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INVESTMENT COMMENT

July/August 2017

- **Volatilities are low – and getting lower**

  Despite global uncertainties in North Korea, the Middle East and the unconventional style of leadership in the White House, global financial market volatility continues to fall - and equity indices keep reaching new cycle or all-time highs. Investors appear to not be bothered by the geopolitical uncertainty in the short-run, and are focusing on opportunities that currently present themselves as all major economies are growing in sink for the first time in at least a decade.

- **“Steady as she goes”: grinding higher**

  Bull markets do not die from old age – nor from valuation – but from fears of a recession, rising interest rates, falling profits, sharply rising commodity prices or exogenous shocks (such as war). None of the above conditions are imminent. We are generally positive about the state of the economy and would advocate to buy the dips (favoring equities and selective risk assets). Global central banks continue to flood the markets with liquidity, with the ECB and BOJ investing more than USD 150 billion per month combined into fixed income markets (nearly USD 8 billion per day).

- **European equities: gaining momentum**

  Pro-Europe signals are strong, and consumers are pushing the economic sentiment indicator to its highest level since the eve of the financial crisis in 2007 - all but annihilating worries about deflation.

- **Japan: gradually build up exposure**

  Japanese equities continue to be overlooked by foreign investors. Equity markets rose for the fifth consecutive year in 2016 despite a sell-off by foreign investors. During the last six years, effective corporate tax rates came down from 39.5% to 30%, which contributed to higher returns on equity. The end of the deflationary spiral (which stifled consumption) is also changing the investment narrative to that of a growth story (from that of a value trap).

- **Opportunities in Latin America fixed income**

  In Argentina, Peru, Brazil and Uruguay and soon Chile, there is a general political shift to a more market-friendly approach which merits some attention. The best risk/return opportunities lie in high yield (where real credit risk is over-estimated), local currency-denominated bonds (currencies are undervalued after sharp sell-offs in the past three years), and in Argentina (changes introduced by President Macri). Inflation and fiscal deficits are falling in all the major economies across the subcontinent while genuine growth is returning.

- **Main risk: geopolitical instability**

  The next market turn could be triggered by deteriorating political developments, which could happen without much warning. The elephant in the room is clearly North Korea. Expanding and testing his arsenal to his liking, Mr. Kim is provoking his enemies. Syria and the Middle East in general continue to be concerning, and the strength and danger of terrorist organizations lie in the unpredictability of their strikes against civilians. During such unpredictable times it is prudent to buy protection, which – thanks to historically low volatility – can be bought at rock-bottom prices.