MONTHLY PULSE FRIDAY, 01 JUNE 2018

ECONOMIC OUTLOOK

May was fully prepped with uncertainties - this might be just a foretaste for the upcoming months. Volatility has risen, and the geopolitical headlines continued to play a significant role in unsettling investors, particularly the prospect of a trade war between the US and China, the road map of FED's interest rate policy as well as the recent Italian crisis. But let's not tempt fade – the overall economic picture still looks promising.

The US economy is still on track. PMI data show elevated levels alongside with a solid industry, increasing capacity constraints, and the tax incentives encourage corporations to continue to invest. Meanwhile, the FED is about to normalize its monetary policy at a leisurely pace. During the last FED minutes, the members reinforced their previous path. Some members even indicated that they will allow an inflation above target resulting in a steady interest rate hike. Additionally, the minutes indicates that the rates have soon reached its long-term level which underpin its leisurely pace. The US 10Y government yields declined after the FOMC minutes below the psychological level of 3 percent.

Markets focused this month on the Eurozone and especially on Italy: worries over a new election reverberated across the markets. The EUR weakened rapidly against major currencies – a similar reaction observed during the Greek crisis. Apart from the Italian crisis, the economy slowed further down. The PMIs for the two largest European economies, France and Germany, have worsened and missed the market expectations clearly.

Bonds of the European periphery lost significantly: the credit spread of Italy jumped from 86bp to 250bp. The current bond market sentiment reaches levels seen during the European debt crisis. However, we think that markets overreacted. Even though the yield difference between the Italian and German bonds might be elevated, the economic outlook as well as the ending of the QE program might spread optimism. US Treasury yields were slightly lower due to their save haven function. Overall, bonds are underweighted in the portfolios.

Global Composite Purchasing Manager Indices

	Current	1m ago	3m ago	1y ago	2y ago
USA	55.7	54.9	55.8	53.6	50.9
Eurozone	54.1	55.1	57.1	56.8	53.1
Germany	53.1	54.6	57.6	57.4	54.5
France	54.5	56.9	57.3	56.9	50.9
Italy	52.9	53.5	59.0	56.8	53.1
Spain	55.4	55.8	56.7	57.3	55.2
United Kingdom	53.2	52.4	53.4	56.3	52.1
Japan	53.1	51.3	52.8	52.6	48.9
Emerging Markets	52.4	52.3	53.6	52.1	50.0
Brazil	50.0	50.4	50.0	50.3	37.4
China	52.9	52.3	54.7	51.5	51.8
India	51.9	50.8	52.5	51.3	52.8
Russia	54.9	53.2	54.8	55.3	51.3

Source: Bloomberg, Clarus Capital Group

Earnings are on pace for more than 20 percent YoY growth, the highest rate since 2010. Many company managements have pointed to lower taxes and strong sales growth as primary drivers of profit. Our recommendations stay at an overweight to Equities.

Gold was unimpressed by the Italian crisis. Oil spiked above USD 70 and retreated when Russia and Saudi Arabia proffered to possibility of higher supply. Hedge Funds were flat across most of the strategies. We are still neutral on Alternative Investments.

TACTICAL ASSET ALLOCATION

Liquidity	Neutral
Bonds	Slight underweight
Equities	Overweight
Alternative Investments	Neutral

EQUITY INDICATORS

Valuation	Attractive
Momentum	Attractive
Seasonality	Neutral
Macro	Attractive

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

clarus capital

MARKET OVERVIEW AS OF FRIDAY, 01 JUNE 2018, 2:43 PM

FIXED INCOME

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	1.71	0.01	0.27	0.28
USD 1y Swap	2.53	-0.02	0.26	0.63
USD 3y Swap	2.78	-0.07	0.20	0.61
USD 5y Swap	2.85	-0.08	0.16	0.60
USD 10y Swap	2.93	-0.06	0.11	0.53
EUR Overnight	-0.36	0.00	-0.01	-0.01
EUR 1y Swap	-0.24	0.02	0.02	0.02
EUR 3y Swap	0.01	-0.03	-0.05	0.00
EUR 5y Swap	0.32	-0.09	-0.12	0.00
EUR 10y Swap	0.93	-0.06	-0.15	0.04
CDX Xover 5y	3.53%	0.15%	0.11%	0.46%
iTraxx Xover 5y	2.99%	0.26%	0.32%	0.66%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.2%	0.5%	0.8%	0.7%
USD Aggregate 1-3y	0.4%	0.3%	0.1%	0.1%
USD Aggregate 3-5y	0.7%	0.2%	-0.8%	-0.8%
USD Aggregate 5-7y	0.9%	0.3%	-1.1%	-1.1%
USD Aggregate 7-10y	1.0%	0.4%	-1.6%	-1.8%
EUR Overnight	0.0%	-0.1%	-0.2%	-0.2%
EUR Aggregate 1-3y	-0.4%	-0.3%	-0.6%	-0.4%
EUR Aggregate 3-5y	-0.6%	-0.3%	-1.0%	-0.5%
EUR Aggregate 5-7y	-0.7%	-0.2%	-1.4%	-0.7%
EUR Aggregate 7-10y	-0.6%	0.3%	-1.5%	-0.5%
US Corp. HY	0.1%	0.2%	0.1%	-0.2%
EUR HY	-1.1%	-0.7%	-1.2%	-1.1%

EQUITY

	Price	P/E	D. Yield	FCF yield
MSCI World	5,957	15.9	2.5%	5.3%
S&P 500	2,705	17.0	2.0%	4.5%
NASDAQ	6,968	20.6	1.0%	4.1%
Euro Stoxx 50	3,437	13.7	3.7%	9.9%
SMI	8,457	14.9	3.8%	3.1%
FTSE 100	7,678	14.0	4.2%	6.8%
DAX	12,605	12.9	3.2%	4.5%
MSCI Asia Pacific	172	13.4	2.7%	5.5%
FTSE China A50	12,271	10.1	3.1%	19.0%
MSCI Emerging Market	1,121	12.1	2.9%	4.9%
PH Semiconductor	1,379	15.1	1.7%	5.1%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	0.8%	0.9%	2.2%	0.5%
S&P 500	1.9%	1.0%	2.4%	1.2%
NASDAQ	4.3%	3.2%	9.9%	8.9%
Euro Stoxx 50	-2.8%	1.1%	-2.6%	-1.9%
SMI	-4.8%	-3.8%	-8.8%	-9.9%
FTSE 100	2.1%	7.0%	5.2%	-0.1%
DAX	-0.1%	3.4%	-2.0%	-2.4%
MSCI Asia Pacific	-1.0%	-2.0%	1.3%	-0.9%
FTSE China A50	0.6%	-8.6%	-5.5%	-7.0%
MSCI Emerging Market	-3.6%	-6.0%	0.4%	-3.3%
PH Semiconductor	8.9%	2.9%	9.6%	10.1%

COMMODITY

	Price	FCST 18	FCST 19	Δ Future
Gold	1,298	1314	1315.18	-0.1%
Silver	16.46	17.0	17.33	2.6%
Platinum	910	963	1003.75	3.7%
Palladium	981	1040	1000	4.5%
Crude Oil	67.14	64.0	63	-3.3%
Brent Oil	77.80	68.3	67.8	-8.8%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	-0.7%	-0.5%	1.5%	-0.9%
Silver	2.0%	0.5%	-0.4%	-4.9%
Platinum	1.8%	-5.4%	-4.1%	-3.5%
Palladium	5.2%	1.3%	-2.4%	-6.2%
Crude Oil	0.0%	11.9%	17.1%	12.3%
Brent Oil	7.0%	23.6%	25.2%	19.5%

FOREIGN EXCHANGE

	Price	FCST 18	FCST 19	Δ Spot
EUR/USD	1.1686	1.2300	1.2900	9.9%
GBP/USD	1.3279	1.3800	1.4300	7.4%
USD/CHF	0.9884	0.9800	0.9500	-4.0%
USD/JPY	109.14	109.00	104	-4.8%
EUR/CHF	1.1550	1.1900	1.2200	5.5%
USD/RUB	62.28	60.50	59.00	-5.4%
EUR/RUB	72.77	73.80	76.40	4.9%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	-2.6%	-4.7%	-1.8%	-2.7%
GBP/USD	-2.5%	-3.6%	-1.5%	-1.7%
USD/CHF	0.8%	-4.7%	-1.2%	-1.4%
USD/JPY	0.7%	-2.7%	2.8%	3.3%
EUR/CHF	3.5%	0.0%	0.6%	1.3%
USD/RUB	1.1%	-8.8%	-5.4%	-7.5%
EUR/RUB	4.9%	-4.2%	-3.7%	-4.8%

Source: Clarus Capital Group, Bloomberg

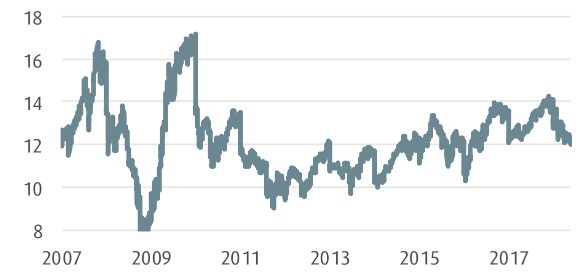
THEME IN THE SPOTLIGHT

EMERGING MARKETS: DOOM OR GLOOM?

Emerging Markets recently got out of investor's favours. The MSCI Emerging Markets dropped by 5 percent whereas its developed peers closed flat or slightly positive. Geopolitical tensions, tightening financial conditions as well as further worrying developments in countries such as Argentina and Turkey weighted heavily. Argentina requested an IMF program to stabilize the economy and Turkey raised uncertainty whether monetary and fiscal policy are adapted sufficiently. In equity markets everybody's darling China lost more than 7 percent. Nevertheless, China exceeded expectations about the further growth path. Furthermore, the government is willing to loosen policy to soften a slow-down. Valuations are back to levels of 12 - about 4 points lower than developed markets. Corporate earnings growth is set to excel more than 20 percent in the upcoming 12 months. We therefore recommend to overweight Emerging Markets in Equities.

Nevertheless, investors must treat Emerging Markets debt cautiously. Countries with large external funding are suffering from an appreciating dollar. During rising US interest rates, FX markets normally favour surplus vs. deficit Emerging Markets. Considering the higher volatility, investors might concentrate on hard-currency denominated bonds of countries with little need to raise funds. Furthermore, as yields of hard-currency EM debt converged further to local-currency debt's yields, it might be just the right moment to enter a position.

MSCI Emerging Markets: Price/Earnings



Source: Bloomberg, Clarus Capital Group

For global markets and especially for emerging markets the risks are twofold: accelerating US interest rate hikes and an escalation in global trade tensions. We assign only low probability to these two risks and see support from corporate earnings. In an environment of expensive asset classes, Emerging Markets equities are preferred and cheap.

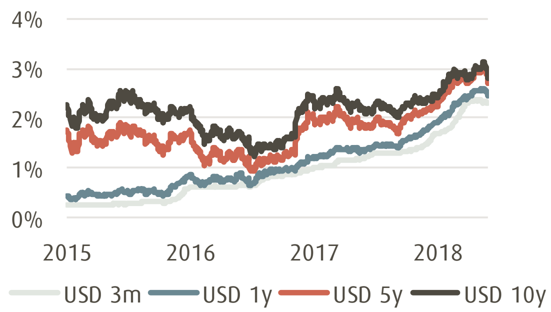
FLATTENING YIELD CURVE

Despite the booming economy in the US, bond markets speak another language as long-term yield forecasts the economy to fall into recession by 2020. This might be the result of fading fiscal stimulus. The predictions of a recession by the yield curve have been quite accurate since the 1970s. On average, a recession occurs 15 months after the yield curve inverts. Considering the pace of the FED, the yield curve might invert at the end of the year or latest beginning of 2019.

What are the main driver of a flat yield curve? One could be concerns about the further growth path of the US economy. This should raise a red flag for investors. We do not expect it to be the case as the flattening is a result of higher short-term yields. However, to explain it only by the FED would be too easy. The Treasury department is preparing for the higher deficits from the tax reform and the budget deal. Treasury net issuance has spiked: in February USD 111bn and in March USD 211bn.

On the other hand, it is inflation fears. Even though the FED accepts a slight overshooting of inflation above target of 2 percent, markets do not expect inflation to spike in the future and believe into the FED's capability to successfully manage it.

Development of US interest rates



Source: Bloomberg, Clarus Capital Group

Nevertheless, the odds are raising that we will see a recession in 2020 and investors should be prepared to have a bumpy road in front of them.

DISCLAIMER

IMPRESSUM

PUBLISHED BY CLARUS CAPITAL GROUP AG, GUTENBERGSTRASSE 10, CH-8002 ZURICH, RESEARCH@CLARUSCAPITAL.CH, WWW.CLARUSCAPITAL.CH

EDITORS ROGER GANZ, HEAD ASSET MANAGEMENT, DEJAN RISTIC, ASSET MANAGEMENT