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Review

Wall Street started February with a strong downward movement, putting the Dow and other equity markets within a few days in correction territory with losses of 10% from the top and more). Stretched valuations, inflationary fears and weakening bond markets caused by a weak US $ and rising commodity prices have led to profit taking and to a very quick and hefty sell off in equities after a long bull run. After months of extreme low market volatility, the VIX Index spiked to recently unseen high levels. Investors were caught by surprise and have begun selling to protect their portfolios especially in the cyclicals. The 10-year US Treasury bond yield had nearly reached the critical 3% level, equally affecting all other industrial bond markets in all maturities. Oil dropped briefly to 58$, copper close to 3 $ per pound, while the price of gold stayed relatively flat around $ 1340. The US $ has twice shortly topped 1.25 against the Euro finishing at 1.234 at the end of the month.
The Dow Jones and the S&P500 have already recovered about half of their losses over the course of the month. As quarterly earnings and economic numbers were all in line with expectations most US market participants obviously have not lost their confidence in the US and global economic outlook. Rumors about big short positions by a US hedge fund in European equities made participants even more nervous and, although, some investors used the fear to pick up assets at reduced prices, the German and other European equity markets have not been able to catch up with the US stock market recovery. The reasons presumably lie in the abstinence of foreign investors who meanwhile are at least confused if not concerned about the political development in Germany, Great Britain, Spain, Poland, and Hungary and possibly in Italy after the elections.

Economic Outlook

From todays' point of view, politics should be the only real risk to the future uptrends of the equity markets. Political irritations from Europe should persist for the rest of the year. A possible impeachment of Donald Trump on the other side of the Atlantic, which can still not be totally excluded for the time, should negatively affect the capital markets as well as a still pending implementation of trade barriers by the US President. Therefore higher price volatility in the bond, equity and commodity markets should become realistic from now on. On the other hand, economically things still look great. In the USA, unemployment will stay low and elsewhere employment is rising. Globally, infrastructure investments and capex should continue to grow and the digitization of the world is in full swing. Corporate profits will be strong throughout 2018 and rising labor productivity and further private consumption should additionally support this trend.
The current economic cycle in the USA is further advanced than in the rest of the world. Therefore, the positive interest US rate differentials against other countries should eventually lead to a slightly stronger US Dollar over time, which should help boosting the European and Asian equity markets, at least, until interest rates should start to rise there as well.

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Capital Market Outlook

From an economic perspective, the overall attraction for equity investments should persist and therefore the overdue correction of the equity bull markets around the globe should offer another long term buying opportunity. The sharp correction should take some time of repair, but various market leaders of the past in the fields of IT, technology and digitization, semis and consumption innovation have recovered large parts of their losses or even have achieved new highs. This has especially applied to the US but to some extent also selectively in a few European stock markets. The long-term trends for Technology, especially semiconductors, sensors, Fiber optics and Artificial Intelligence are emerging and these companies should be part of every equity portfolio.
The European equity markets have surprisingly lagged because of their cyclical exposure towards traditional industries and their political adversities. France might become an exception. President Macron has provided the political direction of the renovation and reforms of the country towards economic growth, employment and prosperity. The unconditional labor reform already passed and the tax reform on its way should pave the way for the restructuring and realignment of the entire French economy and its industries. All French companies and those with large assets in France, in particular, should become long-term profiteers from these measures. Investing in France, therefore, could emerge to become an interesting investment theme. The future relative performance of the French Index bears watching.

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