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Review

Politics were once again dominating the capital markets in the past month. Trade war talks, Putin meets Trump, Juncker meets Trump, Trump introduces tariffs and softens or withdraws them, the white house theatre continues. Stock markets reacted to the earnings' season and bond markets to the liquidity reduction of the FED. US rates have moved up a little bit further as the US economy is moving along nicely looking at the latest 4.1% GDP growth number. Corporate earnings are coming in very well, driven by economic growth and the first effects of the tax reform. Blow out numbers of Google and Amazon have catapulted the Nasdaq Index to new all-time highs, while i.e. Facebook, Netflix and Twitter delivered slightly below the most optimistic expectations which caused the shares to fall sharply thereafter. The broader S+P500 index has challenged its recent January highs, while the European markets, although recovering somewhat from their June lows, and Germany, in particular, have suffered from the trade conflict. This issue has also affected the emerging markets, especially China and Japan. The US $ and the Swiss Franc were unchanged against the Euro, while Sterling weakened slightly and some emerging market currencies like the Turkish Lira have dropped quite sharply. The US oil price has given up most of its profits made in June and was flat over the two-month period. The price of gold made new lows for the year.

Outlook

Expectations are low for the summer months. Ongoing discussions about trade, immigration, Brexit and the upcoming elections in Bavaria and in the USA later this year will overshadow the good economic climate. Capital investment and employment should therefore be lower than it should be at this stage of the business cycle. That should dampen any aggressive steps towards tightening by the central banks, the Fed included. Technical market corrections and industry group rotations are very likely to happen over the summer months. The allover positive long-term direction of the Western stock markets, however, should continue due to a still healthy global economic environment, a moderate inflationary climate, strong corporate earnings and rising corporate and private cash flows.

There is hope that the trade dispute between Europe and the US and the UK should eventually turn out well. All parties involved know that they are sitting in the same boat and need each other. It applies for the hard liner Mr. Trump, too, whose support of his hard stance on trade is publically waning in the US. As the EU and Germany, in particular, have signaled to review their defense spending budgets and Juncker has agreed on increased imports of US agricultural products and liquid gas, the path should be paved for a new and constructive round of trade negotiations. The focus, of course, lies on the German auto industry as the dominant driver of its economy. It would be great, if it would get off lightly at the end. The issue with China is far more

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complex, as the bilateral strong manufacturing connections over their various supply chains for a magnitude of products need to be put quickly on a solid footing. A disruption on US$200 billion worth of Chinas Imports thru a tariff of 10% alone would definitely affect future global economic growth. On top of this, Industry 4.0 is irrevocably on its way. Politicians should know by now that the long-term implications on workplaces, employment and on the future development of their societies will be dramatic, everywhere. They have to find answers for their constituents and develop visions, how their future generations should cope with these fundamental challenges. A policy of looking back on the past will be fatal for everybody, including the USA. It is questionable, however, whether the existing political establishments under Merkel, May, Abe or Donald Trump will be able to meet those challenges. Eventually a new generation of politicians has to stand up and replace them, before things really change. Therefore, politics could negatively influence the direction of the capital markets more so than in the past, while global industries with their entrepreneurial spirits and creativity will create further value for their people.

Capital Market Outlook

Central Bank policies will not change much over the summer. The FED will reduce liquidity and eventually will raise interest rates again in September. The ECB, as well as Japan and China, will stay put. Therefore the interest differential between the US and Europe should widen, which should support the US Dollar. Nevertheless, 10-year treasuries' yields should move above 3% and towards 3.4%. Therefore, the bond markets should still not offer respectable returns and the stock markets should be able to cope with it.

After last week's earnings disappointments and sell offs of various FAANG/high tech growth stocks the question arises, whether investors should focus on relatively cheap value/old economy shares and sell some of the highly valued FANG/high tech growth names. It is a legitimate question, as valuations have even widened throughout the last quarter. Industries and companies, however, with traditional business models will face risk longer term, if they are not able to adopt the production and operation technologies of the new digital age, in order to further grow and to survive in an international grim competitive environment. This applies for traditional businesses in the fields automotive, capital goods, retail, banking and financial services, restaurants and health care etc. In contrast, companies like Facebook, Apple, Amazon, Netflix, Google, Microsoft and the Artificial Intelligence companies, which lead and dominate the digital revolution, should be part of every long-term constructed equity portfolio, as long as they can maintain their growth potential thru product excellence, USP, global market position and their financial power. It applies also for various companies outside the USA.

At this stage, the stock markets and certain stocks should remain volatile with even sharp corrections as already witnessed. They should create buying opportunities for long-term oriented investors, even if valuations will stay high. It is a long-term call on the future.

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