swisspartners
Advisors

thenavigator

Summer 2017

Brace yourself!

The recent volatility in both the bond and equity markets can be mainly attributed to the words rather than the deeds of central banks. Whilst the recent hike in US interest rates came as a surprise to some participants (ourselves included), for the market overall the decision was pretty much built in. What was not expected was the rather hawkish tone of the Federal Reserve who maintained that the undershoot of their inflation target was in their opinion transitory and they were willing to look through it and continue on their path of increasing interest rates letting their balance sheet (QE) reduce. As if this were not enough, recent comments by the ECB regarding the robustness of European growth caused investors to contemplate the reduction of the ECB balance sheet and believe that rates were also likely to rise. The icing on the cake was the announcement by the Bank of England (after much flip flopping) that rates could rise as a result of their overshooting their inflation target.

These recent central bank communications (which were supposed to provide clarity) could be viewed by some as confusing and muddying the waters.

This is complete and utter nonsense in our view. There is no suicide pact amongst central banks (for this is pretty much what it would amount to). Rather, investors should view the recent commentary as a Christmas wish list. Anyone with children knows that as their age progresses so does the length of the wish list to Santa Claus; however, it is rare for all the presents on the wish list to be delivered at Christmas and there is bound to be some disappointment.

Starting with the US Federal Reserve, which has a clear dual mandate of low unemployment and inflation at or close to 2%, it is clear that the employment part of their mandate has been fulfilled with an unemployment rate below 5%, although some could argue this is due to factors such as people dropping out of the workforce. It is also equally clear that the second part of their mandate regarding inflation is evidently failing. Whilst the FED believes that inflation will eventually pick up, it may be somewhat deluded given the weak wage growth and very modest US GDP growth of around 2%. Other factors such as the much anticipated fiscal and economic stimulus from Washington (tax cuts and infrastructure spending) seem to be delayed until next year at the earliest (some are even saying, 2019 after the US mid-term elections). We fully expect the Federal Reserve to move at a snail`s pace in terms of interest rate rises and balance sheet reduction given

the rather moderate nature of growth in the US economy.

If the Federal Reserve is moving at a snail`s pace, then the ECB is likely to move at the speed of a sloth given their single mandate of price stability with inflation at or close to 2%, which they are significantly away from at the moment. The recent rise in the EUR, especially against the USD, will also be somewhat problematic for the ECB as, if it lasts, it will likely mean a somewhat further undershoot of their inflation target. The strong EUR will make imports cheaper. A prime example is the price of oil and other commodities, which are input costs into the final product of many European manufacturers. Whilst not in their mandate, it is evident that the ECB also looks at the Eurozone unemployment rate, which is close to 10%. With youth unemployment north of 20% in many Eurozone countries, it would seem somewhat insane to expect the ECB to move towards an aggressively hawkish monetary policy. We are completely aware that the recent strength in the EUR has been partly down to expectations that the ECB will start to discuss reducing their balance sheet at the September meeting. However, talking is not the same as doing, and investors would do well to note Mario Draghi`s protestations that it is way too early to think about a less accommodative monetary policy. The other side of the equation is the weakness of the USD due to the incessant media headlines and investigations surrounding President Trump. At some point he is likely to catch a break!

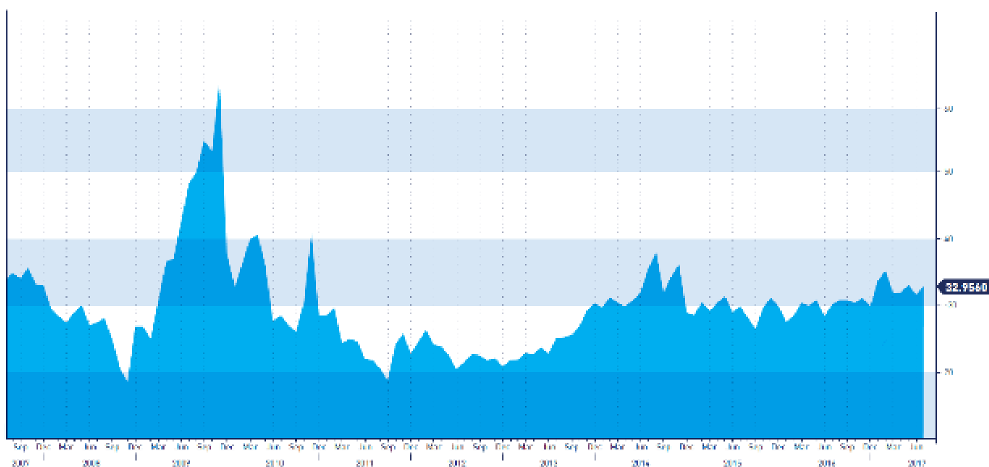
So why have markets become more volatile?

Perhaps the best way is to use an analogy. If you tell a heavy smoker that they are going to be forced to quit, the immediate reaction is likely to be one of increased nervousness and heavier tobacco consumption. If, however, you then took one cigarette away from their packet every 2 months, the reduction would be very gradual and perhaps not even noticed. This is the magic trick that the US Federal Reserve will attempt to perform over a long period of time. Whilst many commentators have suggested that central banks will take away the punch bowl from markets, we view it more as the punch bowl becoming less spiked. Instead of three bottles of vodka in the punch, there will only be two!

Fang unlikely to go Bang

Looking at the recent market sell off in the technology sector (which has been an outstanding sector this year), brings to mind

PE Ratio of NASDAQ Composite Index (10 Years)



Source: Bloomberg L.P.

the expression, "throwing the baby out with the bath water". Observing the internal market action over the past couple of weeks, it seems glaringly obvious that investors have sold down the sector on an indiscriminate basis and have rotated into other sectors on an equally willy-nilly basis. For the thoughtful investor, this can almost be viewed as manna from heaven given that not every technology company is on an extreme valuation whilst every utility, oil or bank stock equally is not cheap. These sharp moves have been primarily driven by ETF trades and give the diligent active investor an opportunity to outperform the market if they are prepared to ignore the short-term noise, do their research and take a somewhat contrarian stand. In fact, within the US market as an example, it is not difficult to find technology companies trading on dearly double-digit PEs with PEG (price to earnings growth) ratios significantly below 1. In an economy, unlikely to produce significantly more than 2% GDP growth this year (the USA), companies which can grow earnings at strong double-digit levels are deserving some kind of premium to the overall market with a reasonable justification. Looking at some real examples, Facebook, whilst trading at a not insubstantial multiple of 40 times trailing earnings doesn`t look that expensive considering its price to earnings growth (PEG) level of just over 1. In fact, this PEG multiple is at one of the lowest points since 2012. When compared to a "safer" company like Johnson & Johnson, for example, which trades on a trailing PE of 21 times and a PEG of 2.9x, one could make the argument that it looks cheap.

Apple is another glaring example that has been caught up in the recent rout and trades on below 18 times trailing earnings versus 21 times for the overall S&P500, has a huge free cash flow yield, significant cash balances and could be a beneficiary of new US tax laws. Given its size, it also remains an emotional stock for investors, and this brings opportunity.

Would you believe that Alibaba only trades at a slight PE premium to a company like Procter & Gamble, for example! When you look at the 2019 PE estimates, you are talking about 23 times forward earnings versus 21 times, and given Alibaba`s recent bold announcement that they can grow revenues and earnings by 45% or more for the next several years and that CFOs normally lowball their figures, it seems likely that there could be some upside to these numbers.

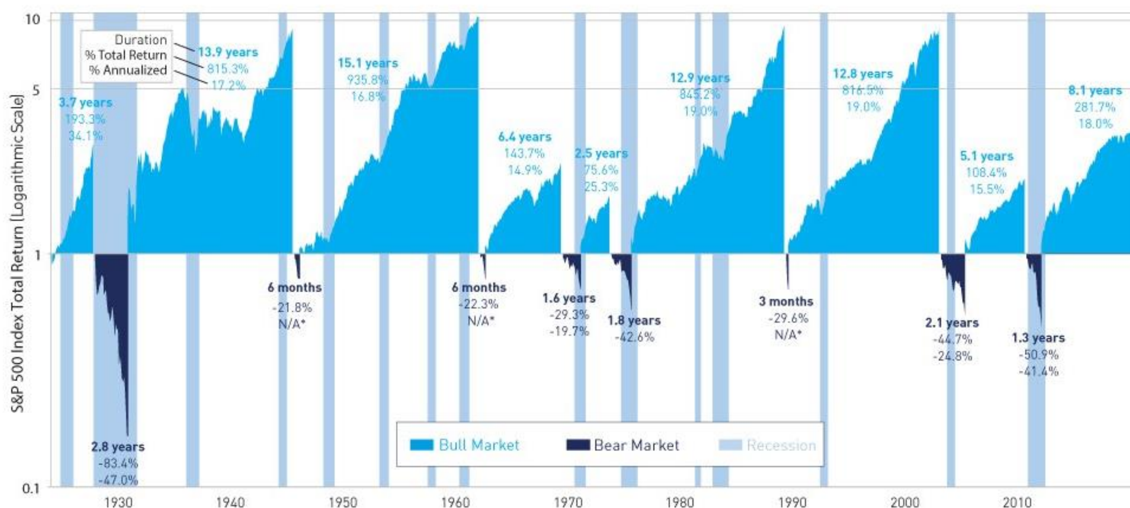
Whilst I am not recommending investors to buy or sell any of the stocks mentioned, the lesson to be learned is that the market is not painted in terms of black and white but rather different shades of grey.

Heading towards nirvana

Whilst there is no doubt that markets have performed well due to easy monetary conditions from central banks, we are now heading into a much more important phase. This secular bull market is now being driven by earnings growth, and we are very excited about this new progression towards fundamentals. US companies have now come out of a two-year earnings recession and European companies are producing the best earnings season in over ten years.

Two very beautiful things are happening, for which we have been waiting almost a decade: global synchronized earnings growth and global synchronized economic growth. Combined with the Goldilocks (not too hot or too cold) policies we are expecting from central banks, it builds a type of nirvana for equity investors. We know that this is not a

consensus view but we are quite comfortable to be in a minority. Never in 30 years have I seen a bull market so loathed as this one. Investors remain nervous, skeptical, cash rich and are likely to be wrong footed by this secular bull market once again. Looking at previous bull and bear market cycles, we can clearly see that in terms of duration this current bull market is definitely not the shortest. However, its gains are somewhat pathetic when compared to previous cycles. In fact, when measuring a secular rather than a cyclical bull market (you only know for certain which one it is after it is over), it is normal to start measuring it when the previous cycle`s high has been broken, which was in 2013 for the S&P500. In this case, that would mean that this secular bull market is about a third of the way through its course with the best gains still yet to come. We will not worry about what comes after it just yet, as that is a long way in the future!



Source: First Trust Portfolios L.P.

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 / © 2017 swisspartners Advisors Ltd. All rights reserved.