KEHRLI & ZEHNDER

January 2019

TOP TEN THEMES FOR 2019:

1. **Contrarian and 35% probability.** Warren Buffett once said: «Be fearful when others are greedy and greedy when others are fearful.» If Buffett were right, this is a good time to get greedy: according to chart analysis, markets bottomed on December 26. The previous two corrections in 2011 and 2015 remained above the trendline and rallied from similar levels. Hence, should a recession be avoided, this cycle could have another leg up and propel the S&P500 to as high as 3,150 points, but not before retesting the lows of 2,350 and forming a double-bottom first.

2. **Mean Reversion:** Growth of household wealth and growth in GDP are closely correlated and have always mean-reverted when one outpaced the other. During the last few years, the "everything-bubble" in the U.S. has resulted in private household wealth growing significantly faster than GDP. For this to mean-revert, either GDP growth needs to pick up drastically or U.S. household wealth needs to correct by 25 – 30%. Our money is on the latter.

3. **Revival of stock picking.** Focus on small- to midcap, owner-led, growth stocks. After a decade-long bull market and an unabated inflow into ETF's, the Q4/2018 correction has demystified this passive investment strategy. ETF investing magnifies trends. In a bull market, index investing pushes equities up with a bias for large cap equities (represented in more and bigger ETFs). In a selling environment, the same occurs. Expect the more widely held stocks to be oversold in a down market.

4. **U.S. Fed will slow rate hikes.** Having raised short-term interest rates 9 times since 2015, the Fed also stopped quantitative easing. This has sucked additional liquidity out of the system. We see further further rate hikes as less necessary in order to prevent a potential overheating of the U.S. economy.

5. **The return of volatility by Twitter.** President Trump's style of communication continues to spook markets. Confrontive antagonism is his style to reach a deal, as seen with his push against Congress to finance the "see-through wall of steel", against China and Europe over trade tariffs, and against his neighbors over the NAFTA treaty. This continues to push up volatility and further supports our call for more opportunistic investment strategies, such as stock picking and long/short strategies.

6. **Worries in Europe.** It looks increasingly unlikely that the UK will leave the EU with a deal that is acceptable to both sides. A disorderly exit will rattle equity markets and the British pound - at least in the short-term. Italy's populist government remains firm on lowering taxes while increasing welfare spending. This will add additional pressure to public finances. Germany could enter a recession, France's people are not ready for its president's reforms and Greek solvency will be back on the agenda. We remain underweight European equities.

7. **Buy Japan**. We liked Japan in 2018 due to valuation. After the recent correction we like it even more. Valuation, political stability, continued demand from a strengthening Asia, a firm trend in capex and higher-than-expected wage increases more than compensate for the proposed sales tax increase.

8. **Emerging Markets: not yet.** While Latin America remains attractive based on valuations and pro-business leadership, its equity markets need calmer waters and a weaker USD as a catalyst for revival. India and China offer pockets of value but their markets overall are not for the faint at heart.

9. ***Good morning, Vietnam!*** We continue to see Vietnam benefitting from the U.S./China trade war. Due to favorable demographics, attractive wages, low electricity costs, improving logistics and a pro-business administration, it ranked first among seven emerging Asian economies in a recent Natixis study.

10. **Fixed Income: Inadequate compensation of assumed risk.** It makes limited sense for CHF or EUR based investors to hold local or US treasuries due to low or negative local rates and/or the high cost of hedging. High yield and private credit are still too expensive. Consider cash as an alternative.