KEHRLI & ZEHNDER

INVESTMENT COMMENT

March 2017

- **Equities - shift from the U.S. to Europe**

  In Europe, core inflation rates are slowly creeping higher. Nominal wage growth has accelerated to 1.8% and rising credit growth signal a slow but steady recovery. Somewhat traditional, i.e. conformist election results in the EU will pave the way for Mr. Draghi to dial back his ultra expansionary policies and adopt a more optimistic forward guidance. Given that interest rates in the U.S. are almost certainly going to rise, the time seems ripe for a gradual shift from richly valued US equities to the European laggards.

- **Buy protection on US equities**

  Volatility levels are at new record lows, which implies utmost complacency in the markets. Valuations of US equities are stretched, yet insurance is not expensive. Mr. Market's mind-boggling complacency has given us an opportunity to buy protection at a huge discount. We recommend buying put options or selling S&P500 futures. The cost of liquid long-dated hedges in equities and credit has reached its lowest level in six years.

- **CTA hedge funds are another hedge**

  Out-of-favor and out-of-luck CTA managers traditionally fair well in times of distress and could be another way to protect against losses from an unexpected sell-off.

- **Buy gold and keep short maturities**

  A recently recovering USD has pushed **gold** prices down by more than 4.5% providing an attractive entry point **at USD 1,200** per ounce.

  For your credit portfolio we suggest to stay with a **short duration** portfolio hedged back into your reference currency.

- **Oil trade – not yet**

  As we said in previous comments, the OPEC oligopoly is broken and cannot influence prices the way it used to. All OPEC countries including Russia only control about 50% of global oil supply. Hence, oil is trading more in line with supply and demand. Recent huge discoveries in Alaska and continued efficiency improvements in shale production have fundamentally changed the supply-side, limiting the upside to oil prices - at least temporarily.

- **Regulatory and educational framework need to change in the U.S.**

  Contrary to public perception, the U.S. actually reached a manufacturing record last year – but without a lot of people. Thanks to automation, the U.S. now makes 85% more goods than it did 40 years ago but with only two-thirds of the number of workers. While unemployment fell drastically during Obama's presidency, the participation rate remained at record lows. A high percentage - 18.5% - of Americans in their prime working years are neither working nor looking for work. As digital disruption continues, each country's education system needs to turn out workers with different skills to meet the changing demands of the workplace.

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