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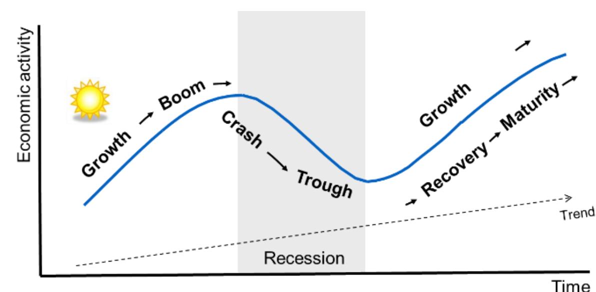
Briefing from the ARVEST Investment Committee

Investors can look back on a very pleasing stock market year. After a strong final quarter, global share prices rose by about 15% in Swiss francs over the course of the year. All leading stock exchanges posted double-digit gains, with currency-adjusted share prices in Japan, Hong Kong and Europe increasing at a somewhat faster rate than in the US and Switzerland. The year under review was characterized by relatively small deviations in annual share price performance and by low daily volatility. A careful analysis of the technical indicators shows that even during temporary price corrections there was very little selling pressure, which could be met quickly even without euphoric new shareholders. The existing shareholders let their profits run in view of good economic data, which, as expected, was reflected in good company reports. With short to medium-term real (inflation-adjusted) interest rates remaining negative in all major currency areas, fixed income remained unappealing to many investors in the past year.

In our investment commentaries published quaterly in 2017, we discussed how longterm investors in the spirit of the banker Carl Mayer von Rothschild should react to political uncertainty, what significance China's domestic economy - the invisible elephant in the room - has and what impact rising interest rates, yields and inflationary pressures might have on the valuations of various asset classes. From the point of view of the ARVEST Investment Committee, these are also the crucial issues for 2018 and beyond. They can be evaluated by looking through our typical "glasses" of economic and stock market-cyclicality.

Future Prospects



The ARVEST Investment Committee assesses the global economy as a whole to be in a moderate and regionally synchronized phase of growth. The past strong momentum of the

initial recovery could slow somewhat, especially in China, but global growth remains strong and broad-based. We do not see any relevant recessionary risks in this environment and accordingly do not yet align the investment structure of our client portfolios to a corresponding downturn phase.

Looking at the dollar area, we assess a higher likelihood of rising interest rates, rising yields and higher inflation. We do not expect any significant signs of slowdown in the real economy if the announced monetary policy measures are implemented gradually in the coming quarters. From a valuation point of view, however, this could well have the first relevant consequences for the financial markets. In the case of long-term fixed income, great caution is called for, as rising yields or higher inflation lead to much more direct valuation adjustments than for equities. As long as the rise in the US dollar's core inflation remains contained and has mainly cyclical reasons (such as falling unemployment or wage pressure), we remain constructive for real assets such as equities. Simply because with a growing economy, corporate profits usually increase as well. In addition, the US tax reform passed shortly before Christmas offers further opportunities to some companies to increase profits.

As announced in the last investment commentary, the ARVEST Investment Committee reduced the previous tactical overweighting of equities in the past quarter in order to increase its share of liquidity or short-term investments in the US dollar. After last year's devaluation and also in view of increasing yield spreads against the Euro and the Swiss Franc, the US dollar is likely to become an increasingly attractive alternative to parking liquidity and to having it available for new investments later on. Moreover, short-term bonds and cash are the only asset classes that can cushion the now unlikely but not impossible scenario of a strong inflationary shock.

This slightly more cautious investment structure can thus be interpreted as a first measure in Rothschild's sense: "Sell when the violins play". The sweet tune of low equity volatility was gentle on the nerves of many investors last year. The geopolitical uncertainties have likewise receded significantly since last spring. Nevertheless, the corresponding indicators have not yet been fully attuned to the "Largo" which was typical for relaxed times in the past.

As long as our assessment of the stock market and economic cycle does not change significantly and equity market valuations remain attractive relative to other asset classes, we do not see any acute need for further reductions in the equity allocation. It is quite possible that investors will differentiate more between individual companies next year. Therefore, stock picking and positioning within the sectors may become more relevant to investment success than last year. This would be a development that we, as active investors, would look forward to. We are hence fundamentally optimistic about the new year, albeit not overly exuberant.

02.01.2018
On behalf of the Investment Committee
Stefan Kimmel
Chief Investment Officer ARVEST Funds AG

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