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Review

In anticipation of a more restrictive US monetary policy into 2018 the Western fixed income markets under the lead of the USA have continuously lost ground since the beginning of September with the exception of wrongly priced Portugal. Two-year treasury yields have risen more than 35 basis points ever since pricing in another rate hike in December. Due to widening yield spreads the US $ has started to strengthen again against the Euro and the Yen after it had devalued by 13% and 7% respectively since the start of the year.

In contrast, the developed equity markets have resumed their bull markets after the summer consolidation. At the end of October, the US and German equity indices have achieved new all-time highs followed by a crowd of others making new cyclical multiyear highs. In this respect, it is notable that the Japanese Nikkei225 Index has recently taken out the important resistance of 21000 that had been in place for more than 20 years. The reasons are evident. It has become relatively clear since the summer that the industrial world has entered a synchronized and robust global economic recovery and in the absence of other rewarding assets, investors have rediscovered equities as an attractive long-term investment vehicle. On top, the reporting season has just started surprising the investment community with better than expected quarterly earnings in nearly all areas.

Politically, the Western countries and their media have been quite busy, recently. In the USA, the lengthy advocated tax reform looks to become reality, Germany is probing a new coalition formula with three parties, called Jamaica after their party colors black, green and yellow. In Europe, the stalled Brexit talks have been revisited and the dreams of Catalonia and Northern Italy towards greater autonomy should turn out to be unrealistic in the end. In Japan, Mr. Shinzo Abe has won the latest elections with a landslide victory, securing him another four years in government. All these events have created some confidence, that policies are also moving in the right direction.

Economic Outlook

The US tax reform could become the first real success for the Trump administration. There seems to be consensus among the Republican Party in Washington to make it happen. This combined with low unemployment, a stronger global economic outlook and decent domestic demand for goods and services should create even higher earnings and fuel some wage growth and an increase in inflation. The FED might finally reach its desired 2% inflation target and proceed with its slightly more restrictive monetary policy, while other Western central banks will continue their easy money policies because the global deflationary trends elsewhere are still in force. Industry 4.0 is on the rise and the implementation of robots and artificial intelligence will continue to reduce demand for traditional labor in the years ahead, but it also will create new businesses and superior jobs.

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Europe and Asia are also seeing a pickup in economic activity underlined by very healthy economic numbers due to a steady increase in private and public demand. Within the Eurozone, Germany is showing the strongest growth rates in more than 10 years, but other areas notably France should also get a boost in the near term as well. China and Japan also have reported very healthy economic numbers, which seems to affirm the idea that a synchronized global robust economic recovery is in place.

Capital Market Outlook

The summer of 2016 was a monetary and economic inflexion point. The disinflation trade slowly disappeared followed by the start of the reflation trade in 2017, which has become visible over the last two months. Interest rates have started to rise slowly, while the equity markets have resumed their established uptrends after the end of the summer correction, however, with a change in market leadership.

Equity markets at their all-time or cyclical highs have recently begun to show greater disparities. It is notable that during the ongoing reporting season economic sensitive stocks like Caterpillar or 3M Company have reported extraordinary strong earnings, while the more defensive ones like Procter Gamble and Unilever have shown disappointing numbers, which also were reflected in their stock price behavior after the announcement. In a late cycle-economy, cyclical/value driven businesses, as witnessed in the past, should benefit in particular from cheap finance combined with strong global economic growth and create a strong persistent earnings stream. Therefore, construction, transport, finance and machinery companies and technology companies, too, should continue to surprise earnings wise, while the classical more defensive disinflation type of businesses like cosmetics, food and tobacco should relatively disappoint.

From a technical market perspective, those groups and stocks should become market leaders, which will benefit most from the acceleration of digitization and the implementation of cost saving new production and service facilities. The buzzwords are sustainable productivity and profit enhancement. Those technology companies, which provide the necessary hardware like semiconductors and memory chips as well as the information technology like application software and cloud services, should of those groups and stocks further be at the forefront of investors' interest. The new iPhone X could turn out to be such a driver for another wave of strong demand for memory chips and of all kinds of technology and software applications. Insurance companies and banks which have adapted to the financial change after Lehman and have developed new strong business models should continue to do well and they should help to drive the equity markets higher. From an investment point of view, the relative unimpressive earnings' momentum of gold, oil and other commodity producers should hold their stock prices in the established trading ranges.

Political jitters in Europe or America, as in the past, could lead to temporary higher volatility. Equity markets at these high index levels always bear the risk of sudden technical market corrections. They, however, should create buying opportunities, as the allover bull case should remain in place.

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