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Review

The capital markets had a difficult year 2016 with a very positive finish of the US Dollar and the equity markets. Slower than expected economic growth, Brexit, terror threats and the US election caused an emotional roller coaster among investors and led to increased volatility in all capital markets' aggregates. The central banks had still dominated the first half of the year with quantitative easing policies for fear of a collapse of the commodity and some emerging markets and of a renewed stress of the international banking system. The culminating points laid in the months of February and July. The excessive growth in the money supply and temporary negative interest rates in Europe and Japan helped these countries, especially Brazil and Russia to recover in the aftermath.
Politics were the dominating factor in the second half of 2016. The ballot in Britain over Brexit, in the USA with the presidential election and at the end Italy with the turn down of the referendum was a complete rebuff against the political establishment that has been in existence for many decades. The public in these countries has made very clear that they want a complete directional change in politics. It includes limits on immigration, the end of wage dumping through globalization, a fair distribution on income, future economic security and the restoration of national pride. With pending elections in France, Holland and Germany, state and government, these trends could run even further.
After the shocks namely in Germany and the EU had somewhat abated investors have returned to the markets, trying to evaluate the future global economic growth prospects, the longer term consequences of the second interest rate hike of the US central bank for the bond markets and foremost of the political concepts of Mr. Trump and his 100 day program. To the surprise of most observers and despite all warnings beforehand, the financial markets have reacted positively after the elections. The US equity markets have made new all-time highs since then also pushing other Western stock markets to the long awaited upside, in expectation of the creation of additional economic growth from new fiscal and economic programs. It also has helped to strengthen the US Dollar, while the bond markets have tended to the downside.

Outlook

Despite all political worries, consumption in the industrialized economies has been supportive, which should enable the global GDP to return to higher growth rates in 2017, despite likely further interest rate hikes back to normality by the FED over the course of the year. High employment, higher wage settlements and rising general cost of living should be the main drivers. Despite of rising inflation expectations, however, corporate earnings should continue to rise in absolute and relative terms in the Western economies, still giving the equity markets further upside potential even in the USA, where valuations have already become somewhat tense.
Until the inauguration of Donald Trump in January and his first 100 days in office, many questions will remain open as to the extent and to the speed of his announced changes and implementations of his plan to make America great again. The

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complexity of his program would pose an extraordinary challenge for the entire USA, its citizens, corporations and last but not least for its administration in Washington. In fact, the implementation of his vision of the world and his home country could be the start of a comeback after nearly 20 years of political slack or a risk of a failure, too. May it be as it is; it seems to be realistic, to expect the start of major and large infrastructure programs in order to improve the US American economic region, a tax reform for the middle class and its corporations. A program to enable a tax friendly repatriation of foreign funds of US multi nationals and the deregulation of financial services is also high on his agenda as well as the future immigration policy. An early implementation could be another driver for a stronger US Dollar.
The impact of the new American agenda would definitely affect EU policies on top of various important elections ahead. The political pressure on the unresolved questions of a possible Brexit, the restoration of the EU banking system and the safeguard of civil security will impose additional stress on Europe’s policy makers.
To put the situation into a nutshell, 2017 could politically become a bumpy and economically a transition year, before the dust will have settled and politicians will be back at work in 2018.

Capital market outlook

After a prolonged and late economic cycle with its various ups and downs, investors will find it not easy to properly evaluate the return and risk perspectives of the various asset classes for this year. The better prospects in the USA, however, should still drive the US$ higher against other major currencies. Therefore, it should grant the European exporting companies at least for most of 2017 an additional competitive advantage despite the various unresolved structural and fiscal problems still pending. On top of that, the EU equity markets are considered still to be relatively cheap and their bond markets unattractive. Japan should also benefit from the weaker yen and if the reforms should finally take effect, the outlook for the stock market should remain attractive.
The fiscal stimulus in the USA should also help the world economy and the emerging markets, especially those with large resources like Brazil and Russia. Oil should stay stable, as the additional demand should be met by greater US shale oil production. Although the emerging markets, especially China and Mexico, but also the developed countries should face tougher trade conditions under the new administration, they should however be manageable, once the US economy should gain additional momentum.
These should be positive aspects for further stock market advances, but not so good for the government bond markets as rates are likely to go up in this more inflationary late cycle environment. Given this outlook, preferred areas of equity investment should be financials, technology, internet, some basic resources, industrial, construction and health care. The Euro based investor should additionally benefit from a higher US$ allocation and has to be prepared to deal with an increased equity volatility especially if trade talks with China and the new US administration should get hostile.

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