INVESTMENT OUTLOOK
February 2017
Politics take centre stage

Developed and Emerging Markets
After a solid rise into yearend, most global markets have moved into a digestion phase. The earlier strong advances in the U.S. dollar and bond yields have recently paused, which we view as a positive development for keeping the leading U.S. economy on a recovery path. However, politics has the potential to disrupt the financial markets, as seen with President Trump’s comments about the U.S. dollar being too strong. There is a valid concern that he will be active on the trade and currency fronts, to the detriment of the global economy and, ultimately, the U.S. as well. Our mildly upbeat economic view for the next 6-12 months is unchanged, although we strongly recommend a close monitoring of business and consumer confidence at this critical political juncture. The key issue is whether the recent lift-off in sentiment from an already improving trend actually translates into greater economic risk-taking, which would reinforce existing financial market trends, or reverses and triggers a risk-off phase because of anti-growth steps by key countries such as the U.S. and U.K.

Currencies
The U.S. dollar is moderately expensive, but economic and monetary policy pressures will remain supportive. Elsewhere, it has been a volatile couple of weeks for the British pound. The currency initially sold off sharply heading into U.K. Prime Minister’s speech regarding Brexit. It then bounced as market participants struggled to figure out the timing and ramifications of leaving the EU.

Energy and other commodities
Gold prices remain vulnerable to the downside, while upside for oil is dependent on the unlikely occurrence that recently-agreed production cuts come fully to fruition. Industrial commodities have already discounted a sizable rise in global manufacturing activity that would need to shift into overdrive to catalyze further significant price upside, which we view as improbable.

(see illustration on next page: “Asset Class Comparison”)
Illustration (Section “Macro-Economics and Currencies”):
Asset Class Comparison

Commodities vs. Equities, Government Bonds and US Dollar

Source: Bloomberg Finance L.P.
Graph: Quantum Global Investment Management (1-year rolling, daily, indexed)
Indices:
- Commodities: RJ/CRB Commodity Total Return Index
- Equities: MSCI All Country World Index
- Govt. Bonds: The Bank of America Merrill Lynch Global Government Index
- USD: The U.S. Dollar Index
Global Bond Markets

Global credit markets started the year with strong issuance and performed well. The rout in bond yields continued across the European region whilst US Government rates have stabilised for the time being. Notable outperformance came from the lesser credit quality spectrum, within Emerging Markets and the US High Yield sectors. Credit spreads compressed as the growth story is an ongoing theme. Expectations are high as investors await data indicating growth and traders have so far speculated on rumours not facts. Monetary policy remains a huge contributing factor throughout the global bond universe and major central banks have formed a landscape to maintain low rates for some time. The US is set to continue their divergence in policy stance however, and we expect further rate increases this year. Japan’s yield curve adjustments and the European Central Bank’s continued stimulus should help reflation of domestic economies in the medium-to-long term. Geopolitics are a concern and major risk to this and could therefore holding rates lower for longer.

*(see illustration on next page: “Government Bonds vs. Corporate Debt”).*
Illustration (Section «Fixed Income»):
Government Bonds vs. Corporate Debt

Source: Bloomberg Finance L.P.
Graph: Quantum Global Investment Management (1-year rolling, daily, indexed)
Indices: Various Bloomberg (BBG) Proxy Indices
Too far, too fast?

Global Equity Markets

In January, Mr. Trump began work as U.S. President after saying that he would place American interests at the forefront of his agenda. His pro-growth pronouncements helped drive a rally in equities since November 2016, while the U.S. Dollar surged and bonds weakened. Most equity indices entered a consolidation phase towards the end of the month after hitting record highs. Slowly though, investors are starting to assess whether equity valuations has become rich and prices have pushed too far, too fast.

The U.S. Equity market continued its positive trend in January hitting record highs on all three major domestic indices (Dow Jones Industrials, S&P500 and NASDAQ). Cyclical sectors such as Information Technology and Industrials were the main return contribution drivers of both the Standard & Poor’s 500 as well as the NASDAQ Composite Index. Being less exposed to U.S. Politics, European equities joined the rally somewhat later. The broad STOXX Europe 600 Index finished on a positive note. Japanese equities started a relief rally during the last week of January turning positive for the month whereas the Hong Kong Hang Seng Index managed to return the highest single digit return amongst developed equity markets.

(see illustration on next page: “Major Equity Indices“)
Illustration (Section “Equities”): Major Equity Indices

Source: Bloomberg Finance L.P.
Graph: Quantum Global Investment Management (1-year rolling, daily, indexed)
Indices: Indices are shown in local currency / volatility index is % in USD
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Market Implication
The improving economic outlook warrants maintaining a moderately pro-growth investment stance, despite the strong post-U.S. election rally in many risk assets. The latter are vulnerable to a consolidation or modest correction phase in the near term, but fundamentals point to further upside for equities this year as corporate profits rise and investors continue to rotate out of low-yielding government bond and cash positions. Potential positive surprises include a global growth “boom”, while potential negatives include increasing geopolitical/trade stresses, disappointing U.S. fiscal stimulus or a China bust.

Asset Allocation
Risk assets are overbought in the near term, but cyclical conditions remain favorable. We remain positive on stocks versus bonds in a multi-asset portfolio on a 6-12 month horizon.

Fixed Income:
Global economic conditions, as well as the potential for significant U.S. fiscal stimulus, argue for a modestly short duration stance in 2017. The economic backdrop remains favorable for corporate credit in relative terms and we expect spreads versus government bonds to tighten further. Both investment-grade and high-yield corporate debt should continue to outperform. However, the anticipated backup in G7 government bond yields in the year ahead implies low absolute returns for IG debt, and only modest gains for HY.

Equities:
U.S. forward earnings have rebounded strongly in recent months, and are poised to be upgraded further as top-line growth recovers, the prior drag from energy fades and margins rise. Earnings outside the U.S. should also be gradually upgraded as economic conditions improve, albeit more so in local than in common currency terms given a firm U.S. dollar.

Currencies:
The U.S. dollar is significantly overbought and susceptible to a near-term pullback, but has cyclical tailwinds. Relative economic growth and interest rate differentials will move in its favor, at least in the first half of the year.

Commodities:
We continue to be cautious on commodities given a backdrop of a firm U.S. dollar, rising interest rates, buoyant global supply capacity and the likelihood of a slowdown in Chinese housing/heavy industry later this year.
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