

12 March 2012

Economic Outlook

Investment Views in brief



- Growth rates in our major markets are still showing a mixed picture, with the US economy marching ahead, Switzerland managing to stay on the growth path at least for now, and the euro zone facing a technical recession. The leading indicators have stabilised, thereby allowing the expectation that economic activity will pick up as the year progresses. The Greek haircut, but even more importantly the ECB's injection of liquidity into the system, has elicited a temporary sigh of relief in Europe, but the next challenges already loom.
- The latest leading indicators for most of the emerging nations continue to point north. The rise in the "new export orders" subcomponent of the Chinese purchasing managers index is cause for optimism. The minor pullback in China's exporting sector should gradually reverse direction in the second half. But several increasingly ominous blips are showing up on the macroeconomic radar screen, amongst them the bulging dual deficits in India and Brazil.
- Despite the otherwise expansive monetary policies of central banks, inflation rates are generally on the wane and should level out in 2012 at roughly 2% because of the lacklustre economy. Switzerland is still suffering from the deflationary tendencies brought on by the strong Swiss franc. Here, hardly any price increases are likely in the current year.
- We do not expect to see any interest rate hikes in our major markets for the foreseeable future. The challenging economic environment hardly allows for that. Another rate cut in the euro zone is entirely conceivable, but for the time being we are not anticipating such a move.

USA: The economic picture in the USA continues to brighten. Thanks to lively consumption and a notable increase in capital spending, Q4 GDP rose by 0.7%. Given America's huge national deficit, government spending will barely increase. Despite a high level of unemployment, personal spending is astonishingly robust but it will hardly be capable of generating more than a moderate 1.5% rate of growth in 2012.

Europe: The euro zone leading indicators generally appear to be stabilising but nonetheless have been towards an economic contraction for quite some time now. Thus it came as little surprise that Q4 GDP fell by 0.3%. It cannot be ruled out that the euro zone economy shrinks again in the first quarter of 2012 and thereby, at least technically, puts the Continent in a recession. For the entire year, however, we currently expect to see only a minor 0.5% retreat in GDP.

Switzerland: In Q4 2011, the economy actually grew by 0.1% – the bleaker leading indicators in the second half of last year suggested that Switzerland's GDP would in fact shrink. Despite the strong franc, exports increased by 1.2%. Going forward, however, one to two negative quarters are not out of the question. Switzerland is progressively feeling the pain of weak growth in the euro zone. We reckon that GDP will increase at best by 1% in 2012.

Emerging nations: More and more emerging-market central banks are adopting the "easy money" approach. There, the monetary stimulus should lend support to personal spending and capital investment. But it remains to be seen whether the Chinese economy will manage to compensate for waning export dynamism through increased private consumption.

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Tactical Positioning

Investment Views in brief



Bonds

- Currently, government bonds are either generating low returns or suffering under the European debt crisis. Accordingly, we are underweighting sovereign debt in all mandates.
- The higher risk-adjusted yields afforded by corporate bonds continue to argue in favour of this segment. Accordingly, we are increasing our exposure here at the expense of the money market quota.
- Due to the asymmetrical interest rate risks, we are keeping the duration slightly below the benchmark.
- The premium on high-yielding bonds remains attractive. We are maintaining our overweight.
- On a risk-adjusted basis, emerging-nation bonds in hard currencies appear to be attractive, thus we are still overweighted in this segment.

Equities

- Although the hefty price gains in February appear to be fundamentally justifiable, the risk of a short-term consolidation is on the rise. But for the medium term, valuations remain attractive. A favourable tidal change is also to be seen in earnings expectations. We are sticking with our neutral equity weighting.
- Owing to the buoyant US economic data, we continue to prefer North America over the Asia/Pacific region.
- At the sector-specific level, we are maintaining our overweight in North America IT stocks, this at the cost of utilities.

Alternative investments

- In terms of real estate, hedge funds and listed private equity, we prefer to maintain a neutral quota.
- Commodities (especially crude oil) are benefiting from the today's tense geopolitical situation. Despite the potential for a pullback in oil, we have slightly increased our commodity quota out of risk and diversification considerations.
- Convertible bonds are attractively valued at present. They participate in rising stock markets but, thanks to their bond-like nature, offer a modest buffer against price declines. Here, we are maintaining both our investment opinion and quota.

Currencies

- The SNB can be expected to defend its self-imposed 1.20 floor in EUR/CHF. For now, we consider it rather unlikely that CHF will depreciate even more against EUR. However, in our CHF-based mandates, we continue to forgo hedging a portion of the EUR and USD positions. On the other hand, the CHF positions in our EUR-based mandates remain 100% hedged.
- The trend in EUR/USD has switched to a bias in favour of the dollar. In spite of the successful Greek haircut, EUR is weakening in response to the ECB's more expansive monetary policy. We are going on the assumption that the EUR/USD exchange rate will return to its previous dollar bias and retreat into our 3-6 month target range of 1.20 to 1.30. Owing to the SNB's "guaranteed" 1.20 floor in EUR/CHF, the dollar should therefore also appreciate against CHF. In our EUR-based mandates, we are placing an active 3% bet on USD.

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