HOVING & PARTNERS

WEALTH MANAGEMENT

QUARTERLY INVESTMENT VIEW

Issue No. 34 2nd Quarter 2017

SUMMARY

Besides rising political tensions, the greatest risk for global markets is a significant slowdown in worldwide economic growth. Our base case remains for growth to continue, before slowing down near the end of the year.

Market valuations are dear, especially in the U.S. The inexperienced Mr. Trump could cause damage to stability and investors' confidence. Central banks have to move very carefully withdrawing liquidity to maintain stability in the financial systems. Any set-backs in stock markets should be carefully analyzed to avoid traps. Basically, investors should stay optimistic for the moment as global growth is returning, jointly pulled by all major economic regions.

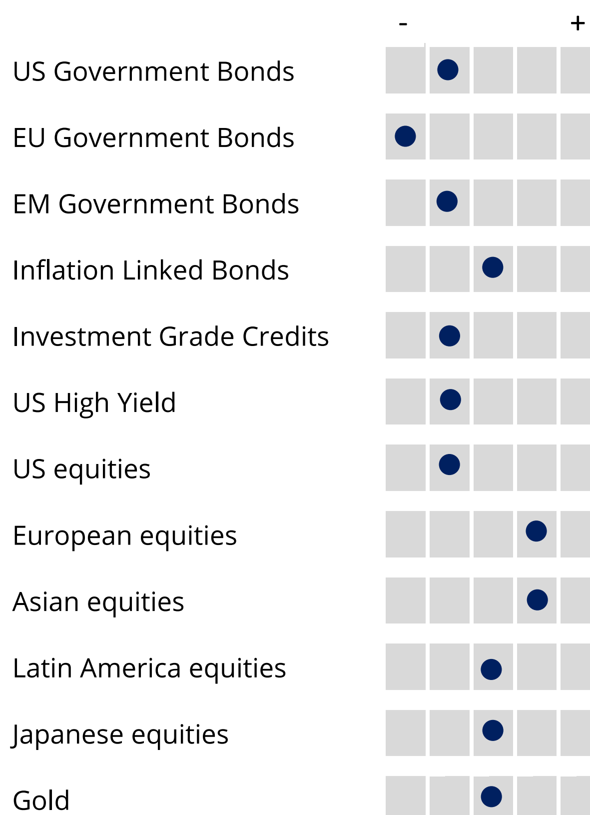
In this scenario, security selection and regional focus will be the drivers for returns. New technologies will continue to be developed and there are many investment opportunities especially among smaller companies in Europe, U.S. Large capitalization companies will continue to struggle with revenue growth. Financials should perform, especially in Europe. Real assets such as Commodities and Real Estate represent value, as do emerging market stocks and more specifically Asian equities including Japan.

Alternative fund strategies in mergers & acquisition arbitrage, credit and volatility will continue to be an attractive diversification in any portfolio.

We remain positive on several secular growth themes; ***1) Software & Robotics*** should receive a core exposure as companies are continuously cutting costs and manufacturing will become essentially software based. ***2) Security*** is a major issue and increasingly present to governments and large multinationals. ***3) Payment systems*** will undergo material changes moving from physical to digital. ***4) Monitoring and connectivity*** are getting increasingly more important as machine to machine communication takes off in sectors as healthcare and automotive.

At this stage of the cycle, equities are still the preferred investment class over generally bonds, the latter offering little value.

ASSET ALLOCATION



ECONOMICS & POLITICS

Is it the "Trump factor" or the strengthening of the global economy, already accelerating before the U.S. presidential election, which has been pushing markets to new all-time highs? We prefer the latter argument and see most important economic indicators still flashing green.

Global growth is becoming uneven however with the U.S. recently showing some weakening in its hard economic data. But Europe still reports positive surprises and China and Japan seem on a more solid track.

Inflation is rising globally and although interest rates came down in recent weeks, most Central banks started pulling back some of their accommodative liquidity policies.

The Euro area has entered an electoral season (France, Germany in 2017 and Italy in 2018) which may significantly impact its political landscape. The outcome of the Dutch elections was perceived as a halt to growing populism.

UK Prime Minister Mrs. May has initiated two years of complex and difficult Brexit negotiations with the EU, while two weeks later she has announced new elections in June betting on the Labour party to lose seats in Parliament. The Labour party opposes Brexit which complicates negotiations.

In the April 16 referendum, designed to hand Turkish President Erdogan and the country's prime minister sweeping powers, victory was claimed by Mr. Erdogan with only a slight majority. However, the opposition parties claim that the referendum was rigged. Relations between the EU and Turkey should be deeply affected as a result.

Relations between the new U.S. government and China are tested from a trade and political point of view posing a particular challenge to the inexperienced Mr. Trump. In addition, North Korea's nuclear capabilities present a serious threat to World stability impacting U.S. allies South Korea and Japan in particular. The initial overtures between Mr. Putin and Mr. Trump have cooled down threatening an unwelcome escalation between the two powers.

ECONOMIC REVIVAL ACROSS THE GLOBE

The cyclical return of economic growth across the Globe, recently including Japan and Europe and to some degree the "normalization" of interest rates appearing on the horizon, signal the definite end of the huge economic crisis that started in 2008. This is very good news and it should boost consumer confidence across the Globe and incentivize corporations to invest more into the future.

Economic revival is the core reason to continue to invest in the stock market.

A number of indicators such as Purchase Managers Indices (PMI) in the U.S. and Europe indicate a sharp improvement in manufacturing, although recent U.S. data suggest some weakening of the U.S. economy. But the 1st Quarter in the U.S. has often been weak caused by adverse weather conditions. The EU's economic revival has been significant in the first Quarter. Factories in the Euro area enjoyed another bumper month in March reporting its highest level of activity since 2011.

The Eurozone jobless rate has been pushed to its lowest in almost eight years. More than one million people were lifted out of unemployment during the past year.

This good news masks the stubbornly high unemployment of the EU-28 as a whole with a seasonally adjusted unemployment rate of 9.5% in February 2017. Among the Member States, the lowest unemployment rates were recorded in the Czech Republic (3.4 %), Germany (3.9 %) and Malta (4.1 %). The

highest rates were observed in Greece (23.1% in December 2016) and Spain (18.0%).

Youth unemployment in the World (age between 15 and 24) in 2015 is still too high: 20.3% in the EU-28, 11.8% in the U.S., 5.6% in Japan and 7.2% in Germany.

In the U.S., we can speak of full employment (4.8%); any increase in demand for labor could put more pressure on wage increases.

Global deflationary forces are diminishing. Basic material prices made large jumps.

Economically, advanced economies seem to be close to ending a disastrous 10-year cycle, and to quote Winston Churchill, seem "at the beginning of the end".

POLITICAL RISKS

Politics mask the economic revival of the EU-28. The outcome of the French Presidential election (April-May) may sour Euro area's future with two front runners (Marine le Pen and Jean-Luc Mélanchon) wanting France to leave the union and the EUR. A Frexit would be too much for investors to handle leading to a massive exit from European equities, bonds and the EUR.

However, the European stock markets seem to tell us that reason should prevail and that either Emmanuel Macron or François Fillon, both more moderate candidates and pro EU, will be elected.

GLOBAL TRADE

Global trade agreements are vital for stability, global economic expansion and improvement of living standards across the Globe. Trade protectionism, does not make economic sense and, hopefully, Mr. Trump will abandon his negative stance on trade.

PRODUCTIVITY SLOW-DOWN

The IMF recently warned that the world is caught in a productivity trap. If productivity growth had followed pre-crisis trends, output of advanced economies would be about 5 per cent higher, the equivalent to adding another Japan to the global economy. A new wave of technological breakthroughs, particular artificial intelligence, is hoped for, argues the IMF. Slow-down in business investments and trade, and misallocation of capital to low-risks projects are the main cause of productivity slow-down. The aging workforce is another cause.

To address productivity slow-down, Governments need to invest more in education and infrastructure and resist trade protectionism and curbs on immigration.

INFLATION AND U.S. LABOR RESOURCES

Wage growth or cost of employment is probably the most significant source of core inflation (inflation coming from energy and food are not part of core inflation). If wage increases are accompanied by higher productivity, there should be no fundamental issue with wage increases.

On average, about 190'000 jobs are created every month in the U.S. This is more or less the same as the number of people joining the U.S. workforce. With an unemployment rate of 4.8% (7.5 million people), the U.S. economy operates near full capacity. Adding the number of long-term job seekers (4.8%) should increase available U.S. labor resources in reality closer to 9.6% (14.9 million).

The high number of U.S. available labor resources should keep a lid on wage inflation.

CENTRAL BANK POLICIES

The Fed hiked its benchmark interest rate in March this year to 75bp. In December last year, the Fed hinted at three more hikes in 2017.

Although announced, further rate hikes are not so clear cut; the U.S. economy is in its eighth year of expansion and its growth engine may falter. Fiscal stimulus as

announced by Mr. Trump should help the economy, markets await the first moves in that direction.

Following the last rate hike in March, the U.S. equity market did not correct and fixed income investors did not commence a massive stampede out of the bond market either.

The ECB has announced the extension of its QE program into 2018, while scaling asset purchases down in 2018. A first rate hike by the ECB could be expected in Q1, 2019. This suggests the ECB to support relatively low EUR bond yields for a prolonged period of time.

The Fed's balance sheets

The Fed has yet to shrink its balance sheet build up as a result of past QE. Its monetary policy stance is therefore still accommodative.

Any balance sheet reduction by the Fed should signal rising bond yields.

In the absence of balance sheet tapering by the Fed, U.S. bond yields may remain low, underpinning U.S. financial markets (in 2018, the Fed needs to replace $425Bn of U.S. debt, equivalent to 2.7% of total U.S. debt).

Equity markets

Full year 2017 valuations (P/E) of the U.S. and European stock markets are acceptable provided companies deliver the necessary earnings growth. See below full year estimated P/E's as published by Bloomberg:

P/E Ratios	2017	2018
S&P 500	18.20	16.21
STOXX 600	15.60	14.20

On a P/E basis, Europe is cheaper than the U.S. (STOXX 600 P/E is about 20% below S&P 500 P/E), but also for a reason: return on equity is much better for U.S. companies (16.27% versus 8.71%) similar to operating margins of U.S. companies that are also much higher (12.63% versus 8.67%).

European companies pay higher dividend yields than their U.S. counterparts (3.48% versus 2.07%).

Estimated earnings growth 2017 into 2018 is about +10% for both U.S. and European companies.

Returns Q1 2017	Local	EUR
Dow Jones	4.56%	3.25%
S&P 500	5.53%	4.22%
NASDAQ	9.82%	8.45%
Euro Stoxx 50	6.39%	
FTSE 100	2.52%	2.84%
IBEX 35	11.88%	
AEX	6.91%	
DAX	7.25%	
Swiss Market	5.34%	5.77%
NIKKEI 225	-1.07%	2.61%
Shanghai	3.83%	3.61%
Nifty 50	12.07%	16.05%

Risks are also perceived as low demonstrated by the low volatility of share prices, one way of measuring risk.

Of the two markets, the U.S. stock market is probably a little bit ahead of itself and it would be good if the U.S. S&P 500 rally would pause to keep its P/E below 20.

To deviate from the World Index benchmark, the momentum may be in favor of investing in European over U.S. companies.

For the first time in many years, we recognize that the monetary policies of the Bank of Japan finally start to pay off. Inflation numbers are up, and due to the weak Yen, Japanese

exporting companies are making substantial profits. Valuations are benign.

M&A activities caught the public eye earlier this year when a transatlantic take-over battle was started by Kraft Heinz making a surprise bid on the much more profitable Unilever. PPG Industries soon followed starting a take-over attempt on AKZO Nobel.

The size and complexity of such transactions is enormous and often initiated by eager activist hedge funds like Elliott Advisors. It also suggests that world leading companies are no longer protected by their size. Only expensive share prices can protect public companies against potential take-overs. China will also continue to try and buy western companies but more for strategic reasons.

On the longer term, we are reasonably optimistic that earnings growth will continue to come through on the back of all major regional blocks simultaneously growing, which we have not seen for a long time.

Our current equity strategy continues to focus on company candidates benefitting from an economic upswing, transforming from growth to value investing.

We remain positive on several secular growth themes; ***1) Software & Robotics*** should receive a core exposure as companies are continuously cutting costs and manufacturing will become essentially software based. ***2) Security*** is a major issue and increasingly present to governments and large multinationals. ***3) Payment systems*** will undergo material changes moving from physical to digital. ***4) Monitoring and connectivity*** are getting increasingly more important as machine to machine communication takes off in sectors as healthcare and automotive.

BOND MARKETS

10-Y Government bond yields moved down in Europe and in the US. Most of the down move occurred and the end of the quarter. Similarly, the U.S. and European stock markets moved down in April as well. The 10-Y Swiss and Japanese Government bond yields remained in negative territory.

All the major bond markets, except Japan, showed positive YTD returns.

10Y Gov. bond yields	31/12/16	04/19/17
Germany	0.196%	0.153%
Netherlands	0.434%	0.407%
France	0.941%	0.882%
UK	1.051%	1.012%
Switzerland	-0.247%	-0.256%
U.S.	2.212%	2.168%
Japan	-0.005%	-0.005%

Why did bond yields go down in developed economies, despite the recent moves by the Fed? While our positive economic outlook has not changed, the perception of risks clearly seems to have changed to more risk adversity.

One factor is perhaps a lapse in confidence following the confrontational style of Mr. Trump.

A second factor could be the weakening of some of the hard data coming out of the U.S. economy. Perhaps the U.S. economy is not as strong as investors anticipated and Mr. Trump seems less effective as well in introducing tax reforms and fiscal stimulus.

Is this the beginning of seeking safe havens by investors' money? We do not believe this to be the case.

In our investment policy, we assume that the 1st Quarter behavior of the U.S. bond markets should reverse itself later in the year with better data, and that bond yields may be even higher than expected today. We anticipate the current spreads between U.S. and EUR interest rates to narrow as well. Therefore, the rise in EUR interest rates could be much higher than currently anticipated, despite the tone set by the ECB.

French, Italian and Spanish Government bond yields should be dragged higher by Bund yields.

At the moment, the Euro area Government bond market is a high risk asset class for interest rate and foreign exchange reasons.

The U.S. Dollar: Up or Down?

U.S. economic growth has been lagging compared to Europe during the last few months. Continuing outperformance of the European economy and reduced political risk could drive the recovery in the euro further. Currently we are neutral on EUR/USD and await the outcome of the upcoming elections and US data.

Commodities

Mohammed bin Salman, Saudi Arabia's deputy crown prince and the power behind the throne, has announced that Saudi Arabian Oil Company (Aramco), its state oil company, is going public probably in 2018. Once listed, the company is valued at over $2 trillion easily absorbing Apple as the World largest company by stock market value. A new tax regime has also been introduced to tax Aramco royalties at 50% instead of 85%, bringing the tax rate in line with international benchmarks. The going public of Aramco is an event that should change the competitive landscape for oil companies for many years to come. The World energy index will be re-balanced to include Aramco.

The respect for the production cuts agreed among OPEC members in November 2016 and the large oil reserves recently reported by the U.S. have kept a lid on the surge of oil prices around the world to about $50/barrel.

On May 25 2017, OPEC meets in Vienna. The outcome may determine whether the oil price will climb or remain stable. Global economic fundamentals are improving, probably leading to more oil production and supplies to meet increased demand.

The Hoving & Partners Investment Committee

Hoving & Partners S.A.

30A, Route de Chêne

1208 Geneva

Switzerland

Authors

Michael Hoving

Jan-Paul Menke

Enquiries

Website
www.hovingpartners.ch

E-mail
jpm@hovingpartners.ch

Telephone
+41-22-544 12 90

This document has been made by Hoving & Partners S.A. (H&P) and is offered solely for your information and is strictly confidential. This document has been made by staff of H&P using current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. H&P and staff of H&P cannot be held responsible for possible incorrectness of the assumptions in this document. No part of this document may be copied, photocopied or duplicated in any form by any means or redistributed without the prior written consent of H&P.

This document does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual investors and is meant for professional investors only. Investors should consider whether any advice or recommendation in this document is suitable for their particular circumstances, and if appropriate seek professional advice.

H&P is a professional wealth manager based in Geneva, Switzerland, and a member of the Swiss Association of Asset Managers.

The value of your investments may fluctuate. Past performance provides no guarantee for the future.