Market Review End of December 2017

2017 was an excellent year for investors as the world economy continues to enjoy a remarkable period of synchronised growth. This monthly write up is the occasion to offer some wider perspective. We leave 2017 with mixed feelings as happy investors and worried citizens. Rarely have regional economic prospects been so uniformly good. Yet, rapid technological disruptions, which are the source of this acceleration, are transforming the very foundations of social cohesion. Populist, protectionist and nationalist policies are emerging from people's frustrations. Markets can continue to ignore these profound social changes for a while and focus on the top line growth, but for how long?

Market moves at the end of December

	Equities in Local Currencies							
End of December	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	UK	Hong Kong
Perf 1 Month	1.26%	0.98%	-1.85%	-1.12%	-1.64%	0.68%	4.93%	2.54%
Perf 3 Month	5.14%	6.12%	-2.53%	-0.32%	-3.25%	2.45%	4.27%	8.58%
Perf YTD	20.11%	19.42%	6.49%	9.26%	7.40%	14.14%	7.63%	35.99%

	Commodities				Currencies vs EUR			
End of December	WTI Oil	Gold	Copper		USD	JPY	GBP	CHF
Perf 1 Month	5.26%	2.20%	7.17%		-0.94%	-1.09%	-0.88%	0.01%
Perf 3 Month	16.93%	1.79%	11.82%		-1.58%	1.78%	-0.71%	2.30%
Perf YTD	12.47%	13.09%	30.92%		-12.37%	-9.10%	-4.02%	-8.39%

	Bloomberg Indices Bonds Total returns					
End of December	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year	German 10 Year	Emerging Sovereign USD
Perf 1 Month	0.35%	0.46%	-0.60%	0.23%	-0.87%	0.39%
Perf 3 Month	1.08%	0.39%	0.55%	-0.25%	0.68%	0.62%
Perf YTD	7.39%	3.54%	0.68%	2.54%	-2.40%	8.17%

The long overdue market correction did not happen in December! The DowJones Industrial and S&P500 actually reached new highs.

The long awaited US Tax reform was voted in the very last days of 2017. Such a large fiscal change happens only every 2 decades and will have a profound impact on the US economy. On the short term, it can extend the US economic cycle by a few quarters. Leading indicators for US business climate are still rising while they are retracing in Europe (from extended levels).

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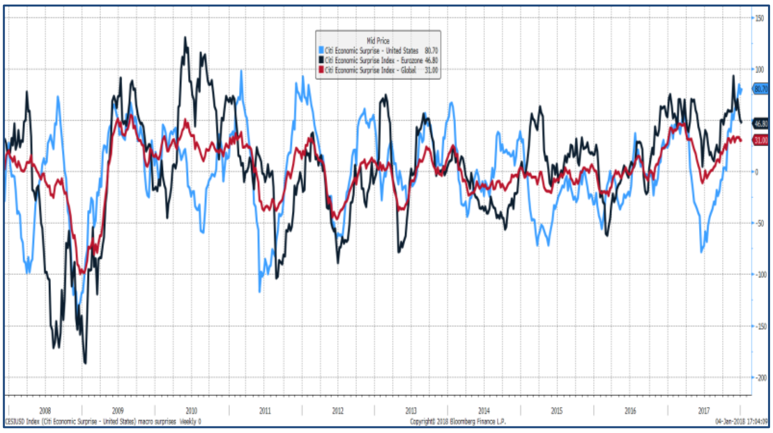
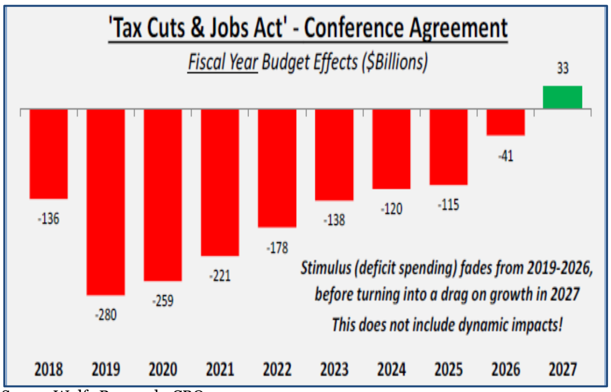
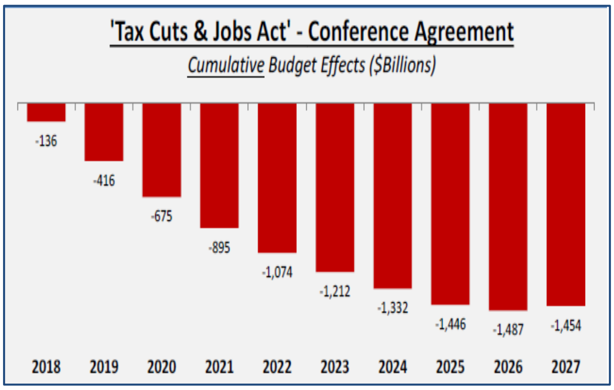
Strong synchronized global economic momentum



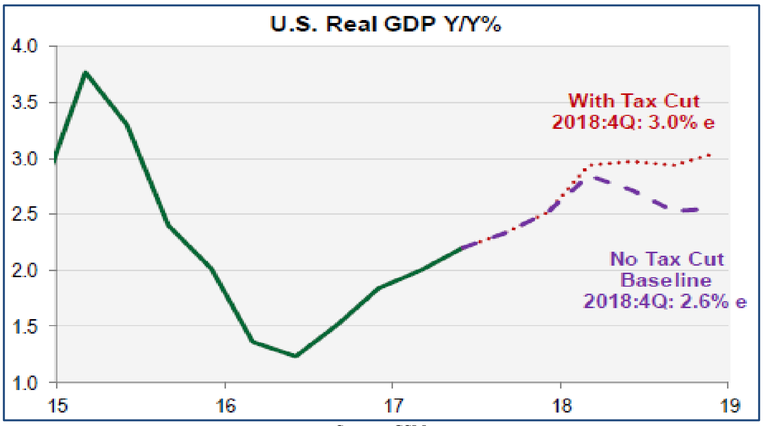
Source Bloomberg

Our worry is that such a Tax reform will increase debt in the coming years by a significant amount.





Source Wolfe Research, CBO



Source: CSM

The Tax reform will have short term benefits on GDP but this additional debt will have long lasting consequences which might reduce financial flexibilities during the next recession.

Adding debts in a rising rates environment in order to extend the economic cycle by a few quarters might have political support but financial consequences!

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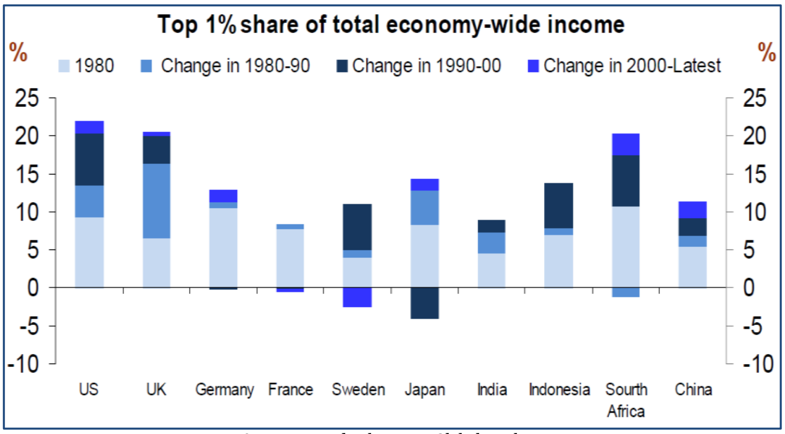
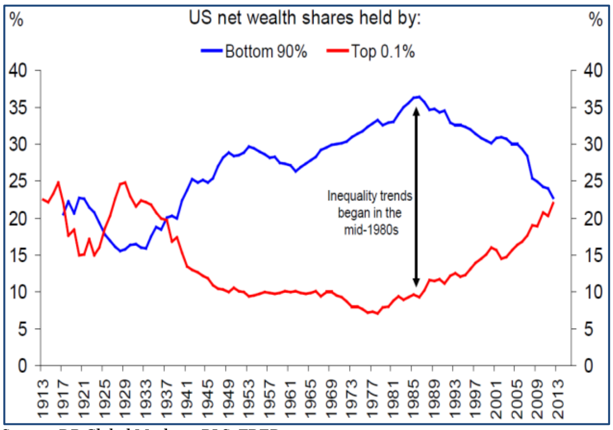
Income and wealth inequalities have developed in many countries around the world and there are no signs of this changing anytime soon. There is a clear lack of political vision. Inequalities lead to instability and populism. Markets hate instability

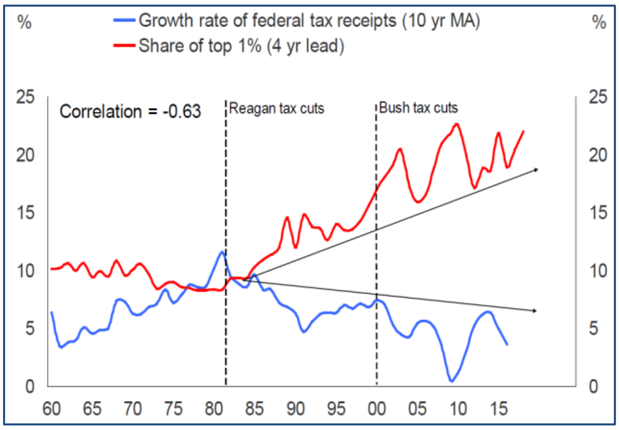
The rich has gotten richer over time in most countries.



Source: WID database, DB Global Markets

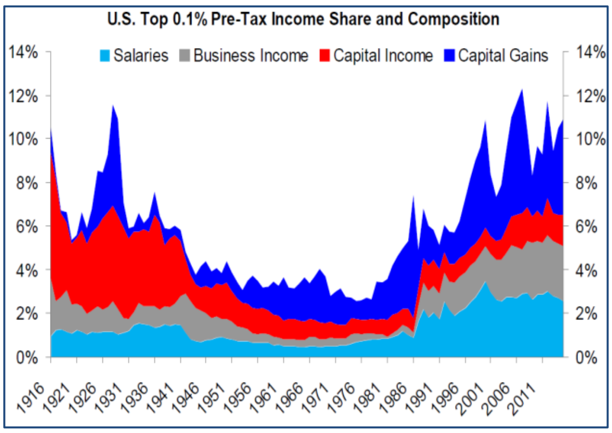
Example: in the USA previous tax cuts have increased inequalities

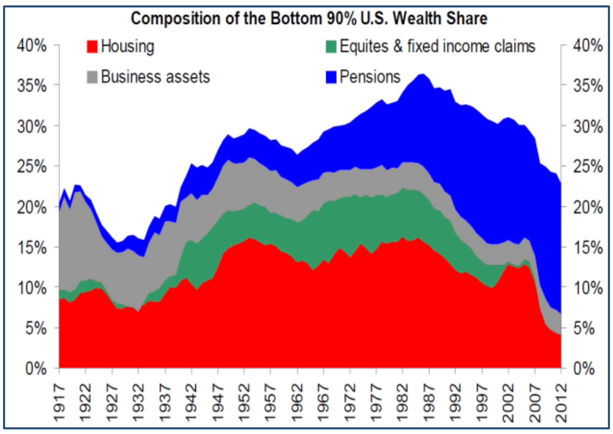




Source: DB Global Markets, BLS, FRED

What worries us even more, is the composition of this wealth, or the lack of it.

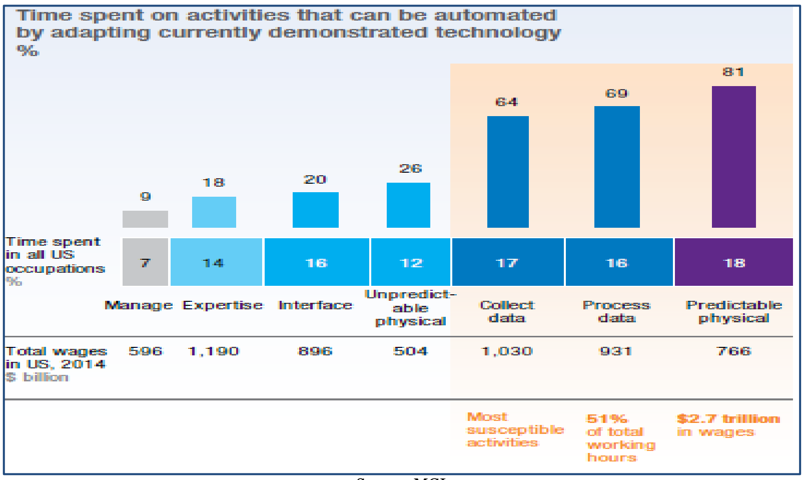




Source: DB Global Markets, BLS, FRED

Booming stock markets and supportive Central Banks policies have benefited a fraction of the population. By opposition, the bottom 90% of the population is at the mercy of problematic pension income and can no longer rely on hard assets such as real estate.

Rapid technological evolutions are radically transforming the economy and large chucks of our society. The following chart demonstrates that it's not just the low-skilled workers who are at risk. It's also mid-level and even some high-level people. There is more job risk than many of us imagine. The world can be broken up into the Unprotected, the Protected, and the Vulnerable Protected classes. The latter group doesn't even realize their vulnerability.



Source: MGI

Beware of people when they have nothing left to lose!

Although Central Banks remain accommodative, they have clearly signalled the end of their expansionary mind-set (the US Fed and ECB). Interest rates creep up slowly at the front end of the curve in the USA. But they remain stubbornly low at the back end. Low inflation prospects as well as the current technological revolution are raising many questions about the future growth profile of the world largest economy.
Short term, the number one risk is Central Banks mismanaging their balance sheet reduction. Interest rate spreads are low but corporate leverage is high. Should credit standards tighten too quickly, defaults rate could rise.

The previous lines may sound alarming. But we are not too bearish in the medium term. There are permanent creative destruction forces as would say Schumpeter. We just want you to keep that little warning music in the back of your mind.
Equity markets are expensive but are not yet in bubble territory. We always look for new investment opportunities. The breath-taking technological revolution we are living in offers many investment challenges. Society is evolving with it: the sharing economy, millennials, aging society, environmental awareness, etc...New words to become familiar with!

Consumption habits change, financing needs as well. These are the themes we are contemplating for future investments.

We invite you to read our monthly investment committee publication for more details on our strategy and outlook.

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