KEHRLI & ZEHNDER

INVESTMENT COMMENT

July 2018

- **Enjoy the Beach**

  During the first half of 2018, almost every major global equity market lost ground, so did US treasuries, US investment grade bonds and European debt. What fared well were "high-beta" investments such as small cap, technology and energy stocks as well as junk bonds.

  It might make sense to reduce market exposure before the summer. The upcoming earnings season will not deliver the needed boost to the equity markets given the macro overhang – rising interest rates, rising oil prices, ongoing trade concerns and pressure on immigration in Europe. But remember to re-invest in September when the U.S. orients itself toward the mid-term elections.

- **Are Asian equities already a "Buy"?**

  Asian and global mutual fund managers reduced their exposure to Asian equites on a massive scale, erasing 14 months of prior inflows. Risk appetite on Asian equities is nearing over-sold levels. The looming trade war between the U.S. and China will have spillover effects across Asia (that supplies many of the intermediate goods). At some point the pullback will present an attractive risk-reward opportunity, but we are not there yet.

- **European Worries**

  Financials across the world have retreated, but European bank shares have suffered the most, having fallen 24% since their intra-cycle high in late January. The fact that the ECB has not followed the Federal Reserve's tightening path that would have yielded steeper curves (beneficial for banks) is one reason. Without support from tax cuts or pro-business policies, the continent is also suffering from political changes and uncertainties in Spain, Italy, the UK and most recently in Germany. Confidence and optimism could return from fiscal or monetary expansion, external demand, and the animal spirits of entrepreneurs and consumers. While the first three look increasingly less likely, the sell-off in bank shares is evidence that consumer and entrepreneurial confidence is getting increasingly gloomy.

- **Emerging Markets suffer a retreat**

  Emerging markets have been negatively affected by a stronger US dollar, rising rates and higher oil prices. Furthermore, given that the US treasury continues to issue large amounts of debt, it sucks up demand that otherwise could go into emerging market debt. Indonesia, Turkey and Argentina had to deal with country-specific issues as well.

  The sharp depreciation of the Argentinian peso and the significant widening of sovereign debt spreads followed by decisive reaction of the Argentinian central bank to raise short term rates to 40% reminded investors of that country's grim recent economic history at the beginning of this century. However, timely action by the Macri government and a large support package from the IMF (USD 50bn), which was designed by the Argentinians (sense of ownership!) helped restore confidence and reduce volatility. Argentina has been upgraded by MSCI to Emerging Market status (from Frontier Market status) which is a boost.