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Investment Report

July 2018

Strategy overview

One half of the year 2018 is already history. Time to take stock of the first six months of the investment year. Investors were able to earn money with commodities and US technology stocks. Cryptocurrencies are looking back at a disastrous first half. The price of Bitcoin fell 56%, while that of Ethereum declined by 45%. As stated at the start of the year, we take a sceptical view of cryptocurrencies. Despite the collapse in prices, we advise against investing in this category of assets. This is because, in our view it is impossible to determine their fair value in the absence of effective benchmarks.

"The cryptocurrency Bitcoin had a disastrous first half – the price collapsed by 56%."

Emerging country assets also experienced a challenging first half. This applied to equities, currencies as well as bonds. The MSCI Emerging Countries Index eased 6.6% at the "total return level". The combination of trade disputes, tightening monetary policies in the United States and the stronger US dollar had a negative impact on these fast-growing economies. If one compares the valuations of emerging country shares with US stocks, the former appear favourably valued within a historical context. The broad-based S&P 500 in the USA gained 2.65% during the first half of the year, while in Europe the Euro Stoxx 50 eased 0.50%. An exception was the French stockmarket, which clearly profited from a Macron effect.

"In overall terms, global equity markets experienced a challenging first half of 2018."

The first half of the year 2018 was difficult for Swiss investors too. Swiss equities came particularly under pressure, partly due to the rise in the value of the Swiss franc against the euro. As a consequence, the SPI index ended the period 4% lower. The two big banks UBS and Credit Suisse fell 14%, and even defensive companies such as Novartis, Roche, Nestlé or Swisscom shed between 8% and 15%.

"Swiss equities came particularly under pressure."

Markets are currently in the grip of the worsening trade deficit dispute and the introduction of punitive tariffs. An escalation of the trade conflict would

"We are responding to the risk of a trade war by partially hedging the equity ratio."

lead to greater protectionism and would weaken the global economy. In addition, production would slow, as it would have a negative impact on supply chains. In recent months, stockmarkets have begun to price in the scenario of a trade war. We are countering this risk by partially hedging the equity ratio, and raised this once again last month.

We remain firmly of the view, however that a trade conflict will be avoided, enabling global equity markets to recover. Conscious of the need to keep its electoral base happy, the Trump administration is determined to ram a number of election promises through before the congressional elections on 6 November of this year. As discussed in previous issues, no country on the planet has a real interest in a trade war, as this would negatively impact everyone.

“We are firmly of the view that a full-blown trade war will not materialise.”

Politics

However erratic the 45th US president appears to be, this has not damaged his ratings to date. In fact, approval of his economic policies has hit a record high. In a survey conducted by the stockmarket broadcaster CNBC, 51% of respondents stated that they were satisfied with Trump’s economic policies. This represents a 6% improvement over the previous survey. 54% are even of the opinion that the economy is in good or excellent shape. No previous president has ever achieved such a positive rating. While this CNBC survey was launched only ten years ago, it is clear that Donald J. Trump enjoys widespread approval.

“US electorate is giving Trump’s economic policies the thumbs-up.”

Populist parties are continuing to boom. Election of the left-wing populist Andrés Manuel Lopez Obrador as President of Mexico is a remarkable slap in the face for the established parties. It should be seen as an expression of the Mexican population's deep displeasure at rampant corruption and the violence of drug cartels. Lopez Obrador announced that he will act against poverty, social injustice and the lack of responsibility shown by the political elite. It will also be interesting to see how the relationship between the newly elected president and his northern neighbour, the USA, develops.

“Left-wing populist Lopez Obrador elected as President of Mexico.”

It would be an understatement to say that this came as a surprise. After the German Interior Minister Seehofer offered his resignation, agreement was eventually reached on a common asylum policy after weeks of fierce arguments between the CDU and CSU parties. There are plans to establish transit centres between Bavaria and Austria. The authorities will use these to house

“Surprise turnaround in the asylum dispute – Seehofer remains Minister of the Interior.”

asylum seekers until it can be ascertained whether another country is responsible for the asylum procedure. If this is the case, then migrants will be returned directly from these centres.

Economy

The US labour market remains in fine fettle. First-time applications for unemployment benefits have fallen for the fourth time in succession and are at an exceptionally low level of 218,000. At 3.8%, the unemployment rate is the lowest it has been for 18 years. Indeed, the last time the rate was lower than 3.8% was back in the year 1969. First-time applications for unemployment benefits also show an optimistic picture. The last time the figure was so low was in the 1970s.

"At 3.8%, the US unemployment rate is the lowest it has been for 18 years."

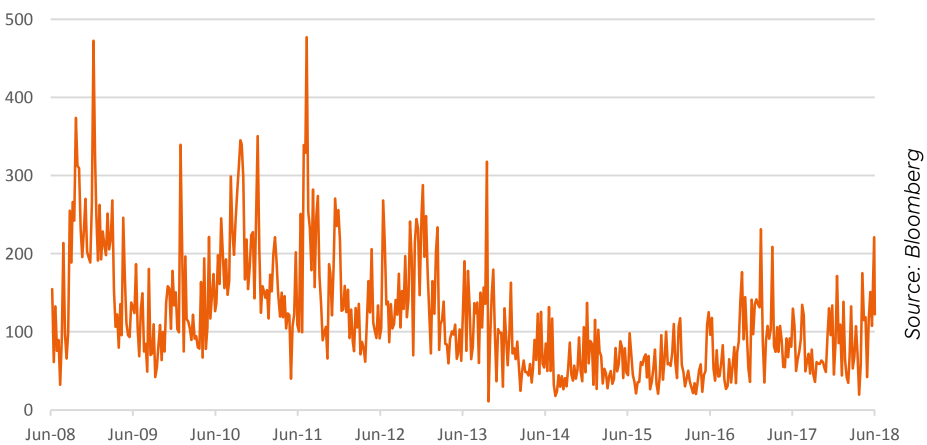
The US economy is clearly in good shape, and has resumed its leading role in the global economic upturn. Whether one views the labour market, leading indicators or the real estate market, things are going well in America. The Atlanta Fed, which prepares current growth estimates on the basis of all current available economic data, has reported that GDP growth in the United States was likely to have reached 4.8% for the past quarter.

"US economy is in good shape."

This does not disguise the fact, however, that recent disagreements at the G7 summit or the looming trade war are casting ominous shadows. The following chart reflects this, showing that political uncertainty in the United States has recently been on the rise.

"Political uncertainty has increased."

US Economic Policy Uncertainty Index



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According to a third estimate, the Eurozone's economy grew 0.4% in the first quarter relative to the previous quarter. This confirms previous estimates. Despite the slowdown at the start of the year, year-on-year growth was nevertheless a robust 2.5%, having been 2.8% in the previous quarter. The current batch of leading indicators is looking less rosy, though. Investor sentiment continued to worsen in June. The Sentix Economic Index for the entire Eurozone declined unexpectedly from 19.2 to 9.3 points, meaning that it has been in decline for the past five months.

"Eurozone losing momentum."

Economic divergence in the three big emerging countries has continued. While growth has remained consistently robust in India and China, the economic situation in Brazil has continued to deteriorate. The Brazilian PMI Composite has also fallen back below the critical level of 50 points for the first time since the end of 2017. The substantial decline in the value of the real is a further indication of the lack of confidence amongst investors.

"Mixed picture for emerging markets."

The Reserve Bank of India surprised market-watchers in June when it raised its base rate for the first time in four and a half years. The base rate was lifted from 6% to 6.25%. The Reserve Bank of India has adjusted its growth and inflation forecasts upwards relative to April. Concerns about inflation picking up is likely to have been the main reason for the hike in interest rates.

"Surprise base rate hike in India."

Chinese foreign trade continues to perform well. Exports kept pace with the high rate of growth, rising by a substantial 12.6% relative to the previous month. Export growth increased to all important regions, with the exception of the EU. If the customs duties, totalling USD 50 billion, that the USA has threatened to impose on Chinese goods do indeed materialise, this is likely to have a tangible negative impact on export growth.

"Chinese foreign trade continues to perform well."

Equity markets

The old stock market saying "sell in May and go away" would have been well advised this year. Announcements of trade tariffs coming out the White House and immediate countermeasures by the EU and China put pressure on prices. Unsurprisingly, the biggest losers were emerging country stocks. There are essentially two issues here: Rising dollar interest rates and concerns about sinking exports in the USA. Over the course of the year, the MSCI Emerging Market Equity Index has lost 6.6% of its value.

"Sell in May and go away – this would have been an excellent strategy in the current year."

At the regional level, we are sticking to our positive view of Europe. Valuations in the United States are decidedly elevated, and the price trend is already well-advanced. This is not necessarily the case in the "Old World". In addition, the US stockmarket continues to be bolstered by cyclical consumer stocks such as Amazon or Netflix as well as information technology. These sectors have posted double-digit gains since the start of the year, and collectively account for almost 40% of total market capitalisation on the S&P 500 Index. We are, for the present, sticking to our neutral weighting for emerging markets and Japan.

"We continue to favour European stocks."

An event of historical proportions occurred in New York. General Electric was removed from the Dow Jones Industrial Index, of which it had been a member since its original foundation in the year 1896. This was the last founding member to leave the index. There had been increasing signs of this move in recent months. GE's stock price has plummeted 55% over the past year. 18 years ago GE had a market capitalisation of almost USD 600 billion, making it the most valuable corporation in the USA. Today the value of the once powerful industrial group has shrunk to around USD 100 billion. A succession of unfortunate management decisions over the years and seismic shifts in global economic balances brought about its decline and fall. Some experts have even been calling for the group to be broken up. The place it vacated in the Dow Jones Index will be taken over by the pharmacy chain Walgreens.

"Historical event in New York – General Electric was removed from the DJI."

Bond markets

As widely expected, the US Federal Reserve raised its key rates in June by 25 basis points to 1.75% to 2%. The decision was unanimous. In view of the strength of economic data and rising inflation, it also came as no great surprise that the Fed adjusted its anticipated interest path upwards. Central bankers in the USA are now expecting three interest rate moves this year, instead of the previous three. This means key interest rates are likely to be lifted again in September as well as in December. For the coming year the Fed's projections are continuing to foresee three interest rate moves, followed by a further rate rise in 2020. The Fed identifies the long-term, neutral interest rate at just under 3%.

"US Federal Reserve raises the pace."

The Fed is decidedly optimistic about the outlook for the US economy. In the accompanying statement, it now described growth as "strong", instead of "moderate" as had previously been the case. Characteristically, the US Federal Reserve Chairman Jerome Powell began the press conference with the statement: "The main takeaway is that the economy is doing very well." Against this backdrop, the Fed lifted its growth forecast for 2018 from 2.7%

"The US economy is looking hunky dory."

to 2.8% and cut the anticipated unemployment rate at the end of 2018 from 3.8% to 3.6%; the former forecast figure had been achieved in the previous month. It adjusted its inflation forecast upwards by 0.2% for the current year, and by 0.1% for next year. By contrast, no changes were made to long-term forecasts.

As expected, the European Central Bank left base rates unchanged. This means the key lending rate in the Eurozone remains at the record-low figure of zero percent. Monthly securities purchases amounting to EUR 30 billion will be reduced to EUR 15 billion from October 2018, provided there is no significant shift in inflationary pressures. Purchases are to be phased out completely by the end of December 2018. The monetary watchdogs reiterated their statement that interest rates would remain at their present level for a prolonged period, well beyond the time horizon of the bond buying programme. The ECB declared that key lending rates would not be raised before the end of summer 2019 at the earliest, and could remain at this level even longer if there is still no sign of a marked hike in inflation in the direction of 2%.

"ECB shelves interest rate turnaround to the third quarter of 2019 at the earliest."

In view of the Eurozone's slowing growth momentum in recent months, the risk has increased that the ECB will raise interest rates only slightly in the current cycle and will then have little room for manoeuvre in the next recession. There is consequently a marked divergence between the monetary policies pursued by the ECB and the US Federal Reserve. While the Fed is already heading in the direction of a restrictive monetary policy by the time next summer arrives, the ECB has not even begun to take its foot off the accelerator.

"Limited scope for the ECB to act when the next recession arrives."

Commodities

At its meeting in June, the Organisation of Petroleum Exporting Countries (OPEC) agreed to boost production by one million barrels per day from July. The real rise is likely to be lower, however, as several countries are having difficulty restoring their full contingents, Venezuela in particular. OPEC is assuming that the actual figure will be 700,000 barrels per day. The meeting was marked by differences between Saudi Arabia and Iran. As Iran is unable to boost its supply for political reasons, it is keen to see prices maintained as high as possible. This aim is contradicted by the increased volume of production. Nevertheless, oil prices rose markedly in the wake of OPEC's announcement. We have replicated the oil sector (oil companies) using a solution created specially for us, meaning we have been able to profit from rising oil prices.

"OPEC agrees to boost production volumes."

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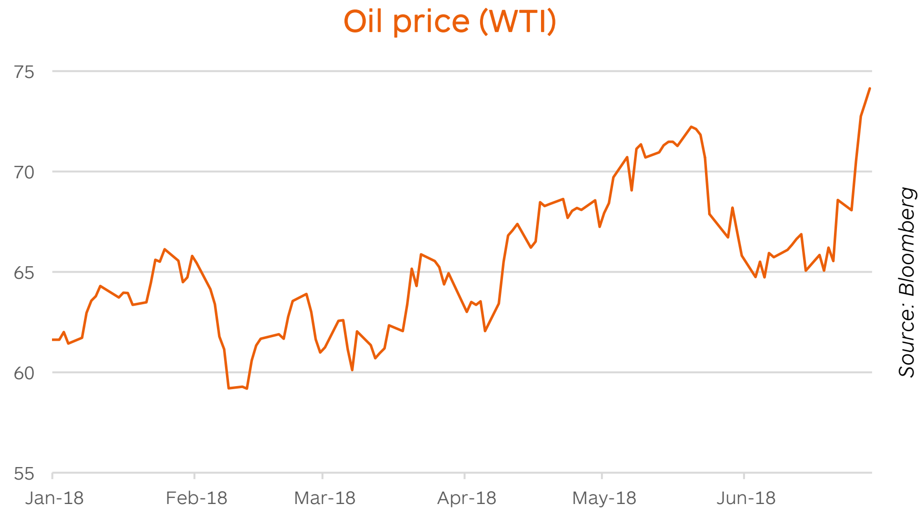

Despite the marked rise in uncertainty, the gold price has not shifted significantly. Quite the contrary: it has actually fallen 4% in the current year. One reason for this might be the moderate rise in real interest rates in the USA. We are sticking to our overweighting of gold, however, as a protection against inflation and as a so-called "safe haven" in the event of an escalation.

"Despite the weak price of gold, we are sticking to our exposure."

Currencies

The weakness of the European economy is currently depressing the euro while at the same time strengthening the greenback. Consumer growth in the retail sector is a good example. While year-on-year growth in the USA reached 5.9%, the figure in the Eurozone was just 1.7%. This is weakening the euro and strengthening the US dollar. History teaches us that when the dollar strengthens against the euro, it also often rises in value against other currencies such as the Japanese yen, the Brazilian real, the Russian rouble or the Swiss franc. This is because the euro accounts for by far the largest share of the trade-weighted US dollar, which explains the demand for US dollars.

"Eurozone's weak phase is burdening the euro."

The ECB contributed to the weakening of the euro at its mid-June meeting. It reduced its forecast for gross domestic product within the Eurozone for 2018 from the previous figure of 2.4% to the new figure of 2.1%. This is a weaker forecast than the market consensus, and caused the euro to drop by almost 2% within hours.

"ECB reduces GDP forecast from 2.4% to the new figure of 2.1%."

FACTUM

Market Overview 29 June 2018

Stock indices	Current	1 Mt (%)	YtD (%)
SMI	8,609.30	1.80	-5.16
SPI	10,327.29	1.60	-3.95
Euro Stoxx 50	3,395.60	-0.16	-0.47
Dow Jones	24,271.41	-0.49	-0.73
S&P 500	2,718.37	0.62	2.65
Nasdaq	7,510.30	0.98	9.38
Nikkei 225	22,304.51	0.57	-1.06
MSCI Emerging Markets	1,069.52	-4.13	-6.60
Commodities			
Gold (USD/fine ounce)	1,252.60	-3.54	-3.85
WTI oil (USD/barrel)	74.15	10.61	22.72
Bond markets			
US Treasury Bonds 10Y (USD)	2.86	0.00	0.45
Swiss Government 10Y (CHF)	-0.06	0.00	0.09
German Bund 10Y (EUR)	0.30	-0.04	-0.13
Currencies			
EUR/CHF	1.16	0.37	-1.13
USD/CHF	0.99	0.49	1.67
EUR/USD	1.17	-0.08	-2.67
GBP/CHF	1.31	-0.19	-0.64
JPY/CHF	0.89	-1.24	3.48
JPY/USD	0.01	-1.70	1.80

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