LimmatWealth

Investment Strategy – December 2017

Data & Forecasts

	Growth (%)		Inflation (%)		Equities		
	GDP 17	GDP 18	CPI 17	CPI 18	Actual	3 Mths	12 Mths
Switzerland	0.9	1.8	0.5	0.6	10'722	↗	↑
Germany	2.2	2.0	1.7	1.6	13'032	↗	↑
Eurozone	2.2	1.9	1.5	1.4	3'569	↗	↑
UK	1.5	1.4	2.7	2.5	7'333	↗	↑
USA	2.2	2.5	2.1	2.1	2'642	↗	↑
Japan	1.5	1.2	0.5	0.8	22'707	↗	↑
Brazil	0.7	2.5	3.5	3.9	72'264	↗	↑
Russia	1.8	1.8	3.7	3.9	1'131	↗	↑
India	7.1	6.7	4.5	3.5	32'870	↗	↑
China	6.8	6.5	1.6	2.2	3'310	↗	↑

	Bonds (10 Years)			Currencies (vs USD)		
	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Switzerland	-0.13	0.00	0.25	0.98	1.01	1.00
Germany	0.33	0.50	1.00	-	-	-
Eurozone	-	-	-	1.19	1.17	1.20
UK	1.27	1.40	1.70	1.35	1.30	1.30
USA	2.39	2.50	2.75	-	-	-
Japan	0.04	0.00	0.00	113	114	112
China	3.93	3.70	3.60	6.62	6.65	6.65

Review – Quick burst of volatility leads to mixed markets

Last month the VIX Index, a market estimate of future volatility in the S&P 500 Index, reached its highest level since August. This quick burst of volatility in the markets in mid-November led to a mixed result for equity markets around the world. Major global equity markets were led by Japan (+3.2%), the US (+2.8%), and Russia (+1.6%) while markets in the UK (-2.2%), Europe (-2.8%), and Brazil (-3.1%) lagged last month. Swiss stocks finished the month in positive territory (+0.7%) bringing their year-to-date performance to +19.1%.

Yields on ten-year government bonds barely moved in developed markets in November. Ten-year yields increased slightly in the US (+0.03% to 2.41%) while they decreased in Japan (-0.03% to 0.04%) and Switzerland (-0.04% to -0.12%). Ten-year government bond yields remained unchanged in Germany (0.37%) and the UK (1.33%). Yields in emerging markets showed more volatility, especially in Brazil (+0.49% to 10.36%), and India (+0.20% to 7.06%).

Currency markets were impacted by the depreciating US Dollar in November. The US Dollar lost ground against most major currencies, most notably against the Euro (-2.2% to USD 1.19), Swiss Franc (-1.4% to CHF 0.98), and the British Pound (-1.8% to USD 1.35).

Alternative investments such as hedge funds and gold finished the month unchanged. Hedge funds added to their best year since 2013 (+0.1%) while gold closed the month at USD 1,275 per ounce (+0.3%).

Outlook – Earnings growth to continue in 2018

Global earnings look set to deliver double-digit growth this year. Earnings of global equities as measured by the MSCI World Index are on course to grow by almost 18% in 2017, the best year for global earnings since 2010. The strength is broad-based with all key regions contributing (see table below).

Country/Region	EPS Growth (2017e)	GDP Growth (2018e)
World	17.9%	3.6%
Switzerland	5.7%	1.8%
Europe (EU)	8.7%	2.0%
Eurozone	13.1%	1.9%
US	12.9%	2.5%
UK	16.4%	1.4%
Japan	17.7%	1.2%
China	27.0%	6.5%
Emerging Markets	30.5%	4.9%

Source: Bloomberg, Limmat Wealth (as of December 5, 2017)

Although base effects are turning less favorable, we believe earnings will remain supportive for equities in 2018 mainly due to four reasons:

- Global activity is forecasted to stay robust next year and GDP to grow at above trend pace in most countries (see table above).

- There is room to grow for the absolute level of profit margins in Europe. Interestingly, US profit margins also do not appear all that stretched. In aggregate, they are at similar levels today as in 2011. Corporate pricing power is improving and some of the margin pressure from higher input costs in 2017 should ease going forward.

- FX movements might have less of an impact next year than it had this year.

- Consensus expectations for next year are not overly demanding at 10% earnings-per-share (EPS) growth in the US and 9% in the Eurozone. In the past, these typically ranged between 12% and 15%. In addition to this, none of the potential impact of US tax cuts is yet reflected in analyst projections.

As we have written in last month's investment strategy, we believe that the rally in equity markets is not going to end soon. We currently do not see any fundamental signs that could negatively affect the markets and EPS growth worldwide is supporting this view. We are positive on all major markets over the next twelve months but we expect an average year for equities in 2018 (6-7% performance).

The probability of a further interest rate hike by the FED in mid-December is over 98 percent now. This hike is fully priced in and should therefore not lead to any surprises. We expect only gradually higher interest rates in developed markets in the mid-term and therefore bond markets should not be negatively impacted.

We do not expect a lot of volatility in the currency markets short-term.

Alternative assets and strategies will more and more shift into focus as equity markets edge higher. As mentioned in earlier investment strategies, the current environment with higher volatility and lower correlations is ideal for most hedge fund strategies. Barring any unforeseen events, hedge funds will finish 2017 with the best yearly performance since 2013. It makes sense to diversify early enough into asset classes that we expect to perform well in a more challenging market environment. We maintain our gold position for diversification reasons.

December 6, 2017
Limmat Wealth Ltd.