ARVEST

October 2016 | Issue no. 103

Briefing from the ARVEST Investment Committee

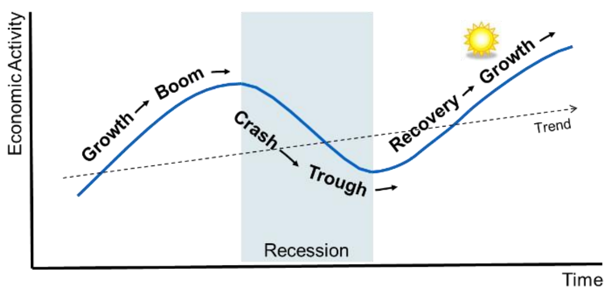
Equity investors enjoyed considerable price gains in the past third quarter. Despite all the prophecies of doom the referendum on United Kingdom membership of the European Union (Brexit) did not lead to a crash in the equity market. «Brexit», on the other hand, illustrated quite well, what actually moves stock markets. If possible outcomes are broadly discussed amongst market participants in the run-up to an event, even the arrival of the more unlikely scenario often only results in relatively small or only transitory price fluctuations. This happens because this negative scenario did not materialize completely unexpected. On the other hand, substantial and sustained price losses often occur if putative certainties are called into question. This happens because market participants were not at all prepared for a negative scenario. They have to revise their expectations much more broadly and sharply. It is, therefore, neither the known nor the unknown, but much more the unexpected, that causes substantial market crashes.

Some investors, ignorant of these contexts, commit the cardinal mistake of selling stocks in a crisis and waiting with new investments until newspapers again report on a positive economic environment. However, since in a crisis negative economic consequences are already known and reflected in the stock prices, these investors sell at bargain prices. Later, when newspapers no longer spread bad news, they often have to buy back into the market at higher prices. Therefore, for equity investors, "bad news" and not "no news" are the really "good news".

We are currently in a period with a stable but very slowly growing global economy, with the US recovering more quickly from the financial crisis than the rest of the world. Since growth has lagged behind expectations of investors year after year, their expectations for the future are quite low. But it should also not be forgotten that the current stability in the economic data continues to be sustained with unconventional measures in monetary policy. In particular, the central banks in Japan, the EU, Great Britain and also Switzerland directly and indirectly influence asset prices that previously were useful as signals for the state of the broader economy. Today, this information has to be interpreted with greater caution since their significance became more uncertain. Also, the zero or negative interest rate policy of recent

years seems to have led to unexpected consequences that even contradict the intended effect to increase demand. For example, a recent survey by the well-known survey institute Gallup showed that - in stark contrast to the pre-crisis period - two-thirds of the young Americans now say they enjoy saving money more than spending. This could be due to the insight that, at very low interest rates, the effect of compound interest becomes insignificant and therefore more has to be saved annually for old-age provision.

Future Prospects



After the US has returned to a normalized monetary policy and very cautious interest rate hikes last year, it is not bold to assume that the rest of the world will follow in the coming years. Financial markets imply this expectation and assume weak global economic growth for years to come.

The ARVEST Investment Committee also assesses the global economy to be in a moderate growth phase. Leading indicators do not show any relevant likelihood of an imminent recession in the US. Moreover, European economies are likely to continue their recovery. In China, despite mixed signals, we expect only a muted slowdown in economic growth. Emerging markets should benefit from stabilized commodity prices and attractive refinancing conditions.

In addition to economic developments the ARVEST Investment Committee considers valuations of various asset classes when forming its investment policy. According to our preferred valuation methods stock markets are still fairly priced relative to cyclically adjusted corporate profits if we take low inflation and low interest rates into account. We hardly observe any irrational prices which market participants are often prepared to pay during a boom at the end of a business cycle. This does not apply to bond markets which have once again soared in the wake of the British referendum and can certainly be described as overpriced. In spite of increased volatility in financial markets the ARVEST Investment Committee continues to prefer stocks and cash over bonds.

Not least because of the difficulty of data analysis in times of unconventional monetary policy, we have been supplementing our analysis with thematic studies for several years. Even if we do not think we have found the proverbial crystal ball, we hope to quicker recognize and better understand any possible paradigm shift. We focus on the topics of inflation / deflation, debt management, market participants / market liquidity, economic change in China and political challenges. We currently assess relevant risks in all five areas, but we estimate the risk of a short-term escalation to be low to moderate.

12.10.2016
On behalf of the Investment Committee
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