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Current situation

The latest European economic figures were still uninspiring. The Eurozone grew just 0.6% with the larger economies, Germany, France and Italy performing the worst with hardly any growth. This event caused the German finance minister Mr. Schäuble to shoot from the hip an extra investment package of Euro 10bln – a drop in the bucket, however. Before, the new EU President Juncker in his first action had already pulled out an EU investment program of 315bln Euro for the coming years, not having a clue how to get it financed. This is accompanied by the pledge from the G20 to place a total of US$ 300bln of investment in the G20 economies to accelerate global growth to 2 plus%. In the US Midterm Elections the Republicans took control over the senate, expanded their majority in the House and even picked up key gubernatorial posts. President Obama will have a difficult time to govern the USA from now on until the end of his presidency.
In a surprise move China has cut its benchmark interest rate from 6 to 5.6% for the first time in more than two years – a clear sign to support economic growth. Japan will after another weak quarter go to the polls again next year to give Prime Minister Abe a new mandate to hopefully then change the Japanese economy for the better. In an important speech Mr. Draghi made clear that the ECB will do its utmost to not only stove away economic stagnation in Europe but also to raise inflation. With other words he will grab all existing means. i.e. QE, to fight deflation, even to the anger of Berlin. It is also notable in this respect that two large German banks Commerzbank and WGZ bank have announced that they will now charge for large cash deposits.

Economic Outlook

The latest set of numbers from North America has been mixed. Though consumer confidence is still rising, the latest consumer figures for October have slowed to 0.2 after 0.3% and durable goods orders ex-military have declined by 1.3%, the same rate as the month before. So the 4thquarter GDP should come in only at 2.5%. Although consumer confidence is still holding up, it must be doubted that the huge decline in oil prices will help to raise consumer spending in 2015. Rising state, local and private investment programs will be the key for sufficient economic growth next year.
Even though consumer confidence figures were a bit better in the EU, it is out of question that 2015 will be a difficult year for the Union in nearly every aspect. Politicians and the Central Banks of the EU member states finally seemed to have captured that time has run out playing games. Structural reforms everywhere and infra-structure programs will be the only way out from stagnation and the risk of long standing deflation. In this respect Mr. Draghi will play a more dominant role. In Helsinki against the mainstream of national lawmakers he called again for an economic and fiscal union, now. He obviously is still concerned about the possibility of a Euro break up.

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It seems that the EU politicians have over the course of the year adopted the necessity of a fundamental direction change. This is what the EU capital markets have been waiting for. The recent weakness of the Euro and lower energy prices should also positively affect the European process towards a normalized economic growth pattern later in 2015.

Financial Markets

With a slightly better and more promising economic outlook and some political action the bond and equity markets have already reacted positively in November. The S&P 500, for example, has now made 48 consecutive highs in 2014 equaling the bull runs of 1987 but not 1997 where 77 records were set. This is even more remarkable for an index that was flat on the year in Mid-October. The market continues to be bolstered by low bond yields and the strength of corporate profits, which are near a post war high as a share of GDP. A falling inflation rate still at 1.7% and annualized GDP growth of about 3% in 2014 and 2015 will not trigger an imminent rate hike by the Fed. So US corporate earnings should also grow further next year. In addition we are in a very favorable period for the stock market looking at the statistics. The US markets have always been up in the 12 months after the midterm elections and we also never had a down year in the year ending with a 5 in the entire history of the stock market. After having been flat to down for most of 2014 the Japanese stock market in tandem with the USA has achieved new multiyear highs, although Japan has fallen back into recession. Here is the hope that Japan finally will escape economic stagnation with a new government in place. Any equity positions taken in balanced portfolios should however been hedged against a weakening Yen.
The EU stock markets and also Germany have until recently had a difficult year. They finally followed Wall Street, when it became obvious that the all over direction of fiscal and economic measures should change for the better in 2015. Their average returns, however, have only been around 2 to 5% so far this year, while the EU periphery and the Northern countries have fared somewhat better. In contrast, the long term government bonds of the EU periphery in particular, have been the outstanding performers over equities by a wide margin so far this year, helped by dwindling inflation rates and the convergence against German bunds. Although QE is ante portas early next year, however, it has to be questioned after the stunning performance over the past two years, how much further the future convergence between the periphery and Germany can go in 2015. The odds are that European equities and foreign denominated bonds should outperform long dated EU sovereign bonds from now on.
Investors looking for real returns in balanced portfolios in 2015 should therefore be advised to raise their core equity exposure in Europe and the USA at any market dips and to switch out of EU bonds at future market strength into foreign denominated sovereign bonds, mostly for currency reasons. More risk oriented portfolios could also have a Japanese equity exposure.

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