KEHRLI & ZEHNDER

INVESTMENT COMMENT

June 2017

- **May Day, May Day**

  The surprise election outcome in the UK resulted in the first hung parliament since 1974 (no party with an outright majority). This increases the range of possible outcomes, adds further uncertainty to the path for Brexit negotiations and adds volatility to UK equities.

- **Focus on European equities**

  Within Europe, focus on the continent. Deflation risks in the EU have pretty much disappeared. First quarter GDP growth was revised upwards to 0.6% and the GDP growth forecast for 2018 was recently upgraded to 1.9%. Since Macron is likely to win an absolute majority in the parliament, he will put an end to a multi-party system that shared power in France in the last 60 years. It could give him the mandate to introduce pro-market reforms that France so desperately needs. Meanwhile, reduce US equities, where the Shiller P/E is trading at 30 (a premium of almost 80% to the historical mean).

- **Trump's Paris withdrawal: only moderate impact**

  The Paris climate agreement is non-binding to begin with. At the end of the day, consumers will demand energy-efficient LED lights or battery-powered cars because they are superior products offered at a lower total price than their inefficient incumbents. Technology will drive the shift to a low carbon economy - not governments or multi-lateral non-binding agreements.

- **We are increasing our Chinese equities weighting**

  Despite Moody's downgrade of China's sovereign debt rating to A1 from Aa3 on the back of concerns about the high levels of debt in the system, we remain constructive on China. The country is where the U.S. was after World War I – a giant in the process of waking up. There will inevitably be short-term ups and downs, but the long-term trend remains intact. The government's hands-on involvement in improving institutions and processes is a far cry from its emerging market peers. Not only has capital flight dwindled during the last few months, the government's efforts to cap leverage has shown signs of success.

- **Belt and Road Initiative**

  The recent Belt and Road Forum gave further credence to China's growing role as an economic and political hegemon. The infrastructure spending initiative (formerly known as One Belt One Road) is the largest infrastructure spending project the world has ever seen and will connect China with its neighboring countries - extending all the way to Western Europe. Beneficiaries are the infrastructure and construction-related sectors, both in China and globally.

- **Impeachment risk**

  Pressure on the current U.S. president is mounting and the odds of an impeachment have gone from improbable to possible. Do investors need to worry? No, since his probable successors (VP Mike Pence or House Speaker Paul Ryan) will likely pursue a similar pro-business agenda of deregulation, tax reforms and enhanced infrastructure spending but without the unpredictability and personality deficits of the current President - so it may even be a plus for financial markets.

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