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Review

A politically and economically tough year for the capital markets has gone by with a renewed collapse of crude prices and the overdue decision by the Federal Reserve Bank to raise rates for the first time after almost 10 years. Economic growth in China due to high debt levels and low capacity utilization has been disappointing and so has been the contribution of the remaining emerging world. With the Western economies being the main drivers of global GDP, economic growth was only around 3% and that has been reflected in capital market returns. 2015 was one of those years where no asset class be it bonds, equities, commodities or precious metals have achieved very positive results which made it very hard for an actively managed global portfolio to generate satisfactory returns. The Euro based investor, however, has benefitted from the relatively strong Dollar and the positive European equity markets, especially the German DAX. This gave the investor another positive year of about 4% plus which still is an acceptable result, given the inflation and risk free rate near zero percent.
The political events of the past year in and around Europe, and not least the wave of refugees of more than 1 million people from the Middle East have also contributed to temporarily unsettle the capital markets. In addition the Western world this year has experienced a dramatic increase in terror attacks with more than 30.000 victims. This has alarmed all democratic political leaders and forced them to commonly act against the terrorist cells in the Middle East. It has generated the hope that the tensions among the leading nations especially with Russia will soften over the course of the year. Furthermore it is encouraging that Syria and Libya are supposed to open peace negotiations early in 2016.

Outlook

The current economic and monetary data only point to a slight increase of global economic growth in 2016 of somewhat more than 3%. This would mean another year of transition on the path to more normal monetary conditions, but with increasing divergences. In case of the further economic recovery with relatively low unemployment and a soft revival of inflation the USA should continue to raise interest rates in a second and last step before the November elections. It should happen not later than early summer while the rest of the world will still be forced to ease monetary conditions. The US Dollar should remain stable at around these levels and US companies should face not only rising financing cost but also even a stronger domestic and international competition. 2016 could turn out to be another year of weak top line and bottom line growth. European companies, however, would be somewhat better positioned. They will still benefit from a relatively strong Dollar, monetary easing and rising public investment programs due to the refugee crisis. On top of this Germany in particular should benefit from expected real wage increases

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which would create an additional economic stimulus in 2016 through rising consumption.
Other drivers of global economic growth, China, Brazil and Russia, are still stuck in various problems. The latest Chinese data do not hint to an imminent stabilization and a turnaround of its economic affairs yet, although government action has been very supportive. Brazil still is caught by the collapse of the commodity and oil markets, the erosion of the currency, high inflation and by various corruption scandals and Russia is still feeling the tight grip of the economic sanctions. As long as a material recovery of the three BRIC states is not in sight, the world commodity markets and the commodity prices should not be able to substantially improve. The gradual amelioration of the Chinese economy together with the end of the sanctions against Russia, today a joined partner in the fight against terror, and the stimulus through the Olympic Games in Brazil could, however, become a trend changer in the second half of the year.

Capital market outlook

2016 will be another challenging year for investors. Political insecurity due to upcoming elections/referendum, only modest global growth and rising rates in the USA will lead to increased volatility in the Western bond and equity markets. The end of the bull market in US bonds could be upon us. Depending on the strength of the US business cycle yields on 10-year government bonds could rise to 3%. This will influence European bond markets as well despite the prolonged ECB repurchase program. This development would lead to capital losses of longer dated government bond investments and of lower rated debt instruments in the years to come, which would worsen the attraction of this asset class even more. In this respect, the risk of default of related high yield bonds as a consequence of the commodity crisis would further increase, which should negatively affect the banking system as well.
Therefore as an alternative to cash, investors will be forced to adjust their investment risk profiles to changed market conditions and to invest in the industrialized equity markets, even though the forced liquidation of large equity positions by many state funds of the Middle Eastern world will not abate soon in order to meet their budget requirements. The emerging equity and bond markets do not offer an alternative yet and it is too early to call, when they will re-emerge as an attractive asset class.
The experience of 2015 questions the validity of a managed globally diversified asset allocation, which would offer a decent return perspective. It would only be recommendable, if markets were able to decouple performance wise, although it cannot be excluded that the EU equity markets and the German in particular offer certain performance advantages due to the relative lower valuations.
From a global perspective, however, it seems to be again recommendable to concentrate on a diversified industry and stock selection in order to meet this year’s return requirements. As mentioned in previous reports an appropriate selection of liquid, high quality and mostly debt free companies with a dominant global market and product penetration should do well as in the past even under changing monetary conditions and lower growth expectations. The strategy at the start of the year should still be: stay with the winners.

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