KEHRLI & ZEHNDER

INVESTMENT COMMENT

February 2017

- **US dollar: limited upside for now**

  In order to “make America great again”, **President Trump would need a weaker dollar**. One obstacle is the US has maintained a bias toward tightening, while Europe and Japan have an stance toward easing. Having said that, the Fed left rates unchanged in end-January even though employment and manufacturing numbers continued to surprise to the upside. Its language also changed marginally, indicating that a rate hike in March is less likely.

- **US equities: gradually take profit**

  Over the past few weeks, the Dow Jones Industrial Average surpassed the psychologically important 20,000 mark for the first time in history, while both the S&P500 and the Nasdaq reached all-time highs. In the past 4 years, profits of S&P 500 companies were largely flat, but the index still appreciated 60%. Naturally, declining interest rates led to higher P/E ratios, but **US equities are over-valued nevertheless**. The total value of U.S. equities is estimated to be more than 170% of GDP - approaching the 177% valuation at the end of 1999 (pre-internet bubble). In comparison, at the end of 2008 (after the financial crisis) the figure was at 85%. We may be nearing peak valuations, regardless what momentum might tell you.

- **Russian equities: capture the value**

  Despite last year’s rally, Russian stocks are still very cheap. Russia will benefit from the return of the **commodity bull cycle** (stable to accretive oil prices), more accommodative interest rates, a strengthening Ruble and significant investments in technology during the last couple of years. Should improved relations with the U.S. lead to an end in sanctions – at least by the U.S. – Russian equities are poised for a rally.

- **Oil: expect an upward move**

  Oil will benefit from an improving business cycle, which drives up the scarcity premia. Typical for a growth cycle, spot prices for oil today are higher than forward prices (backwardation) given that demand is higher than supply. We recommend to **buy oil on a pullback to USD 52** and sell it when it reaches USD 60. With shale production, it is easy increase or decrease supply quickly, which has resulted in a fairly narrow trading range.

- **China: taking over global leadership from the US?**

  At the World Economic Forum in Davos, China’s president Xi Jinping boldly declared that his country would defend globalization and keep its doors wide open to “realize the great rejuvenation of the Chinese nation”. Meanwhile, Trump has all but abdicated the U.S.’ decade-long role as the world’s leader by suggesting new tariffs and exiting the Trans-Pacific Partnership (TPP) for example, leaving a void for China to fill. Should mutual fund managers decide the reduce the largest underweight exposure to Chinese equities in nearly a decade, their buying could push up prices notably.