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Review

Against all odds, the capital markets have done quite well in the month of October, despite headwinds from the political front. The humiliating and disturbing presidential TV debates between Ms. Clinton and Mr. Trump, the depressing Syrian conflict without any perspective of a humanitarian solution, the designated exit of Great Britain from the EU and the worries about the changes in the democratic landscape in sight of the upcoming national elections in Germany and France have given the public a lot of concern. The capital markets, however, dealt with these concerns extremely well. They were focused on future monetary decisions of the central banks, and on economic, commodity and corporate developments. In the currency markets, the US dollar rebounded after months of uncertainty, while the bond markets have begun to adjust modestly to potential interest rate changes. After initial weakness, the stock markets have recovered over the course of the month in anticipation of the publication of reasonable quarterly earnings. With rising interest rates on the horizon, M&A-activity has picked up considerably, culminating in the $108bln ATT - Time Warner merger.

Outlook

Two events will mostly determine the capital market movements over the next few weeks, i.e. the outcome of the US elections and the interest rate decision of the US Federal Reserve Bank. One can only hope that the US polling is more accurate today than the Brexit polling in June, which sees Ms. Clinton as the next president in the White House. It should please the capital markets in first instance, but it is already obvious that the next term will be very challenging for the new administration. The USA and other Western democracies, too, have undergone a social and demographic change for many years, which has accelerated through demographics, globalization and digitalization. The existing social contract between the rich and educated and the poor and uneducated was already broken decades ago. Brexit, enthusiasm for people like Donald Trump and Marine de la Pen or for the young movement of the AfD in Germany are the mirrors of the beginning social unrest and the dwindling credibility in today's existing democratic administrations.

The answer lies in the ability of upcoming new administrations to create a modern social and industrial infrastructure that leads societies into a safe and prosperous future. Although the programs for the renovation and modernization of the US infrastructure and its financing are not visible yet, it is unconditional that these programs at a possible dimension like the programs from the sixties will have to start with the new legislative period, if the USA do not want to fall behind globally.
The situation is not very different from Europe. In Germany, however, even without big public announcements large capital spending programs for highways, housebuilding and infrastructure have already been placed. The just released $19,5 billion Heathrow Airport reconstruction bill in London points into the same direction,

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and it is just a question of time, when Brussels and France will join in. The allover economic climate could therefore get an additional push on both sides of the Atlantic in 2017.

Capital market outlook

Against this background, it should make a lot of sense for the central banks to pull back slowly and to start the monetary change towards a normalization of their monetary policies. With a large probability, the Fed will raise the interest rates for the second time after the elections. It also could create a precedent for the ECB to close the QE Program in March of next year that has been in existence since 2015, unless France and Germany in the forefront of national elections would put pressure upon Mr.Draghi to extend this program for another year.
The money and the bond markets as already in the past should further adapt to the changing monetary conditions. As there is not an external pressure arising from the inflation front, the second hike should be smoothly digested by the capital markets. A move from zero interest rates to a normal interest rate environment should be regarded positively and should not cause any frictions for the statistically already highly priced equity markets for the future. The old American stock market rule “Three steps and stumble”, i.e. three interest rates in arrow by the Fed, therefore, still lies far ahead.
Equity investors from now on will focus not only on the presentation of the latest quarterly earnings’ reports but even more intensely on the 2017 earnings’ developments and estimations of the various industries and their enterprises. After two years of meager earnings’ performances, the expectations of an improving global economic environment, negative future bond returns and relatively high institutional cash holdings signal that the stock markets should switch to green again. From my point of view and as usual without any obligation, the arguments presented herein suggest that the time has come for an extended year-end equity rally, especially for the EU.

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