KEHRLI & ZEHNDER

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TOP TEN THEMES FOR 2018:

1. **Synchronized growth.** Our base case is for continued economic expansion in the U.S., Europe and the Asia Pacific region. Populism will not lead to a significant retreat in globalization and worries about secular stagnation are overdone. Our main caveats are historically high valuations, higher bond yields and complacency. Investors should buy on dips.

2. **"GAFA" and "BAT".** Google, Amazon, Facebook and Apple in the U.S. and Baidu, Alibaba and Tencent in China will continue to deepen their encroachment into our lives – and expand their dominance in the economy. Digitalization, Big Data and Blockchain will open opportunities for those who have the most information about our activities, preferences and behavioral patterns.

3. **The U.S.: "Much ado about nothing".** While President Trump's style may be offensive and polarizing, he has not done much lasting damage to the U.S. nor the global economy (yet). A strong job market, capacity constraints and tax reforms that are expected to stimulate the economy will put upward pressure on inflation and bond yields. Should 10-year yields rise above 3%, equities could come under pressure. Focus on shorter duration cyclical stocks over growth stocks.

4. **Buy Emerging Markets.** Latin America remains attractive with an improved macroeconomic backdrop, accommodative domestic financial conditions, strengthening confidence levels, pro-business governments (especially in the southern cone) and the normalization of risk appetite. We expect a strong rebound in the Indian economy after the recent shocks of demonetization and a new tax regime. This trend should continue well into 2019 and is not yet fully priced into Indian equity markets.

5. **Buy Japan**. As in 2017, we continue to like Japan due to moderate valuations, continued demand from a strengthening Asia, a firm trend in capex and higher-than-expected wage increases.

6. **Steady China:** A pro-inflation bias coupled with an ongoing crackdown on financial risk will ensure steady rather than speculative growth in the Chinese economy. Expect further innovation coming out of China in the areas of artificial intelligence, robotics, mobile payments, car-sharing and electric vehicles.

7. **European equities as laggards (contrarian).** European equities benefitted from an undervalued Euro in 2017 but that is no longer the case. In Germany, another Merkel reign with SPD participation will leave countless necessary reform programs unresolved, it does not curb spending nor reduce taxes despite record economic output, its effort on renewable energy is running out of steam and getting increasingly expensive, labor issues are on the rise. Brexit will take longer and will be more costly than anticipated; Poland is considering leaving the EU. Bright spots include Switzerland and Spain.

8. **Fixed Income: high grade debt is still not an alternative.** Inflation is on the modest rise in the U.S. and the Fed is expected to trim its balance sheet in 2018 and implement three rate hikes. The U.S. yield curve will flatten further. On the other hand, the ECB will remain dovish - 40% of European government bonds trading at negative yields and Europe is far away from its inflation targets. We expect the yield differential between the U.S. and Europe to widen.

9. **TINA ("there is no alternative") – yes there is!** With US treasury short rates above 1% in real terms for the first time in nearly 10 years, investors do not need to fear getting poorer holding short-term paper.

10. **How to protect against the unexpected.** Should the world move into an inflationary environment, bonds will not only fail to provide protection, they will amplify losses. For such a scenario we recommend cash, commodities and gold. Gold is also a hedge against a weaker US dollar.

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