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Review

The recovery of the equity markets from their correction lows in the month of April sharply ended in May as politics in the USA and Europe have confused investors and market participants allover. The see saw about North Korea and new trade frictions and the political crises in Italy and Spain have weakened the Euro and the European equity markets. Italian and also to some respect the Spanish government bonds have tanked. Liquidity has moved to safe bond and currency havens. The price of gold, however, has fallen below USD 1,300 per ounce, negatively affected by the stronger US dollar and rising US real interest rates. The price of Texas oil has retreated to 65 US Dollars after having shortly hit 72 Dollars due to the Iran tensions. Industrial metals have traded sideways despite trade disputes between Mr. Trump and the rest of the world.

Economic Outlook

Although Spain ousted Prime Minister Rajoy and Italy meanwhile has got a new government, probably forced by the dramatic interest rate crash, the Italian and possibly the Spanish government bonds from a technical point of view have already entered into a new bear market. After the steep rise of long term interest rates by over 120 basis points shortly hitting 3% the next level should be at around 4%. It then would more than double the cost of future debt financing. The credit rating organizations will shortly give an answer. The trace of this crisis will stay not only for these two countries but also for the future of the EU in total. The Union at its today's composition and its growing political populism has reached a point, where the risk of a failure after its start in 1992 has considerably increased.

Supported by still positive economic data and growing inflation expectations in the USA, the Fed will continue to raise rates. In the EU, however, due to the political tensions and below average economic and corporate earnings' growth the ECB has to stick to its policy and keep interest rates low, even if inflation should pick up over the rest of the year. The growing interest rate differential should eventually increase the value of the Dollar over the course of the year. It should be positive for EU exports and corporate earnings, which were rather mixed until now as many companies have struggled with the strong Euro until the first quarter. However, it should be less positive for the average emerging economies and negative for leveraged emerging countries like Turkey, Brazil and Argentina.

Trade tensions between the USA, Europe and China should be manageable and therefore should not derail global economic growth perspectives. China still is dependent on Western know how and their markets and therefore will find a way for a trading agreement with Mr. Trump and will further cautiously open its own market. Even the EU needs to find a solution with regard to their steel, aluminum and car exports.

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Therefore corporate profits are still rising above expectations and the globally contained inflation and interest profiles should enable the equity bull markets to further proceed in 2018. Thanks to the tax reform, it should apply for the USA, in particular, which still waits for a pick-up in growth of business investment. Together with strong consumer spending the US GDP growth, however, should reach about 3% for the year. Europe, in contrast, has to work off several problems as there are US trade tariffs, the not yet resolved banking crisis, Diesel emission standards and the political turmoil in the EU. Export-orientated countries like Germany have already seen a drop in business sentiment. Therefore the EU might face a temporary growth dip, which will make the future capital market outlook less predictable.

Capital Markets Outlook

Market volatility is back especially in the bond markets, but the underlying trend for equities is still positive. Earnings' growth will be strong despite worries about trade wars, Western politics, and geo-political issues in the Middle East, Brexit and climate issues. Therefore this late bull market in equities should run a bit further. Near term the cyclical companies from the Old Economy especially in Europe will still have to overcome their sluggish price performance before they can reiterate their bull market configurations. The performance future will belong to the drivers of economic and social change and disruption, as I have expressed many times in this publication. The leaders of the ongoing industrial revolution in electronics, software, internet and intellectual property, retail logistics and selected industrial technology will be the beneficiaries of this irreversible trend. These new global growth stocks have made new all-time highs in this recent volatile environment and should further lead the stock markets despite their high valuations. Gold should continue to trade sideways as the US Dollar should strengthen in this slightly more nervous economic and political international environment. For that reason US treasuries after their latest fall should create an interesting trading opportunity over their European and Asian competitors.

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