KEHRLI & ZEHNDER

INVESTMENT COMMENT

May 2018

- **U.S. – China trade disputes**

  A trade war would hurt U.S. employment, consumer spending as well as economic growth. Estimates show that a typical American household saves up to $850 per year through more affordable goods that are produced in China. Furthermore, the U.S. may be hurting their own companies as they seek to regulate technology investments from China. The case of Chinese giant ZTE illustrates this point – the 7-year ban from buying American technology will impact the businesses of Intel, Micron, Qualcomm, Microsoft and Oracle to name a few. Other countries are affected as well, as Malaysia, Vietnam and South Korea produce a lot of the intermediate goods along the value chain of “made in China” products. We expect higher market volatilities from this uncertain macro backdrop – or rather, volatility levels that are back to the normal range.

- **A flatter yield curve**

  The 10-year US-treasury rate rose above the psychologically important 3% - the first time in four years - up 90bps since last September. There has been 150bps in rate hikes since December 2015 and the market is pricing in three more in 2018. New Fed Chairman Jerome Powell expressed confidence that inflation levels will stay close to the 2% target (after 6 years of falling short). The yield curve has flattened as a result, which is not necessarily bad for equities, as moderate growth, low unemployment and stable inflation (a Goldilocks-like economy such as in the mid-1990’s) creates a positive investment environment. But stay away from traditional financials and long-dated bonds.

- **Will the yield curve become inverted?**

  Should the yield curve become close to flat or even inverted, it could signal an impending recession. Over the past 40 years, there were five recessions in the U.S. and every recession was preceded by an inverted yield curve. But an inverted yield curve does not necessarily lead to a recession or an equity bear markets and also not right away (there is statistically a 17-month lag). At this juncture, we believe the probability of a recession is rather low.

- **A strengthening US dollar**

  The US dollar rose 3 to 4% against the Euro and the Swiss Franc in the past month and touched its 2018 high against a currency basket in expectation of further rate hikes this year. But the rally may be short-lived. The good news is US dollar strength gives the ECB and the Bank of Japan more flexibility to depart from their negative interest rate policies.

- **A tech stock pullback?**

  The NASDAQ index is up 4% year-to-date which disguises the wide disparity in performance among the most-watched stocks. On the one hand, Amazon is up 35% this year, having delivered impressive revenue growth and in particular margin expansion in Q1: revenues grew by 43% while earnings per share expanded by 121%. On the other hand, Facebook is flat year-to-date on the back of privacy and personal data issues. Going forward, the pressure on U.S. firms to adopt to more stringent data-protection requirements (like those already in force in Europe) will continue.

KEHRLI & ZEHNDER · GARTENSTRASSE 33 · 8002 ZÜRICH · SWITZERLAND · T +41 44 222 1818 · F +41 44 222 1850 · answers@kehrlizehnder.com