

## Outlook for 2015 – Ten predictions

- Overall and despite adverse geo-political events, policy uncertainties and subdued growth, the financial year was positive for most investors. The majority of equity markets performed well and most bond markets also delivered positive returns.
- The biggest losers were Russian assets: the RTS equity index fell 45% and the ruble lost about 40% of its value. Russia suffered not only from uncertainties regarding the Ukraine crisis and Western sanctions but also from falling oil prices. Oil prices fell by 45%, due to high volumes of additional supply, especially from the US. Gold fell only 1.8% in 2014, which exactly equaled the drop in the MSCI index for emerging equity markets. The Euro fell victim to looser monetary policy and declined about 12% vis-à-vis the USD.
- By and large we are pleased with our predictions for last year. The biggest surprise was that bond yields, especially in the US, declined further despite stronger US growth and Fed tapering. In fact holding long-dated bonds in 2014 earned almost double-digit returns. While we did expect oil prices to fall, we did not expect such a dramatic decline. We also expected credit spreads to remain rather stable while US investment grade spreads widened somewhat – by 30 bps – and US high-yield spreads widened significantly, by roughly 150 bps. There is a relatively high proportion of energy-related companies among US high-yield issuers, which suffered from falling oil prices. Also, emerging equity markets did not take off and outperform developed equity markets as predicted. Instead the MSCI Emerging Markets Index fell 1.8% in 2014.
- In the following we make 10 predictions for 2015 and look forward to another positive equity year and a stronger USD. We are becoming more cautious on our yield forecast, expecting US yields to go up relatively moderately. Commodity prices will stay under pressure, but some commodities may surprise on the upside during the course of the year. We are thinking primarily of oil and industrial metals.

## A turbulent December

In the first half of December we saw a brutal sell-off of equity markets, followed by a recovery in the second half of the month with some nervous trading during the last days of the year. Overall most equity markets were down in December; the S&P500 fell only slightly by 0.3%, the EuroStoxx50 fell 3.0%, the German DAX 1.8% and emerging markets even 4.6%. As a result of the major December movement, emerging market equities ended the year with a loss of 1.8%.

At its meeting on 17 December the Fed changed its so-called forward guidance and dropped its commitment to hold interest rates low “... for a considerable period ...”. At the same time the Fed’s rhetoric remained rather dovish, and benchmark rates remained



unchanged. Overall, we see this as a confirmation that the Fed is likely to hike rates for the first time in mid-2015.

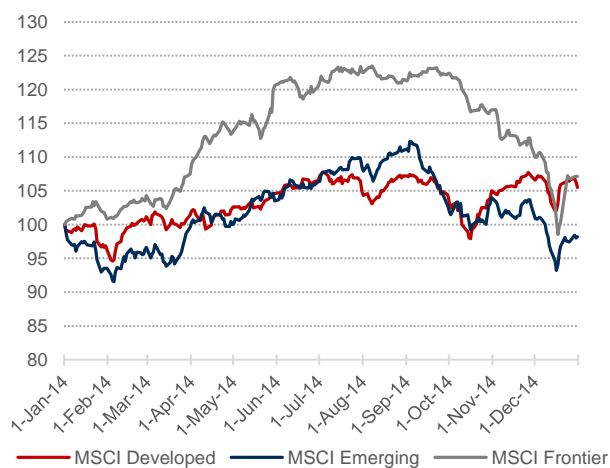
The SNB surprised markets on 18 December – just a short time after its regular quarterly meeting on 11 December, which yielded no policy change – by introducing a negative interest rate of -0.25% on certain bank deposits placed with it. In addition, the SNB changed its target libor band from a range of 0.0% to 0.25% to a range of minus 0.75% to plus 0.25%. The SNB is therefore now targeting a negative CHF libor rate. This decision has clearly been a reaction to the renewed strength of the Swiss franc, with the EUR-CHF exchange rate approaching 1.20. The SNB is committed to keeping the rate at or above this level.

Shinzo Abe’s Liberal Democratic Party (LDP) won the early election on 14 December, which will allow Prime Minister Abe to continue his tremendously expansionary policy, aimed at reviving the Japanese economy and avoiding deflation. Mr. Abe had already postponed a further rise in consumption tax until April 2017 and on 27 December, shortly after the election, introduced a fresh stimulus package worth USD 29 bn, targeted to help the provincial economy, small businesses, and the household sector as well as to increase public spending on rebuilding areas hit by natural disasters

The Ukraine crisis, followed by Western sanctions and falling oil prices, had a strong impact on Russia. A recession in 2015 appears to be inevitable. The Russian RTS equity index dropped 45%, and the ruble lost almost 40% of its value. The fact that a large portion of Russia’s debt, amounting to about USD 60 bn, is USD-denominated intensifies the problem for the Russian leadership. We would not exclude Russia’s introducing capital controls in the near future as Russian citizens’ confidence in the ruble may fall further.

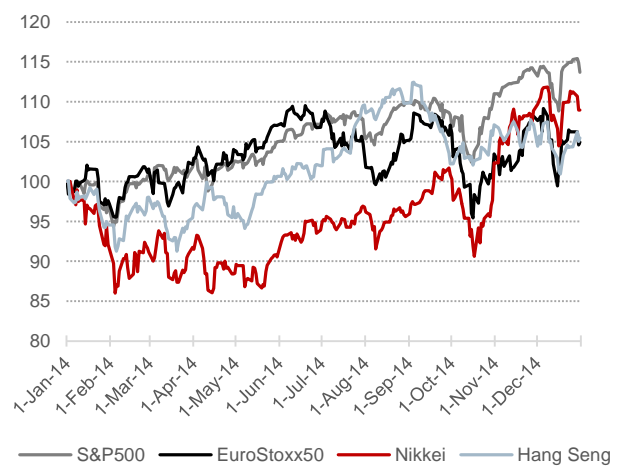
On 29 December the Greek parliament failed to elect a new president, which necessitates a mandatory early snap election, to be held on 25 January. The Athens stock market fell

Fig. 1: Major equity markets in 2014



Source: Datastream, Blue Horizon Wealth Partner AG

Fig 2: Major equity markets in 2014



Source: Datastream, Blue Horizon Wealth Partner AG



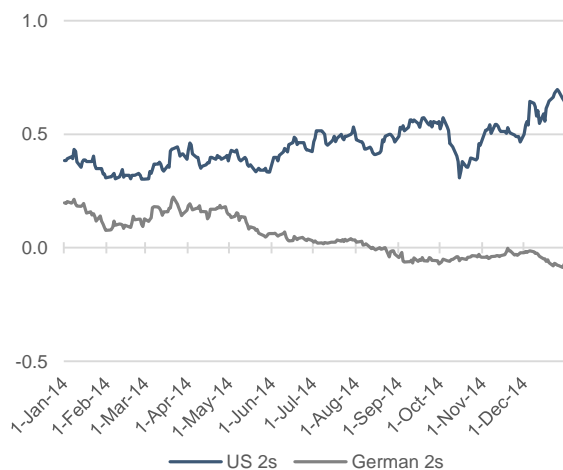
by almost 5% in a single day and Greek 10-year bond yields rose to 9.5%. A major concern for investors is that Syriza, the far-left populist party, could well win the election. This could potentially derail the Greek-European relationship. The Syriza opposes the conditions attached to the EUR 110 bn bailout loan of May 2010 granted by the so-called Troika (Euro-zone countries, ECB and IMF).

Oil continued its remarkable fall. The price of Brent oil fell as low as USD 57 at the end of December and, therefore, is trading at about half of its end of June price of around USD 115.

## Review of last year's predictions

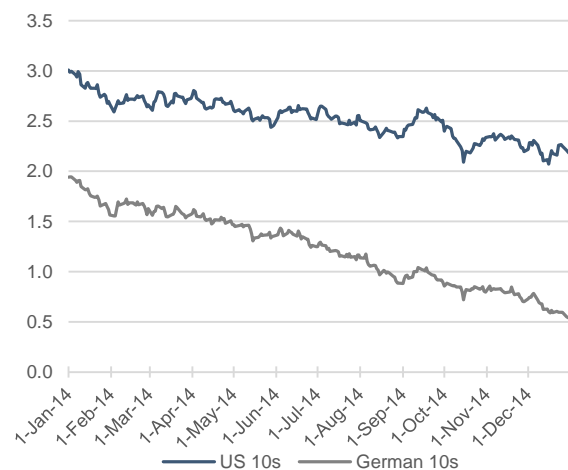
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Fig. 3: 2Y bond yields in 2014



Source: Datastream, Blue Horizon Wealth Partner AG

Fig 4: 10Y bond yields in 2014



Source: Datastream, Blue Horizon Wealth Partner AG



Predictions for 2014	Actual outcome	Comment
<b>Prediction 1 (GDP growth):</b> US: 3% Eurozone: 1% Emerging markets: 4.5% China: 7.5%	US: 2.3% (estimate) Eurozone: 0.9% (estimate) Emerging markets: 4.1% (estimate) China: 7.4% (estimate)	Accurate (US growth a bit lower)
<b>Prediction 2 (Inflation):</b> US: 1.5% Eurozone: fighting deflation	US: 1.4% Eurozone: 0.2%	accurate
<b>Prediction 3 (Monetary policy):</b> Monetary policy expansionary	Despite tapering, Fed rhetoric re- mained dovish ECB and BoJ with further QE	accurate
<b>Prediction 4 (Divergence):</b> Growth and monetary policy diver- gence between US vis-à-vis Europe and Japan Stronger USD vis-à-vis EUR and JPY US treasuries underperform Bunds		accurate
<b>Prediction 5 (Equity markets):</b> Developed market equity single digit	MSCI Developed Markets: 5.5%	accurate
<b>Prediction 6 (Outperformance EM):</b> Emerging markets equity outper- forming developed markets	MSCI Emerging Markets: -1.8%	wrong
<b>Prediction 7 (US bond yields)</b> 10Y US treasury yields rise to 4%	10Y US treasury yields fell to 2.19% from 3.03%	wrong
<b>Prediction 8 (Credit spreads):</b> Investment grade spreads constant High-yield spreads constant	US IG spreads: +30 bps US HY spreads: +150 bps	wrong
<b>Prediction 9 (Commodities):</b> Gold falls below USD 1000 Oil prices under pressure Industrial metals prices fall, but cop- per prices recover	Gold prices: -1.8% (@ USD 1186) Oil prices: -46% DJ UBS industrial metals index: -6.9% Copper: -14%	almost accurate (gold price fell by less, copper price fell instead of rising)
<b>Prediction 10 (Currencies):</b> EUR-USD falls below 1.30 EUR-CHF remains above 1.20, SNB remains committed to defend 1.20 AUD, CAD, NOK under pressure	EUR-USD: fell to 1.21 (-12%) EUR-CHF: 1.2024 (with additional SNB interventions) AUD-USD: -8.5% CAD-USD: -9.0% NOK-USD: -19.0%	accurate



## Outlook for 2015 – Ten predictions

1. The US economy, after a very weak Q1 2014, has shown remarkable strength. Growth and job creation has picked up. The US is likely to grow at 3% in 2015, despite a stronger US-Dollar. Even if the Fed were to hike rates in 2015 monetary policy stance will stay accommodative and low commodity prices will support growth. European growth will gain support from a weaker Euro, lower commodity prices, and – most likely – additional ECB stimulus packages. This should help to bring Euro area growth up to something around 1.5%. Also, Japanese growth could exceed 1%, boosted by very aggressive policy measures. Chinese growth is likely to slow somewhat but remain above 7%.
2. Also in 2015 we do not see major inflation risks. While wage inflation in the US is slightly accelerating, lower commodity prices and a stronger USD should counterbalance this effect. US inflation should stay below 2%. In Europe and Japan deflationary forces are still dominant, and lower commodity prices could even temporarily push the inflation rate below zero.
3. The US Fed is likely to hike rates in 2015. We expect three rate hikes by 25 basis points each with the first hike to be expected in June 2015. At the same time, we expect both the ECB and the Bank of Japan to introduce additional quantitative easing programs, which will expand their respective balance sheets by more than USD 1 tn each. In our view this also means that the ECB will start buying sovereign bonds.

Fig. 5: EUR-USD exchange rate in 2014



Source: Datastream, Blue Horizon Wealth Partner AG

Fig 6: USD-JPY exchange rate in 2014



Source: Datastream, Blue Horizon Wealth Partner AG



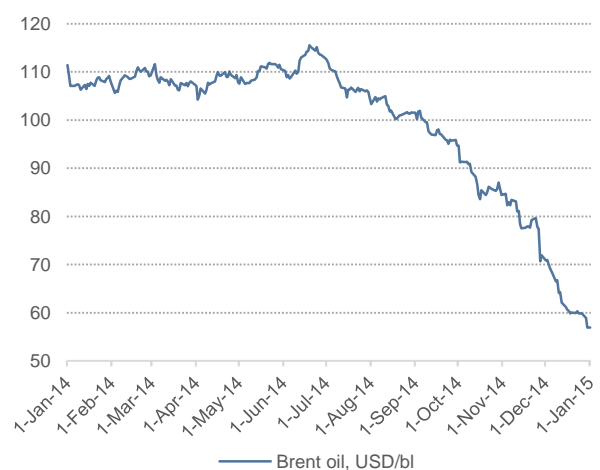
4. The divergence theme will also feature in 2015. We will continue to see a growth gap between the US and Europe as well as Japan, coupled with an even more pronounced gap in the direction of monetary policy measures (compare Prediction 3). As a result, we anticipate a further widening of yield spreads between the US and Europe and a stronger USD vis-à-vis the EUR and JPY. Exactly these developments will also serve as a rubber band preventing the growth gap from opening too widely. A stronger USD dampens US growth, while a weaker EUR and JPY supports European and Japanese growth.
5. Better growth, better corporate earnings, coupled with low interest rates and accommodative central banks should still support equity markets. Since valuations have become more demanding and a tightening Fed will reduce risk appetite somewhat, we expect moderate but positive, i.e. single-digit, returns for developed equity markets. We would favor Europe and Japan over US equity, based on more attractive valuations and different monetary policy measures.
6. As last year, we still like emerging market equity, based on relatively attractive valuations. However, emerging markets have become a more heterogeneous group of countries. Commodity-producing countries may remain under pressure. Within emerging markets we would avoid commodity-producing countries for the time being and favor the Asian region, especially India, Indonesia and Thailand.

Fig. 7: Gold price in 2014



Source: Datastream, Blue Horizon Wealth Partner AG

Fig 8: Oil price in 2014



Source: Datastream, Blue Horizon Wealth Partner AG



7. Despite ultra-low yields in Europe, we see no catalyst for now to drive European rates up. If our assumption regarding a significant ECB QE program is right, yields may even drop further. In the US, however, we are a little puzzled about current yield levels at the long end of the curve, e.g. 10-year treasury yields. The growth outlook, a tightening labor market, and Fed rate hikes should drive yields up in the course of the year. Since, on the other hand, demand for US treasuries is fueled by the prospect of a stronger USD and a rising yield advantage for US treasuries vis-à-vis European bonds, we do not foresee a massive sell-off but rather US 10-year yields moving towards 3% in 2015.
8. Investment-grade and high-yield bond spreads widened in 2014. In 2015 credit spreads should tighten or at least not widen much. Still, in the US total return expectations are limited since benchmark yields may eventually go up and the Europe market has become quite rich. European corporate credit will stay in high demand, especially if ECB bond buying should start, since the ECB will probably stay away from buying financials.
9. In our view, systemic financial risks have declined in recent years, and even if Greece were to exit the Eurozone, which we think is very unlikely, we do not think that the Eurozone would run into serious trouble, though this would not hold true for Greece itself. Therefore, we do not see much of a safe haven argument for holding gold. We stay bearish on gold and would not be surprised if gold were to fall below USD 1,000. While oil and industrial metals will remain under pressure for some time, we think that oil may bottom out in the first half of 2015. Better growth should eventually also increase demand for industrial metals. This is why we expect prices for industrial metals to go up.
10. The monetary policies described will support the USD further. EUR-USD can well fall below 1.10 and USD-JPY move towards 130. We also expect the SNB to defend the EUR-CHF level of 1.20.

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