KEHRLI & ZEHNDER

INVESTMENT COMMENT

February 2019

- **January rebound in equities – more to come?**

  After the worst December (S&P 500 lost over 9%) since the Great Depression, U.S. equities rallied almost 8% in the first month of the year – the best January in 30 years – much stronger than the typical "January effect". Fourth quarter earnings came in surprisingly strong, unemployment remained at 4%, and the Federal Reserve indicated breaks on monetary tightening. Last week's PMI numbers went up by 2.2 percentage points to 56.6% - further indication of the U.S. economy's solid footing. Increasingly likely resolutions on the trade front and the government shut-down put risk-on trades back on the table.

- **Emerging market equities - a contrarian case**

  We observe that all 5 important triggers for a bull case in emerging market assets are present: low oil price, a weakening US dollar, a stable or falling short-term rate environment, capped long rates and relatively tight corporate spreads. Add China's priority to stimulate its domestic economy, we have a strong investment case for emerging market assets - both equities and fixed income.

  Having said that, the environment still does not favor emerging market equities due to U.S. dollar strength, contagion and negative sentiment (Argentina, Turkey and Indonesia), the trade war and potential U.S. repercussions against "non-friends". For contrarian and value investors, EMMA equities look attractive given their historically high discount to U.S. equities (and a forward P/E of 11 times). Emerging markets are growing at 5% (compared with 2% elsewhere), are home to 80% of the world's population and responsible for a purchasing power-adjusted 50% share of the global economy.

- **China – valuations getting attractive**

  Certain measures will improve sentiment and bring foreign capital back to the Middle Kingdom: the Chinese government has targeted stimulus measures (including a tax cut), a new funding facility with lower interest rates for privately-owned companies and SMEs, and a 100bp cut in the reserve requirement ratio to improve liquidity. At the end of February, MSCI will decide whether to raise the inclusion factor for China A shares in all MSCI indices from 5% currently to 20%. A de-escalation of the trade war would certainly be supportive.

- **Gold – finally!**

  Gold rallied by 11% in the past six months. This was driven by a weaker USD, increased demand from central banks, potential supply shortages due to reduced capex and the (at least temporary) death of Bitcoin as a perceived store of value. The change in the downward trend paired with depressed valuations make gold explorers and producer stocks a high beta play.

- **Oil – range bound**

  Oil appears to be in a trading range between USD 50/bbl and USD 80/bbl. While an oil price around USD 50/bbl puts pain on the U.S. oil industry, prices around USD 80/bbl put pressure on U.S. consumers. By either increasing or decreasing its pressure on sanctions on Iran, the Trump administration has turned Iran into an effective swing producer.

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