MONTHLY PULSE WEDNESDAY, 10 JANUARY 2018

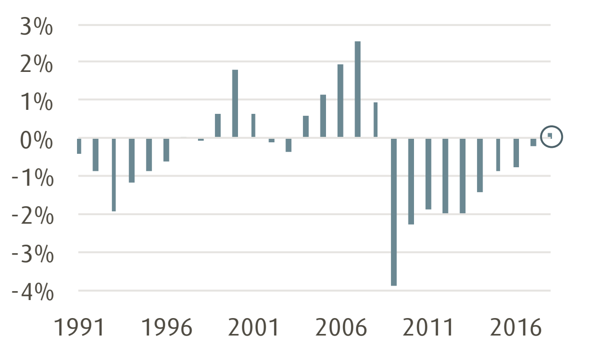
ECONOMIC OUTLOOK

The year ended in very good terms – especially Trump's breakthrough in his tax reform project boosted risky assets. Regardless of the long term negative impact on the US household, the reduction in corporate tax from 35% to 21% as well as the lower tax rate on foreign profits should lead at least to a positive one-off effect for corporate earnings and more room for capital distributions.

Considering the increased valuation in risky assets we do not yet see a threat for the bullish environment. Neither do we observe a decoupling of the financial markets from the real economy nor does the ratio between debt and capital costs point to a credit crunch very soon. Hence the equity markets in the US should further continue to tend higher, despite of the fact that we are in one of the longest stock market rallies.

Global monetary policies confirmed their steady path in December. The FED as well as the European Central bank are cautiously preparing the economy and the markets for a time after quantitative easing. The FED dot plots show three rate hikes this year – the next most likely coming up in March. In Europe tapering started and a change in interest policy before mid-2019 seems improbable. Despite of the economy being in good shape, inflation figures - which recently came in at 1.4% - are currently still well below the ECB's target of 2 percent. However accelerated inflation might be a key theme to watch out for in 2018. Industrial companies across the world are warning they are finding it increasingly hard to keep up with demand. This could result in companies having to hire or invest more to keep up with the demand. Yet it could also force them to push up prices, propelling inflation enough to squeeze the expansion. At the same time input costs remain elevated across many economies reflecting higher raw materials. The IMF just recently published a growth estimate measure showing that advanced economies' output gap will turn positive in 2018 after nearly a decade of negative output gap estimates. A positive output gap tends to indicate high demand for goods and services. Usually it is a signal that spurs inflation since labour costs as well as goods' prices tend to rise in response to high demand.

Economies' Output Gap



Source: IMF, Clarus Capital Group

Fixed Income Markets further retreated leaving investors with a foretaste of what normal interest rate policy could imply. Interestingly, the US interest rate curve rather flattened whereas in the EUR zone it slightly steepened. Credit spreads further tightened due to the risk-on environment. Despite of markets expectations US credit performed better in 2017. The surprise of the year's end was the EUR rally to 1.20 vs. the USD.

Commodities further appreciated with gold and oil being the most remarkable ones. We bought gold positions back at USD 1250 per ounce by mid-December. Crude and Brent moved in backwardation with a potential roll yield of 5% over one year.

TACTICAL ASSET ALLOCATION

Liquidity	Slight overweight
Bonds	Slight underweight
Equities	Slight overweight
Alternative Investments	Neutral

EQUITY INDICATORS

Valuation	Slight underweight
Momentum	Slight overweight
Seasonality	Overweight
Macro	Overweight

Should you require further information or advise, please do not hesitate to contact your Clarus Capital relationship manager.

MARKET OVERVIEW AS OF WEDNESDAY, 10 JANUARY 2018, 11:22 AM

FIXED INCOME

	Rate	Δ 1m	Δ 3m	Δ 2017
USD Overnight	1.44	0.26	0.26	0.75
USD 1y Swap	1.97	0.13	0.36	0.75
USD 3y Swap	2.25	0.14	0.36	0.59
USD 5y Swap	2.34	0.12	0.30	0.43
USD 10y Swap	2.49	0.09	0.17	0.26
EUR Overnight	-0.36	-0.03	0.00	0.00
EUR 1y Swap	-0.26	0.01	0.00	-0.04
EUR 3y Swap	0.00	0.06	0.04	0.09
EUR 5y Swap	0.29	0.09	0.05	0.19
EUR 10y Swap	0.88	0.09	-0.01	0.18
CDX Xover 5y	1.09%	0.01%	0.01%	0.02%
iTraxx Xover 5y	2.24%	-0.08%	-0.24%	-0.66%

	Δ 1m	Δ 3m	Δ 6m	Δ 2017
USD Deposit 1m	0.1%	0.3%	0.7%	1.1%
USD Aggregate 1-3y	-0.1%	-0.2%	0.1%	0.9%
USD Aggregate 3-5y	-0.2%	-0.5%	0.2%	1.8%
USD Aggregate 5-7y	-0.2%	-0.2%	0.8%	2.6%
USD Aggregate 7-10y	-0.1%	0.2%	1.4%	3.5%
EUR Overnight	0.0%	-0.1%	-0.2%	-0.4%
EUR Aggregate 1-3y	-0.2%	-0.1%	0.1%	-0.1%
EUR Aggregate 3-5y	-0.4%	0.2%	0.8%	0.5%
EUR Aggregate 5-7y	-0.6%	0.5%	1.7%	1.1%
EUR Aggregate 7-10y	-1.0%	1.0%	2.9%	1.8%
US Corp. HY	1.1%	1.1%	3.5%	7.5%
EUR HY	0.6%	0.6%	2.5%	4.8%

EQUITY

	Price	P/E	D. Yield	FCF yield
MSCI World	6,083	17.3	2.4%	4.5%
S&P 500	2,748	18.5	1.9%	4.2%
NASDAQ	6,677	21.0	1.0%	4.1%
Euro Stoxx 50	3,623	14.4	3.5%	12.1%
SMI	9,576	16.8	3.4%	7.3%
FTSE 100	7,724	14.9	4.1%	2.3%
DAX	13,386	13.9	3.0%	6.7%
MSCI Asia Pacific	180	14.7	2.4%	3.7%
FTSE China A50	13,759	11.5	2.6%	20.0%
MSCI Emerging Market	1,207	13.2	2.6%	5.8%
PH Semiconductor	1,336	16.3	1.6%	4.6%

	Δ 1m	Δ 3m	Δ 6m	Δ 2017
MSCI World	4.2%	7.5%	13.7%	22.4%
S&P 500	3.6%	8.0%	13.3%	21.8%
NASDAQ	5.2%	10.2%	18.0%	33.0%
Euro Stoxx 50	0.9%	0.4%	4.6%	9.9%
SMI	2.8%	3.5%	7.9%	17.9%
FTSE 100	4.5%	2.9%	5.1%	12.0%
DAX	1.9%	3.2%	8.1%	12.5%
MSCI Asia Pacific	6.4%	10.1%	17.8%	32.1%
FTSE China A50	5.3%	13.6%	21.1%	35.7%
MSCI Emerging Market	8.7%	9.7%	20.4%	37.5%
PH Semiconductor	7.9%	11.3%	26.6%	40.5%

COMMODITY

	Price	FCST 17	FCST 18	Δ Future
Gold	1,317	1258	1268	-5.0%
Silver	17.11	17.1	17.5	0.7%
Platinum	968	951	994	1.2%
Palladium	1,103	855	974	-10.8%
Crude Oil	62.13	50.6	54.0	-11.5%
Brent Oil	68.06	54.0	58.0	-12.6%

	Δ 1m	Δ 3m	Δ 6m	Δ 2017
Gold	5.6%	2.6%	8.7%	11.0%
Silver	7.9%	0.1%	9.3%	0.4%
Platinum	9.0%	4.9%	6.2%	-6.0%
Palladium	10.6%	19.4%	34.0%	44.8%
Crude Oil	8.2%	23.3%	36.3%	10.7%
Brent Oil	8.0%	23.5%	40.8%	19.3%

FOREIGN EXCHANGE

	Price	FCST 17	FCST 18	Δ Spot
EUR/USD	1.1934	1.1700	1.2200	2.2%
GBP/USD	1.3526	1.3200	1.3600	0.5%
USD/CHF	0.9821	0.9900	0.9800	-0.2%
USD/JPY	112.95	113.00	112.00	-0.8%
EUR/CHF	1.1720	1.1600	1.1800	0.7%
USD/RUB	57.11	58.73	59.10	3.4%
EUR/RUB	68.15	68.40	72.29	5.9%

	Δ 1m	Δ 3m	Δ 6m	Δ 2017
EUR/USD	1.4%	1.7%	4.7%	12.9%
GBP/USD	1.4%	2.9%	5.0%	11.2%
USD/CHF	1.0%	-0.2%	-1.7%	3.4%
USD/JPY	0.6%	-0.2%	1.0%	2.8%
EUR/CHF	-0.4%	-1.9%	-6.1%	-8.4%
USD/RUB	3.3%	2.2%	5.5%	5.1%
EUR/RUB	1.7%	0.4%	0.7%	-6.8%

Source: Clarus Capital Group, Bloomberg

FIXED INCOME

2017 was a good year for bond markets. Especially the credit premia showed an outstanding yield. For this year, there are plenty of pitfalls to watch out for: inflation will be the key theme, but also whether credit spreads can persist their tightened levels.

The target in the USD portfolios is to preserve the gains of the last 2 years as the FED resets its interest rate levels higher by three assumed rate hikes. Higher inflation might lead to a steepening of the curve. Therefore, short-term rates could rise by 75bp, whereas the long end could jump by 125bp. Keeping duration short is key for USD reference currency investors.

Global Composite Purchasing Manager Indices

	Current	1m ago	3m ago	1y ago	2y ago
USA	54.1	54.5	54.8	54.1	54.0
Eurozone	58.1	57.5	56.7	54.4	54.3
Germany	58.9	57.3	57.7	55.2	55.5
France	59.6	60.3	57.1	53.1	50.1
Italy	56.5	56.0	54.3	52.9	56.0
Spain	55.4	55.2	56.4	55.5	55.2
United Kingdom	54.9	54.8	54.2	56.6	55.1
Japan	52.2	52.2	51.7	52.8	52.2
Emerging Markets	53.0	51.9	51.9	51.9	49.5
Brazil	47.4	46.9	50.7	45.1	43.5
China	53.9	51.9	50.6	53.4	50.2
India	53.0	50.3	51.1	47.6	51.6
Russia	56.0	56.3	54.8	56.6	47.8

Source: Bloomberg, Clarus Capital Group

As the global economy is keeping its growth path, credit spreads should maintain their tight levels. The synchronized growth can best be seen in the current PMI data with Brazil being the only one below 50. Most of the countries are in very good shape with figures well above 50. The good economic shape also arrived in the labour market with lower unemployment rates around the globe. Some tailwind for the credit market might come from the successful implementation of the US tax reform. The higher quality segment should profit more than the lower graded as the newly imposed 30% limit on interest expense deductibility will have a higher impact on the latter. Emerging markets are also a key beneficiary to an increased global trade and higher commodity prices. We like in Financials to go down the capital structure with Lower Tier 2 and Additional Tier 1 bonds. This not only counts for banks but also for insurance names as they offer sound fundamentals and an attractive valuation.

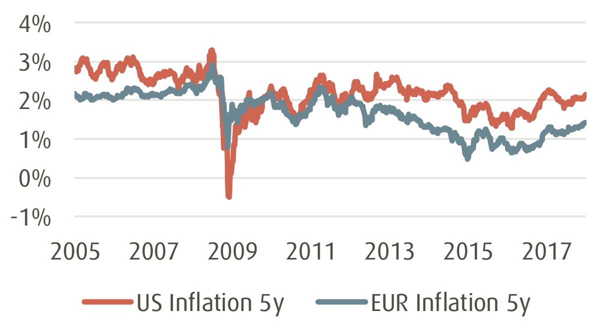
Uncertainty might be caused by Central banks' actions. The monetary policy schedule might be as follows:

- FED: three rate hikes in 2018, starting in Q1 2018
- ECB: tapering from 60bn to 30bn from Jan – Sep 2018, rate hikes likely to follow in 2019
- SNB: no rate hikes or moves before ECB
- Bank of England: one hike over the next 12 months
- Bank of Japan: unchanged policy throughout 2018
- People's Bank of China: unchanged policy in 2018

In the Eurozone, the gradual withdrawal of quantitative easing and monetary policy tightening is likely to result in higher yields but not before the year end. We therefore like to keep a longer duration view of 4 to 5 years in EUR-denominated bonds.

Stable employment figures however are eventually likely to push inflation expectations higher, which would have an impact on the speed of US monetary policy tightening, although for the moment inflation continues to remain below trend. The Phillips Curve implies that low unemployment rate should lead to higher wages and inflation. Current unemployment rate in the US is at its low of 4.1%. One reason for lagging inflation could be the low labour force participation rate of 62.7% (a decrease by 4 percent since the financial crisis). Another reason might be technological advances such as sharing economy and product quality (mobiles, chips, etc.).

Inflation expectations



Source: Bloomberg, Clarus Capital Group

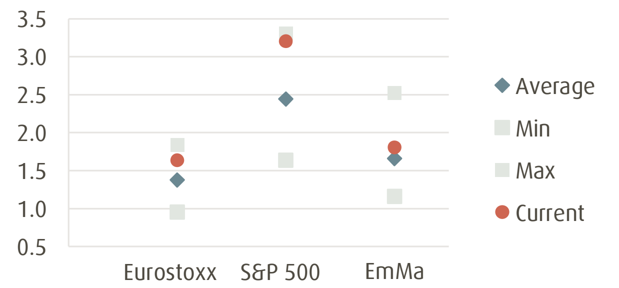
On the currency side we are neutral on EUR/USD. Concerns about subdued US inflation and the cautious ECB rate guidance keep EUR/USD range-bound below 1.20 for now. Yet, EUR/USD is seen to gain again later in 2018 as the Eurozone economic upswing extends and rising Eurozone yields should follow.

However, we expect the path in 2018 to be more bumpy and volatile as the surprises are rather biased on the downside with geopolitical events, inflation figures and Central banks at the forefront.

EQUITY

We examined the global equity valuations based on their P/B ratios over the last 10 years. It comes as no surprise that after one of the longest bull markets, valuation of equity markets is no longer cheap. Markets will no further be driven by P/E expansion but rather based on earnings growth. We therefore believe that there is still potential to the upside for stock markets due to a solid economy and the tax reform. Sectors like materials, industrials, consumer discretionary should get the biggest boost from Trump's overhaul. The techs will most probably not repeat the spectacular performance from last year but remain solid.

Price to Book Ratio Stock Markets



Source: Bloomberg, Clarus Capital Group

In developed markets we prefer the European equities to the US as we are already late in the business cycle for the US markets and Europe still has potential to recover. Unemployment rate in Europe are still above pre-financial crisis. Furthermore, monetary policy might be supportive for another good year with tapering only started in Europe.

The Emerging Markets realized again a higher GDP in Q3 comparing to the previous quarter. Stronger growth rates in Eastern Europe as well as in some different Asian countries could offset the marginal slowdown of the economy in China very well. We are convinced of a continuing and solid growth within the Emerging Markets. Speaking of sectors, tech has gained over 60% through early November and almost double the gain for the broader EM index. This is highly backed by solid profits and the tech sector now accounts for 22% of the trailing 12-months earnings of the MSCI EM compared with 11% a decade ago. The technological shift is unlimited not only in Asia but also in other countries like Chile, Mexico and Africa. Technological disruption in coming years could increasingly stem from the emerging world. However, companies that embrace this shift and remain flexible to adjust their business models remain in the pole position for years to come. Hence, we currently see the most potential for equities within the Emerging Markets region than elsewhere. This view is well underpinned in our EM P/B valuation.

To summarise, equity markets are slightly over weighted in our allocation due to momentum, seasonality and macro-economic fundamentals. On a regional basis we prefer Emerging Markets and Europe to US markets.

ALTERNATIVE INVESTMENTS

Commodities had a volatile year, but with the recovery at year end of energy and base metals they closed in positive territory. Historically, we monitored the biggest upside for commodities especially during the late business cycle. The global economy growth therefore favours commodity prices. Furthermore, most of the commodity companies have significantly reduced their capital expenditures and therefore supply is only limited to the increased demand for commodities. In addition to this, some commodities have turned into backwardation yielding a positive roll return. Risks might come from lower growth in China as well as a higher valuation of the USD. We prefer commodities in backwardation such as energy and are cautious on the precious metals as we see the save haven characteristics too early to implement in the portfolio context.

In the hedge fund universe, trend-following strategies did remarkably well with CTA's with a higher allocation to equities performing better than the ones to commodities. However, most long/short hedge funds have increased their long position to the highest level since the financial crisis. We might see another positive year for hedge funds but estimate the return in alternatives superior. Therefore, hedge funds are underweighted.

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IMPRESSUM

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