swisspartners Advisors

thenavigator

Spring 2017

Random walk, random thoughts

As I sit here writing the current issue of "Le Navigator" on the train à grande vitesse (TGV) heading towards Paris, it seems apt, given the current situation, which I am reminded of an early April day fishing in the Wiltshire countryside.

I was strolling down a small country lane enjoying the early sunshine, when two ramblers crossed my path and noticed the fishing rod in my hand and asked, "Is it a good day to go fishing?" My immediate quip was – "It is always a good day to go fishing!"

This got me thinking about the question many investors ask - is it a good time to invest? The easy quip would be – yes, if you have money. Taking an old fishing guides' saying that you won`t catch a fish if your line is not in the water, one could apply exactly the same principle to markets. If you do not invest, you have no chance of making money.

Of course, you don`t lose any money either; on the other hand, with bond yields at such low levels, and in some countries even negative, investors can hardly be excited.

Looking at European markets, which have recently become more popular due to their current outperformance of their US counterparts and trading at a one year high, the most obvious question is - is it too late to invest? Investors have a tendency to remember the recent past and for many the most pungent memory is that of the 2008/2009 financial crisis, which was bruising, too say the least!

Considering below graph, European equities, as measured by the Euro Stoxx 50, are below their 2015 peak. Even more telling is that they are over 20% below 2007 levels and over 30% below 1999 levels.

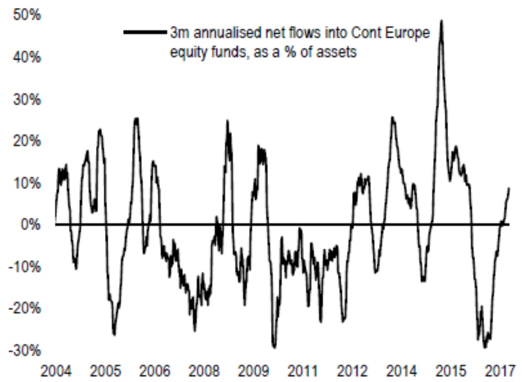
EURO STOXX 50 Index

Source: Bloomberg L.P.

Of course one line of argument might be that if everyone is talking about it, the market has probably already factored this in. Wrong!

Despite the talk about the European equity trade, fund flows have only just turned positive and are significantly below peak levels.

Net flows into Continental European Equity Funds



Source: Thomson Reuters, EPFR, Credit Suisse Research

So, where are we in markets from a psychological point of view? Well, we are definitely not yet at the stage of euphoria which would suggest a market top. If I had to pinpoint it, I would say, we are moving towards the stage of guarded optimism. This essentially means, investors feel more upbeat but are still likely to sell their positions after moderate gains whilst not quite believing they will last. Before we get to the euphoric stage, which I believe lies years further ahead, this secular bull market is, in the meantime, likely to force investors to buy back those same positions at higher prices.

Return of the Sun King

In 1643, Louis XIV ascended the French throne at the age of five and ruled for an unprecedented 72 years thereafter. This was the longest reign of any major monarch in European history. During his reign France experienced a golden age of art and literature, and became the most powerful country in Europe and one of the most important countries in the world.

Whilst it may seem fanciful to expect an exact return to those days, Macron's win in the second round of the French Presidential elections may allow some sunshine to burn away the many clouds that have been engulfing France and Europe as a whole for quite a while. Liberalisation, tax cuts, and incentives for entrepreneurs are massively overdue.

The result of the first round of the French election was seismic in its nature and should not be underestimated. It was the first time in over 30 years that the major French left or right parties did not progress past the first round. We believe, this tells us that the French electorate was desperate for a change. Now that the final results of the French election are in with Macron having won 66 percent of the vote, this is significantly more than most expected (this was our guess), and some interesting observations can be made. For Macron to have achieved this result, considering that his political movement was founded only a year ago, is deeply impressive. Our opinion is that the Le Pen`s Front National party is now on the back foot and will probably have no chance of a major success for another three or four elections, given that this was the best opportunity they have ever had to be elected.

Of course the question remains as to how Macron will govern given the upcoming June parliamentary elections. Our base case is that he gets a majority (the French voter has a history of giving their Presidents a parliamentary majority), and this will enable him to pursue his reformist agenda. Many have queried the parallels between Macron and Renzi and are therefore concerned that nothing will change. This is perhaps a mistake, given that France is a very different country from Italy, and politicians would have to be very stupid not to learn from the mistakes of Renzi and Cameron, who gambled away their leadership.

We maintain our strong overweight towards European equities

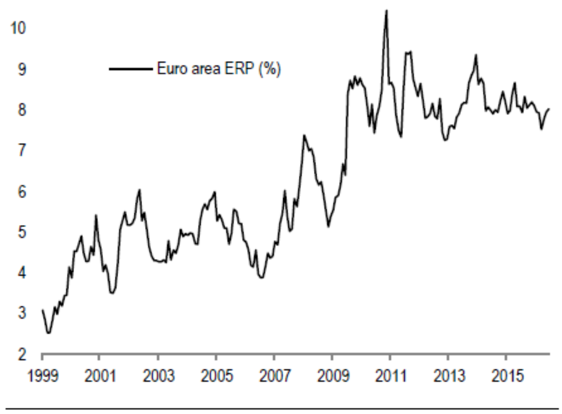
All indicators point to the fact that this is the correct place to be. Although we were early to the European equity trade, we are now in the position to enjoy the fruits of our labour for, what is likely to be, a considerable period of time.

Valuation discount of Europe vs. USA on a normalised basis

	15-year average	Now	Dev. from average
P/B discount to US	36%	45%	-13%
Value to cost discount to US	29%	33%	-6%
CAPE discount to US	29%	54%	-36%
3-year forward P/E discount to US	14%	27%	-16%
Implied discount to US	27%	40%	-18%

Source: Thomson Reuters, EPFR, Credit Suisse Research

Equity risk premium still elevated



Source: Thomson Reuters, EPFR, Credit Suisse Research

Equity risk premium still elevated

The extra penalty – think of it as an insurance premium, or equity risk premium - investors have to pay for holding European equities, is still very high compared to historic rates; Also, given the sensitivity of this measure, just a small decrease can lead to significantly higher equity prices.

An overlooked statistic is last year's European GDP growth which exceeded that of the USA. We expect the same occurrence this year. Looking at European PMIs at this point in time, they are in line with European GDP growth of around 3 percent, but even GDP growth of 2 percent has not been factored in.

The ECB is likely to keep the "pedal to the metal" in terms of loose monetary policy despite increasing vocal protests from the Northern contingent. European consumer demand has significantly lagged behind the USA since 2008. This latent pent-up demand combined with the fact that earnings growth of European companies has now turned positive for only the second time in five years (double digit growth expected for the next 2 years), is likely to lead to significantly higher European equity prices.

I am really scared about what`s going on in the world at the moment

You would have to be living in a cave not to be worried about what`s happening regarding North Korea at the moment. The simple question "Is there anything you can do about it?" can be answered with an equally simple – "No". Sensible voices of reason, namely China, have intervened to de-escalate tensions, and given North Korea`s heavy economic reliance on China, extreme pressure can be applied, if needed. In all of my twenty five years plus of investing into markets, geopolitics has never been a reason to sell but rather to buy.

I know that many are worried about a scenario of a QE exit coming from both the FED and the ECB at the same time. However, it is naïve to think that major central banks are not talking to one another. Given the anemic Q1 growth in the USA and the recent painful lessons the ECB learnt in the Trichet era from tightening too quickly, we believe that central banks are likely to be in a go-slow-mode for much longer than many anticipate. One should also factor in that the current FED chair is extremely measured in her approach and displays empathy towards the average person in the street. She is painfully aware that higher bond yields are likely to lead to higher car lease and mortgage payments. In this environment equities are likely to remain supported by loose monetary policy and bonds are unlikely to experience the apocalypse scenario many foresee but are unlikely to move anywhere fast either.

The new US President is starting to find out that his new job is somewhat more complicated than being the CEO of his own company in terms of implementing decisions. Whilst this may lead to some short term volatility and disappointment, we think, many goals will be achieved but over a longer time frame than originally envisaged.

As the train nears Paris, it becomes extremely difficult to work due to the intermittent internet connection. The more things change the more they stay the same – I think, someone might have written a similar line – perhaps in French!

A couple of observations strike me when talking to the taxi driver on my way back to the station. I apologize for my poor French accent and he replies that I am understandable and that France is a country of many accents.

When I ask him, “Who will win the election?” he assures me, a Macron win is a foregone conclusion and the rest is “sensations pour le média”. He assures me that change is coming, if not in this Presidency then in the next one.

He was right!

The Navigator
has been written by:

Peter Ahluwalia,
Chief Investment Officer

Disclaimer

Important Information

The information in this material has been approved by swisspartners Advisors Ltd. (“swisspartners Advisors”). As a firm providing wealth management services to U.S. clients, swisspartners Advisors is registered under the U.S. Investment Advisers Act of 1940 with the U.S. Securities and Exchange Commission (“SEC”) as an investment advisor. Nothing in this material is a recommendation that you purchase, sell, subscribe or hold, or an offer or solicitation of a purchase or sale of any security, futures, options, other financial instruments or other investment, that you pursue any investment style or strategy or buy any other product or service. The value of, and income from, your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. This material does not take into consideration the specific investment objectives, financial situation or particular needs of any person that enters into a relationship with swisspartners Advisors. Nothing in this material is or is intended to be investment, accounting, tax or legal advice. You should consult with your own advisors concerning such matters. Swisspartners Advisors does not provide legal, tax or accounting advice. The information contained herein was obtained from sources believed to be reliable. Although reasonable care was taken in gathering the information and formulating the opinions contained herein, swisspartners Advisors does not make any representation whatsoever as to its accuracy or completeness and accepts no liability for any loss arising from the use of this material. The information, opinions and estimates expressed herein reflect a judgment as of its original publication date and are subject to change without notice. No representation or warranty, expressed or implied, is made by swisspartners Advisors regarding future performance. The value and income of any securities or financial instruments can go up as well as down. The market value of securities or financial instruments may be affected by several circumstances, including among others, changes in economic, financial or political factors, time to maturity, market conditions and volatility, or the credit quality of any issuer or reference issuer. Foreign currency rates may have a positive or adverse effect on the value of any investment. Investors assume all risk and some or all of the amount invested may be lost. This material is not directed to, or intended for distribution to or use by, any person or entity that is a citizen or resident of, or located in, any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or subject swisspartners Advisors to any registration requirement. IRS Circular 230 Disclosure: swisspartners Advisors and its affiliates do not provide legal or tax advice. Accordingly any tax-related discussion contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with promoting, marketing or recommending to any person any transaction or matter addressed herein or for the purpose of avoiding U.S. tax-related penalties.

Forward-Looking Statements

“The Navigator” may contain forward-looking statements that reflect swisspartners Advisors’ current views with respect to, among other things, future events and financial performance. Any forward-looking statement contained in this material is based on our current plans, estimates and expectations. The inclusion of this forward-looking information should not be regarded as a representation by swisspartners Advisors or any other person that the future plans, estimates or expectations contemplated by swisspartners Advisors will be achieved. Such forward-looking statements are subject to various risks and uncertainties and assumptions relating to our operations, financial results, financial condition, business prospects, growth strategy and liquidity. International investments are subject to additional risks such as currency fluctuation, political instability and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. If one or more of these or other risks or uncertainties materialize, or if the underlying assumptions prove to be incorrect, the actual results may vary materially from those indicated in these statements. These factors should not be construed as exhaustive. swisspartners Advisors does not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. It is important that you carefully read the agreements and disclosures that we provide to you about the products or services we offer.

For more information, please visit our website at www.swisspartners-advisors.com /