KEHRLI & ZEHNDER

INVESTMENT COMMENT

April/May 2019

- **Late cycle in U.S. equities?**

  The S&P 500 has rallied 17% year-to-date to hit a new record high supported by robust earnings, strong cyclical economic indicators (housing, capital goods, autos) and a technical rebound after a horrific Q4 2018. Yet the announcement by the Fed in late March that it will not raise rates further this year has led to an inverted U.S. Treasury yield curve on and off. Even though all recessions are preceded by an inverted yield curve, not all yield curve inversions lead to recessions. The question is whether this is the last leg of a bull market. A large number of IPOs are scheduled for this year, which is often indicative of toppish equity prices.

- **Chinese/emerging market equities – will the rally continue?**

  China's CSI300 was the best performing equity market in Q1 worldwide, up 29%. We think that about two-thirds of the gain was driven by valuation and the rest by positive sentiment. Emerging markets have done well overall, driven by U.S. rate hikes being put on hold, Beijing's efforts to support the Chinese economy and expectations of an imminent resolution to the U.S.-China trade dispute, a positive outcome of which should lead to another upward re-rating of emerging market equities.

- **Continue to avoid Europe**

  Whatever the outcome is for Brexit, more than 100 banks have announced their relocation of some activities to Dublin in preparation for a different legal environment. Italy is in political turmoil, elections are upcoming in Spain and Germany remains dependent on China (which accounts for 10% of total German exports). These concerns continue to weaken investors' confidence in European equities. During the past 12 months, European equity markets saw USD 117bn of outflows – the largest yearly outflow on record. Having said that, Europe offers more value for the contrarian investor than the U.S.. What is needed is a trigger to kick-start the buying.

- **Take some profit on equities**

  Aside from the U.S., other central banks have also remained dovish: the ECB continues to buy besieged assets, the SNB recently threatened to even expand its negative rate regime, India lowered rates recently and the rest of Asia remains accommodative. However, due higher valuations and strong first quarter portfolio returns, we expect markets to take a breather. Heading into the traditionally weaker summer months, we suggest to either reduce equity exposure or put on hedges.

- **Beware of Fixed Income and Credit**

  Government debt continues to be very expensive (Switzerland's 10-year yields are -0.32%, 10-year German bunds yield 0.03%, Japan's -0.04% and almost-broke Italy's 2.57%). Spreads of lesser quality issuers do not compensate for taking on additional risk. In addition, over the last few months, credit has expanded massively, especially in the CLO space. While history will not repeat itself, it does rhyme. We suggest to increase cash at the expense of credit and bonds as well as keeping dry powder for future opportunities.

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