr Vermögen.

Investment Report

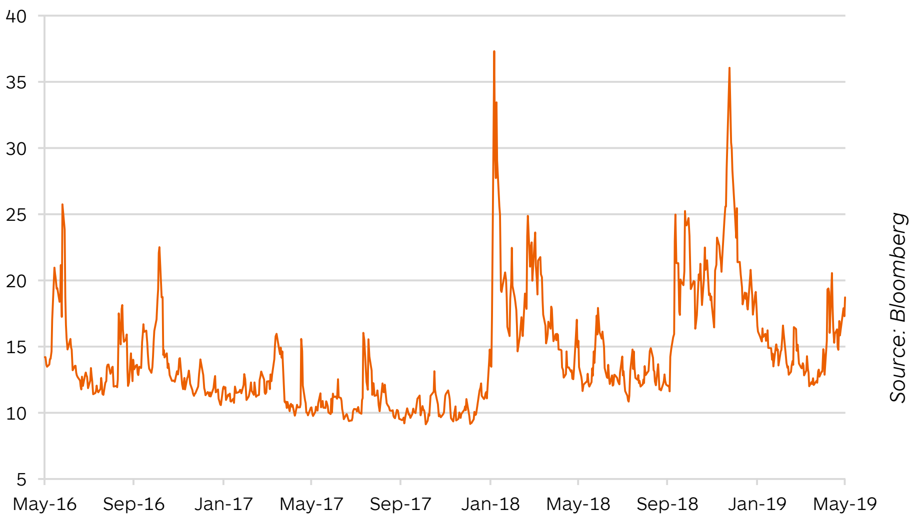
June 2019

Strategy overview

"Are we returning to the 1930s?"

In the 1930s the American "Smoot-Hawley Tariff Act" triggered a trade war that accentuated the recession in the United States. While the significant customs tariff hikes and the responses of other countries were not the cause of the Great Depression, they were an integral part of the downwards spiral of the global economy. Is the world going down this road all over again? Admittedly, the repeated threats issued by the United States and the latest collapse of trade talks between the USA and China are not exactly encouraging. The announcement that the US government was planning to impose punitive tariffs on all Mexican exports to the USA has further dampened sentiment. Volatility, as the following chart shows, has risen slightly. However, this remains far short of the figures seen in December 2018.

VIX Volatility Index - 3 years



The state of the global economy has continued to dampen slightly, and recent data does nothing to suggest that it has bottomed out. It remains the case, however, that a recession in the next twelve months is not our basic scenario. Low interest rates are continuing to shore up equity prices, even if market expectations of an interest rate cut in September in the USA are premature, in our view. Above all political imponderables – which also include the various trouble-spots in the Middle East – could trigger sudden price setbacks.

"Low interest rates are likely to support equity markets."

As noted in the previous Investment Report, we used the positive price gains in 2019 to place our managed portfolios on a more defensive footing in the US equity sector, which helped us last month. Global equity indices – with the exception of Switzerland, also see the Market Overview on the last page – shed between 5% - 8% in value in May. This is a good time to brush up on economic history. Since 1900, there have been only seven 7-week bear runs – measured using the Dow Jones Industrial Average Index – and just one 8-week bear run. We are now in week seven, which gives us hope that the bottom will soon be reached. The Investment Committee is currently discussing whether to use the weak stockmarket month of May to raise the equity ratio moderately.

"Since 1900, there have been only seven 7-week bear runs – measured using the Dow Jones Industrial Average Index – and just one 8-week bear run."

We are maintaining our policy of partially hedging our equity exposure, whereby we closed part of the hedge in May and consequently took the profit. We are sticking to the underweighting of the bond ratio and the overweighting of gold.

"We have closed out a part of our hedging, and consequently took the profit."

Politics

One is getting the impression that politics is playing an increasingly dominant role – but first things first: In Europe, pro-European forces were able to fend off the attack of the right-wing nationalists. However, the newly constituted European Parliament is set to look significantly more fragmented, which is likely to hinder the necessary reform process. In the UK, Nigel Farage's no-deal Brexit Party won 32% of the votes, while the Conservatives were left licking their wounds with a share of just 9%. As the Conservative Brexit hardliner Boris Johnson is moreover the most likely candidate to succeed Theresa May, who is due to step down as party leader on 7 June, the nightmare scenario of a hard brexit is still on the table.

"In Europe, pro-European forces were able to fend off attacks from right-wing nationalists."

At the beginning of May, the United States imposed punitive tariffs of 10% and 25% on goods imported from China worth USD 200 billion, and threatened to hit China's remaining imports with a 25% tariff. The US administration has accused China of breaking its word. China is being accused, for example, of having withdrawn from commitments previously made during the course of the negotiations, which have been going on for months. The USA is demanding far-reaching measures in the fields of market access, intellectual property and enforced technology transfer. It is safe to assume that China will respond to the US customs hikes with countermeasures of its own. Both parties have emphasised, however, that they are keen to continue the negotiations. So what next? This intractable situation is unlikely to change significantly any time soon. No official trade policy talks are on the agenda until the G20 summit in Japan at the end of June, at which Trump and Xi Jinping are expected to meet.

"The trade conflict between the USA and China is one episode richer."

In mid-May President Trump shelved the decision to impose tariffs on car imports by six months, in order to give the EU and Japan time to agree to a new treaty. The background to the protectionist move is the fact that cross-border trade with cars accounts for around one quarter of the US trade deficit. The biggest car exporters to the USA are Mexico, Canada, Japan and Germany. Some of the most important car manufacturers, such as BMW, have already established their largest production works not in Europe, but instead in the USA. EU companies that manufacture in the United States employ around 120,000 people there and export 60% of production – amongst other things to the EU itself. It is rather absurd to assume that global car manufacturers would relocate more of their production activities to the USA if a trade war broke out.

"President Trump has suspended the decision to impose customs tariffs on automotive imports by six months, thereby giving the EU and Japan time."

At the end of May it was revealed that the US government is planning to impose punitive tariffs on all Mexican exports to the USA. A 5% punitive tariff is set to be imposed on Mexican goods with effect from 10 June. These US customs duties would also be steadily raised to 25% by 1 October 2019 if its southern neighbour did not take effective measures to reduce or to block the movement of illegal migrants to the USA. The customs duties would then be left at this level for as long as Mexico failed to tackle the problem.

"The US government is planning to impose punitive customs tariffs on all Mexican exports to the USA."

FACTUM

Economy

The latest escalation of the trade conflict between the USA and China has left its mark on China's manufacturing sector. The official purchasing managers' index for the Chinese industrial sector sank in May from 50.1 to 49.4 points, meaning it has fallen back below the critical growth threshold of 50 points after only two months. As the sub-indicators show, demand eased significantly. The sub-index for incoming orders sank from 51.4 to 49.8 points, while the sub-index for export orders plummeted from 49.2 to just 46.5 points. The job market remains in a difficult state. Employment in the manufacturing sector continued to contract. This meant employment index sank from 47.2 to 47.0 points, which is the lowest it has been since 2009.

"The trade conflict is hitting China's industrial sector hard."

Latin America's biggest economy contracted 0.2% in the 1st quarter. This constitutes the first decline since the sharp recession of 2015/16. The figures highlight the already weak state of the Brazilian economy. The 4th quarter of 2018 saw meagre growth of 0.1%. Investment fell 1.7% in the 1st quarter. Industrial production slipped 0.7% and production in the farming sector decreased by 0.5%. Declining exports meant that foreign trade also hit growth. While imports increased 0.5% relative to the previous quarter, exports fell 1.9%. By contrast, the service sector (+0.2%), private consumption (+0.3%) and the state (+0.4%) made positive contributions towards growth. In year-on-year terms, gross domestic product increased 0.5%, having risen 1.1% in the 4th quarter of 2018. This means the weak recovery following the worst recession since the Second World War might already have run out of steam. Leading indicators for April and May have not shown any sign of improvement to date. For this reason, a further decline in economic output cannot be ruled out for the 2nd quarter. Brazil would then find itself back in recession.

"Brazil's economy is continuing to contract."

It would seem that the escalating trade conflict with China has taken the wind out of the sails of US enterprises. According to provisional figures, purchasing managers' indices (Markit PMI) became substantially gloomier in May. The relevant data was collected in the second half of the month, that is to say after the US imposed punitive tariffs on imports of Chinese goods, meaning that the shock of the escalating trade conflict has been taken fully into account. The PMI Composite, which brings together the performance of the industrial sector and the service sector, plunged from 53.0 points to reach 50.9 points, the lowest level it has been at for three years. The significant slowdown in growth was evidenced by the industrial sector as well as the service sector. At the current level, PMI survey data signal an annualised growth of only slightly above 1%, which would be well below the long-term potential rate of growth.

"US sentiment indicators are clouding significantly."

US consumers are in fine spirits, by contrast. Consumer sentiment recorded by the Conference Board research institute took market-watchers by surprise and brightened significantly in May to reach its highest level in six months. The index improved sharply from 169.0 points to reach 175.2 points. Surveyed households therefore assess the current conditions as better than they have been for 18 years, which is mainly due to the robust state of the labour market and rising wages. There was also a sharp increase in willingness to purchase big-ticket items. Plans to buy cars, houses and household appliances all rose. In fact, the proportion of respondents planning to buy a car within the next six months rose to its highest level since the 1960s.

"US consumers view the current situation more positively than they have for 18 years."

Equity markets

May was an extremely challenging month for international equity markets. The signs increasingly appear to be pointing towards a protracted trade war between the USA and China, heightening fears of a global economic slowdown. Key equity indices around the globe shed between 5% and 8% of their value last month. One exception was the Swiss equity market, which dipped only 2% on account of its defensive quality. In our view, equity markets are currently vulnerable and over-sold. As there are no classic signs of an impending recession (inflation and high real interest rates), we do not think overall demand is likely to suffer a protracted contraction. As already mentioned in the introduction, we are considering whether to raise our equity exposure moderately on account of the bearish month of May.

"Markets currently in risk-off mode, which presents opportunities."

Bond markets

Unsurprisingly, the US Federal Reserve confirmed its wait-and-see monetary policy. This was set out in the Fed minutes of the meeting of 30 April to 1 May, which were published at the end of May. The currency watchdogs are of the view that the current "patient" approach will be appropriate "for some time". US economic growth was described as robust, despite certain signs of weakness in consumer spending and investment in plant and equipment. The robust state of the labour market underscores the healthy state of the US economy, however. Most Fed members also felt that downside risks to the US economy had eased recently due to a slowdown in the global economy and tight financing conditions. For this reason, the Federal Reserve adjusted its medium-term economic outlook marginally upwards. However, this assessment was made before the trade conflict escalated, and may not be valid today. The so-called Fed Fund Rates anticipate a rate cut in the USA in September with a probability of 85%. In our view, this is perhaps a premature assumption. Nevertheless, we believe that if the economic outlook were to deteriorate noticeably as a consequence of the trade conflict with China, the

"Fed fund rates are anticipating an interest rate cut in September with a likelihood of 85%."

FACTUM

Federal Reserve would probably respond immediately by cutting interest rates.

US President Trump's recent tariff threat against Mexico adds another item to the long list of political conflicts. Intensification of the trade conflict with China had already led to a significant increase in risk aversion in the markets, and thus to greater demand for safe havens. The latest turn of events sent yields downwards once again last month. The 10-year US yield dropped 38 basis points in May, and fell to 2.12%. The lowest figure since September 2017. The 10 year German government bond yield sank 22 basis points to reach -0.20%, undercutting its previous all-time low of July 2016. 10-Year Swiss government bonds (Eidgenossen) recently yielded -0.48%, which is 18 basis points lower than in the prior month.

"Rising risk aversion led to falling yields."

The decline in yields in the USA reflects the expectation of many market watchers that the US Federal Reserve could lower its key interest rate this year, against the backdrop of ongoing trade disputes and weak inflation data. Recent developments mean that downside risks have increased. In our view, however, there would need to be a marked cooling of the US economy and in particular of the US labour market before interest rates are cut. Current economic data does not suggest that this scenario is likely. In the short term, however, tensions on the trade front are unlikely to ease, which is why we expect yields to remain low. In the medium term, we continue to expect a rapprochement between the protagonists and, as a result, somewhat higher yields.

"The decline in yields in the USA is anticipating an interest rate cut."

Commodities

The picture for commodity markets is currently mixed. Gold could profit from geopolitical uncertainties, not merely from tensions between the USA and China, but also between the United States and Iran, now that an American aircraft carrier has been sent to the Persian Gulf as a warning. The price of gold gained around 2% last month, and is now back above USD 1,300 per ounce.

"The price of gold gained around 2% last month, and is now back above USD 1,300 per ounce."

Gold price over twelve months

Industrial metals that are dependent on Chinese demand will continue to respond extremely sensitively to any news concerning the trade dispute. In the case of crude oil, a number of factors are at work. Economic risks could mean that demand, mainly from China, grows less strongly. Following the reinstatement of US sanctions against Iran, however, there are also considerable risks for global oil supplies. For this reason, commodity markets are generally likely to move sideways and become more volatile.

"Demand for industrial metals is determined mainly by China."

Currencies

The European single currency is looking weak at the moment. In our view, there are three reasons for this. Firstly, contrary to consensus expectations, economic growth has not got stronger in Europe. Secondly, the interest rate gap relative to the USD suggests that the euro is likely to continue sliding for some time to come. The monetary policy strategy announced by the European Central Bank underscored this on several occasions in recent months. Thirdly, the technical chart analysis shows that below 1.1280 the euro remains vulnerable against the US dollar in the direction of 1.10. The euro against the Swiss franc is determined largely by the momentum of the euro against the US dollar, although during phases of general risk aversion the Swiss franc may rise against the US dollar. For this reason fluctuations in the region of 1.02-0.98 are possible in the short term.

"The European single currency is currently showing signs of weakness."

Market overview 31 May 2019

Equity indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	9,523.98	-1.79	16.63
SPI	11,544.54	-1.62	17.44
Euro Stoxx 50	3,280.43	-5.07	12.42
Dow Jones	24,815.04	-6.32	7.54
S&P 500	2,752.06	-6.35	10.73
Nasdaq	7,453.15	-7.78	12.86
Nikkei 225	20,601.19	-7.45	3.98
MSCI Emerging Markets	998.00	-7.23	4.16
Commodities			
Gold (USD/fine ounce)	1,305.58	1.72	1.80
WTI oil (USD/barrel)	53.50	-16.29	17.82
Bond markets			
US Treasury Bonds 10Y (USD)	2.12	-0.38	-0.56
Swiss Eidgenossen 10Y (CHF)	-0.48	-0.18	-0.23
German Bundesanleihen 10Y (EUR)	-0.20	-0.22	-0.44
Currencies			
EUR/CHF	1.12	-2.22	-0.69
USD/CHF	1.00	-1.83	1.88
EUR/USD	1.12	-0.41	-2.60
GBP/CHF	1.26	-4.86	0.93
JPY/CHF	0.92	1.06	3.15
JPY/USD	0.01	2.91	1.23

Author: Christof Wille, Dipl. Private Banking Expert NDS
Editorial deadline: 31 May 2019