KEHRLI & ZEHNDER

INVESTMENT COMMENT

March 2018

- **Happy 9th Anniversary, may you live forever!**

  The bull market turned nine years old earlier this month extending an epic run for U.S. stocks, the second longest in history. Both the Dow Jones and the S&P500 more than tripled and the NASDAQ Composite nearly quintupled during that time! The past 2,266 trading days witnessed a strong return in corporate profits, the drop in unemployment rates to a 17-year low, and an expansion in the pace of global economic growth.

  With inflation on the rise and the U.S. economic growth still on a firm expansionary trajectory, the question is whether this party can continue despite rising interest rates. Falling share prices are not the inevitable consequence of higher rates: A boost to medium-term growth expectations or a decline in the equity risk premium (ERP) could offset the negative valuation impact of rising bond yields. Goldman Sachs argues that even if 10-year Treasury yields rise (slowly) to 4%, equity prices could continue to rise moderately provided earnings growth accelerates and production efficiency can be implemented.

  We remain moderately bullish on equities globally accepting increasing volatility, despite a looming trade war, slowly rising rates in the U.S. and China, and top economic advisor Gary Cohn leaving the Trump administration.

- **USD and interest rates**

  Conventional wisdom suggests that faster rising interest rates in the U.S. compared to Europe would strengthen the USD. However, history shows no clear relationship between Fed tightening cycles and the value of the USD. On the contrary, when the U.S. introduced trade tariffs against a backdrop of worsening trade competitiveness, the USD usually was associated with subsequent weakness. For this reason we see President Trump's trade restrictions as a reason to remain cautious on the outlook for the Greenback.

- **Rising cost of capital in the face of record debt – and record wealth**

  More worrisome than a long bull market is the record level of indebtedness of U.S. non-financial corporations. As a percentage of GDP it reached 73%, the highest level since 2003. Furthermore, total U.S. consumer credit card debt surpassed 1 trillion dollars, and in 2017 alone U.S. consumers added another USD 92 billion to the tab. However, thanks to strong stock market and real estate appreciation Americans' total wealth surpassed USD 100 trillion putting total credit card debt into perspective. The problem is the unequal distribution of wealth and debt. This could become dangerous, if the Fed had to increase rates more quickly and substantially than anticipated in order to fight potential overheating and falling behind the curve.

- **China is forecasted to overtake Euroland in size this year**

  While the GDP of 19 countries using the euro is expected to grow to USD 12.8 trillion, China GDP is forecasted to reach about USD 13.2 trillion. The last time China's economy was larger than continental Western Europe's based on a study by the University of Groningen (NL) was in the mid 1800's. This is further testament to the rapidly changing world we live in, where Europe is increasingly marginalized.

- **Did anyone say India?**

  Based on a scenario of multi-year expansion, Indian equities provide double the earnings growth at significant discount to the U.S. equity market. Investors with a long-term investment horizon should buy selective Indian equity exposure.