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Review

The summer season is slowly ending and the Western Equity markets have consolidated since May of 2017 for several political reasons, not only in the USA but also in Europe and Japan, while Government bond markets have recovered from their July lows. Global growth has continued on its positive path and the Western Central banks have maintained their accommodative monetary policies. Corporate earnings continued to be strong, but equity markets were not able to break out to the upside. Europe and Japan have suffered most with index losses of about 5% from their tops due to their strong currencies against the US Dollar, while the US equity markets have moved sideways and have relatively performed much better than predicted by important market observers. Over that period, the emerging stock markets in Asia and Brazil have benefited from international capital inflows. Western government bond markets have mostly recovered from their losses, as fears of another US rate hike have waned at midyear. After the meeting of the central banks at Jackson Hole, it is very unlikely that interest rates will rise this year, and if at all, then in the USA at yearend.

Outlook

9 years after the global financial crisis, central banks must still maintain their ultra-light monetary policies to further stimulate global economic growth. Despite stronger economic and business numbers from the USA and Europe of late, the support is still needed to help the banking system to overcome still existing deficits in various business segments namely in Europe. This is a very difficult task, because digitalization on the way to industry 4.0 is not only destroying jobs in nearly all economic areas but it permanently creates wage pressure in traditional industries and social tensions.

Internet of things and industry 4.0 have become keywords in the public discussion. The Western governments will have to tackle these issues through infrastructure investments, new concepts of education, pension and health reforms together with a completely modernized administration, if they do not want risking their public credibility. These are huge tasks for the elected leaders in the USA, Japan, in Great Britain, Germany and France. France needs to completely reform its labor markets, Germany and France need to reform Europe, and the U.K. needs to deal with Brexit. In the USA the Trump administration together with Capitol Hill, will finally have to fulfil the election promises. Until today, Mr. Trump has not delivered on infrastructure, border tax, the Mexican wall and health care. The very important tax reform is the project for September and the chances that it will become law is reasonable, since the Republicans want that law to be passed, too.

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Therefore, the month of September is crucial not only for the societies involved but also for the future of the capital markets. Ms. Merkel could become the most powerful democratic elected leader in Europe with a mandate to reform Germany and the EU. If she and Mr. Macron should fail and the USA should not get the tax reform on the way, capital markets will retreat significantly.

Capital Market Outlook

Geopolitical problems, the lack of reforms and governmental credibility have lately casted a cloud over the very positive economic climate and the capital markets. Despite strong profit growth, which has helped to reduce the rich valuations, equity markets have consolidated through profit taking over the summer months. Investors meanwhile are questioning how long a Trump government can last and therefore they have divested into the Euro, which has strengthened significantly.
European equity markets have suffered from the currency headwinds and the intensified and confusing discussion about the future of mobility and the combustion engine without a clearly defined economically viable exit strategy. The ongoing discussion and the recent zigzag course of Ms Merkel in this matter is especially worrisome with the unprecedented and costly experience of the German nuclear power exit in 2011 still in mind. In Germany, every fifth job directly and indirectly depends on the automobile industry, which still is unconditional to economic growth and public wealth. The already nervous German population therefore expects a clear credo from its politicians about the future job security in Germany’s largest industry. This topic should be highly raised during the current election campaign. The answer will be directional for the social and economic future of the German society.

Once, these obstacles and controversial assessments will be out of the way together with a stabilization of the currency markets and a rerating of the US Dollar the two preferred equity markets then should resume their bull markets. The tailwind from a decent domestic economy plus an immediately starting recovery program of an estimated size of 125 bln US Dollars for the wider Houston and Southern Texas areas should further support the US economy and should increase the profits of US corporations over the coming quarters. On top of it, a 2017 tax reform should grow corporate earnings of another 6 % on average in 2018.
The same should become true for the European equity markets, once the German election is over and a coalition under Ms Merkel with hopefully new partners will paint a directional clear political and economic friendly picture, wherein a realistic future for Germany and together with Mr. Macron for Europe will be comprehendible for the European citizens.

In fact, 2017 still could emerge as a great year for stocks, even if it still could take a while until they will finally kick off. The major beneficiaries have not changed and there might come up a few more new names due to the recovery of the emerging markets. Therefore, in addition to the winners of digitalization, stocks from capital goods, metals and mining, transportation and financials could join in. Gold has recovered a little and is displaying some positive momentum. Bond market yields over time might come under some pressure due to stronger global economic growth.

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