ARVEST

October 2017 | Issue no. 107

Briefing from the ARVEST Investment Committee

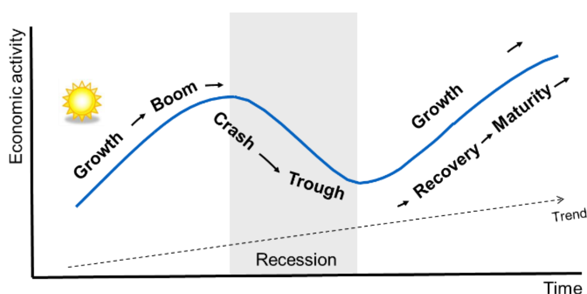
Shareholders are looking back on a very pleasant summer. Global share prices increased by 5.7% in Swiss francs during the last quarter.

This was not least due to the weakness of the Swiss franc, which lost 4.5% against the Euro and around 1% against the US dollar and the Japanese yen. Despite geopolitical tensions around North Korea, the Swiss franc's status as a safe haven was not in demand this time. The currency fluctuations were quite characteristic for the current global economic situation. After the stabilization of commodity prices in the spring of 2016, the global economic upswing became evident in hard economic data across all important regions. This positive development encouraged economic players to change their minds and nurtured their optimism. Thus, foreign exchange investors increasingly switched from a crisis mode, in which the focus was on long-term capital preservation, to an optimization of yields, where low yield differences between currencies shaped their investment decisions.

What applied to currencies was also true for stock markets. Since November 2016, even an unlucky day trader would never have had to cope with a loss of more than 2.5%, no matter what day he had bought into the main American equity index S&P 500. Such a low market volatility is very unusual even in comparison with similar phases in earlier trading cycles. In the past 10 months, investors entered the market at every little correction and pushed prices up anew.

From a historical point of view, the longer a period of low volatility persists, the bigger the risk that many so-called "weak hands" will be invested in the market. These are investors who have not bought on the basis of a fundamental analysis or a strong, long-term conviction. In recent years, passive investing in equity and bond markets with index-based ETFs has experienced huge growth. Thus, passive investors provided the markets with high liquidity and internal stability. This trend benefits short-term traders and long-term investors but also carries the risk that many weak hands will sell these products in the next crash. The subsequent collapse in prices could arguably be excessively strong amongst large companies, as they are heavily represented in the various indices and ETFs.

In this investor-friendly environment, the Federal Reserve's Open Market Committee presented a plan for the gradual reduction of the gigantic central bank's balance sheet of USD 4.5 trillion without unsettling the markets. At the same time, its chairman, Janet Yellen, delivered high-profile speeches consolidating expectations for the next interest rate hike in December. Surprisingly, Janet Yellen quite frankly stated that the persistently low inflation is a mystery that even the Fed's economic models cannot explain adequately. The lower than expected inflation may be based on transitory factors. Therefore, the Fed would be best adviced to look through them and to move gradually in adjusting its benchmark interest rate. Seperately, Claudio Borio, the chief economist of the Bank for International Settlements, also questioned the established models of central banking, referring specifically to structural reasons such as globalisation, demography or digitalization. This honesty and openness of the most important experts in monetary policy regarding the limitations of their own policy bases and models would have caused a great deal of upheaval in more turbulent market phases.



Future Prospects

The ARVEST Investment Committee assesses the global economy as a whole to be in a moderate and regionally synchronized phase of growth, even if the strong momentum of the upturn between early 2016 and mid 2017 is slowing somewhat. Since economic growth is still sufficiently strong and broadly based, we measure no relevant recession risks globally. Looking at the US dollar, we accept a higher probability of rising interest rates, rising yields or higher inflation. But in the next few quarters, we do not expect any significant signs of economic weakness, given the gradual implementation of the announced monetary policy measures. Money is still very cheap worldwide. However, from a valuation point of view, monetary policy is likely to have a significant impact on financial markets. Since corporate profits usually rise with a growing economy, we continue to favour real assets such as equities. Furthermore, rising yields or higher inflation result in even more direct valuation adjustments for long-term fixed-income investments. Nevertheless, in recent weeks, the ARVEST Investment Committee has reduced its former overweighting of equities, which has been in place since 2016. We increased the proportion of liquidity and short-duration investments in the US dollar as an offset. However, the Investment Committee has not yet identified a market-wide boom period with irrational prices that equity investors usually pay at the end of an economic cycle. In the face of a still heavily indebted economy, we will pay particular attention to interest rate developments and the stepwise reduction in the US Federal Reserve's balance sheet.

12.10.2017
On behalf of the Investment Committee
Stefan Kimmel
Chief Investment Officer ARVEST Funds AG

This report represents opinions expressed by ARVEST Funds AG, is exclusively for informational purposes, is not an offer to invest in investment products and does not make any claims related to completeness. The investments or strategies mentioned in this report are subject to suitability testing and do not replace a competent advisor. Investments may include significant risks. The value of an investment may go up as well as down. Past performance is not indicative for future results. Units of investment funds mentioned in this report may be restricted with respect to certain jurisdictions. Investments in funds are made exclusively on the basis of the official fund documents. These may be downloaded at www.arvest.ch.