DIPL.-KFM.
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Zinnecker Monthly 04 / 2015

Current Situation

While the capital markets have handled to a certain degree the currency and oil price changes in recent months, the central banks in the US and the EU have been troubled to achieve their targets in terms of growth and inflation in the foreseeable future. Although the goal of full employment has been achieved with 5.2% in the US and savings from energy price reductions have helped households, consumption growth has not picked up to the desired degree. In addition, the rise of the dollar has led to lower growth expectations in the USA so that the pursued inflation target of 2% does not look achievable in the near future.
This also applies to the EU, although the economic horizon has considerably brightened by low oil prices and the euro devaluation. This is especially true for Germany. The ECB has finally put by the skin of one’s teeth the monthly 60 bln Euro bond purchase program into action. At current yields the ECB obviously has not been very successful to collect the required amounts from the market.
Bruxelles has been haggling over the continuation of Greece in the EU currency union without any visible success and as long as the struggle goes on the ECB is not allowed to purchase Greek government bonds. It is for the citizens of Germany, France and other European nations completely untraceable how little the last two Greek governments have undertaken to collect unpaid taxes and to eliminate tax fraud. It is absolutely incomprehensive that France and Germany have made such allowances for Greece in this question, two countries that have aggressively pursued its citizens in this matter over the past. Der Spiegel recently reported that in Switzerland alone about 600 bln Swiss francs are deposited on accounts held by Greek citizens and presumably are not taxed. In March another 3bln. Euro after 7.6 bln in February of 2015 have been drawn from accounts in Greece according to the Greek National Bank.

In Japan, at least, the world seems to be in order again, despite the relatively slow recovery after the recession. Nevertheless, during the last quarter in local currency the Japanese stock market rose by 10% (Nikkei225) after the EU with +14% (STXE600) and the USA with only +1% (S+P500). The so called “Japan Incorporation” from the Eighties has obviously decided to put an end to the malaise of its stock market by starting aggressive stock buying programs which have helped the market to move to new highs.

Economic Outlook

The US central bank has reduced at its last meeting this year's GDP slightly to 2.3 - 2.7% and inflation rate to 0.6 - 0.8%, quite a distance from its target of 2%. Nevertheless, the central bank seems to be preparing for the end of the easy money policy in anticipation of a gradual recovery of exports and the housing market along with a continued improvement in the labor market.This would be the first rate hike in years and would end the longest period of easy money in the Fed's 100 year history.

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This decision should be seen as the first step to more normal economic conditions and not as a complete reversal of the monetary policy.
The EU and the UK should particularly benefit from the QE program of the ECB. In addition, the positive effects of lower oil prices and the strong US dollar should not only drive the general growth prospects in this region during the year, but also help a lot of companies to grow their revenue and reduce their cost. The ongoing investment programs to improve the EU infrastructure will form an additional element of growth. The oil price and the Dollar should also help countries such as India, Indonesia, Japan and various countries in Africa and South America to improve their future economic perspectives.

Financial Markets

After two quarters of strong capital market performance the question arises what is already priced in? The bond markets, which have stalled since the start of the repurchase operation of the ECB will be driven primarily by the further development of the inflation rates. This also applies to the United States, which also will have to contend with the rising dollar, weak labor productivity in the manufacturing sector and only moderately rising wages and salaries.Despite a possible rate hike in the U.S. the global deflationary trend should continue throughout 2016, so yields of long-term government bonds should continue to decline. This is especially true for the EU despite the Greek problem. Although the scope for further interest rate reductions will be much smaller than in the past, this interest rate cycle may actually not come to an end so soon regardless of the doomsday predictions of various interest gurus. Weak global economic growth and the difficult capital market conditions everywhere will require lower and not higher rates.
Stock markets, as everyone knows, are valued in relation to the long-term statistical average and to the risk free interest. Valuations look high by historic measures, but they look relatively cheap in respect of the deflationary interest rate spectrum. As there is no historical experience it is for the markets to figure out the correct valuation of bond and equity prices and at some point in the future the markets will be too expensive and then will correct itself. This also could culminate in a stock market crash as witnessed in 1987 which, however, would emphasize nothing more than the confirmation of a secular bull market. We are still far way away as of today and if, for instance, one applies Japanese top valuations in 1989 at 40x earnings this would mean about 5000 for the S&P500.
At short term the consolidation of the stock markets, at least in the US and in Europe should continue until some inconsistencies will be eliminated. These include the weak quarterly earnings of many US companies caused by the weak oil price and strong Dollar the uncertainty of the outcome of the negotiations with Greece connected with temporary currency turmoils and last but not least the global economic and oil price development over the summer.
Since the fundamental outlook continues to stay positive and the technical picture of the equity bull markets remains intact, sharp price corrections should therefore be used to increase equity positions by reducing bond, money market and cash positions. The European stock markets look particularly interesting. In addition to the improved economic outlook there is the rising problem of infrastructure damages all-over the EU, which need immediate public attention. The closure of the Schiersteiner Bridge between Wiesbaden and Mainz, a main artery in the Rhine-Main area, and the recent blackout in Amsterdam and Schiphol Airport are just the tip of the iceberg.

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