BLUE HORIZON
Wealth Partner AG

A month of non-consensus market moves

- **April caught many investors on the wrong foot. In particular, those who were positioned to benefit from the broad consensus trends, lower bond yields, European equity outperformance, lower commodities prices and a stronger USD were faced with vivid reversals of those trends. European equities sold off, global bond yields rose significantly, commodities prices recovered and the USD weakened. Meanwhile, the US economy, which is supposed to be the world's growth engine, stalled with Q1 growth almost flat.**
- **After the strong rally in March and the first half of April, European equities sold-off in the second half of April and gave back a large portion of their earlier gains. Meanwhile, global equity markets outside Europe continued to perform well. The S&P500 index rose 1% in April, the Nikkei 225 by 1.6% and emerging markets strongly outperformed and gained 7.7% in April.**
- **Despite ECB's recently announced bond-buying program, European bond yields – accompanied by other major bond markets – rose in the second half of April. For example, 10-year German bund yields climbed from 0.08% on 20 April to 0.36% end of April. Also, US 10-year Treasury bonds rose from 1.86% to 2.1% in the same period. This sell-off happened without us being able to identify a single trigger event. In the following we discuss the bond market dynamics and potential causes in more detail.**
- **Commodity prices recovered in April, especially energy and industrial metals prices. Oil prices rose almost 25% and industrial metals by 7.8%. Chinese stimulus measures may have triggered part of that movement. Gold prices fell slightly by 0.6%.**
- **The Fed meeting on 29 April did not produce significant news. The Fed reiterated that its decision to change rates is data dependent, and it will assess the situation meeting by meeting. In the Fed's view weak growth in Q1 is the result of transitory factors. In our view, the still very dovish rhetoric of the US Fed, coupled with disappointing growth data and still low inflation suggests that a June rate hike has become very unlikely. We still think, however, that a first rate hike is likely for the second half of 2015, probably in September.**
- **April's market moves have been very interesting, not only because of various surprises and counter-movements against long-established market trends, but also because they impel us to check our assumptions regarding our global scenario for the economy and financial markets. We discuss this in more detail in the following and will conclude that we feel encouraged to hold on to our major – optimistic – market views.**

Macroeconomics and financial markets

US growth in Q1 was even worse than expected. The US economy grew only 0.2% quarter-on-quarter annualized after 2.2% in the previous quarter. The US growth figures do reveal, though, that consumer demand has held up relatively well. Meanwhile, bad weather conditions depressed construction activities, a strong USD weakened export demand, and lower oil prices took their toll on oil-related investments. The April US ISM manufacturing index remained at 51.5, unchanged versus the March reading, which is disappointing and does not raise hopes of an immediate growth pickup in Q2.

The US labor market continued to improve. The number of Americans filing new claims for jobless benefits fell to a 15-year low. Initial claims for state unemployment benefits fell 34,000 to a seasonally adjusted 262,000 in the week ending April 25. This is consistent with renewed signs of rising wage inflation. The Employment Cost Index (ECI), the broadest measure of labor costs, advanced 0.7% after a 0.5% increase in Q4.

The Eurozone Markit Composite PMI retreated to 53.5 in April after its strong reading of 54.0 in March, but it remained clearly in the growth zone, above 50. With the exception of Germany and France, expansion accelerated broad-based across Eurozone countries.

Fig. 1: Major equity indices in 2015

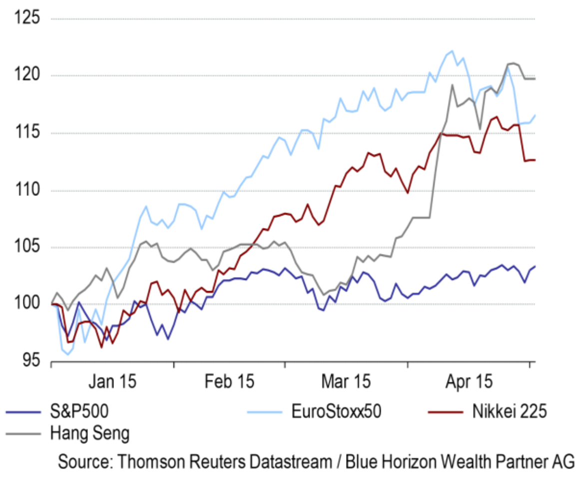


Fig 2: 10Y bond yields

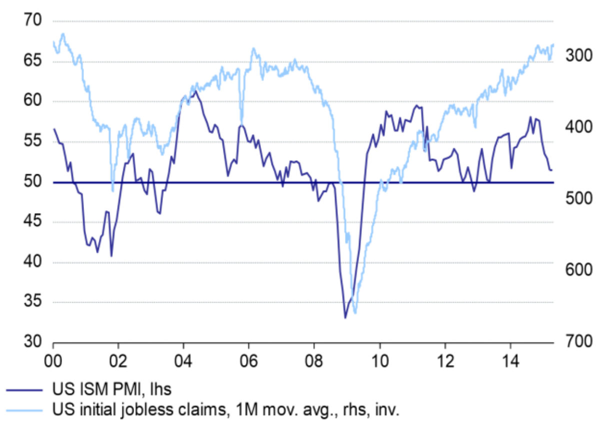
Why do we stay positive?

You can divide investors into basically two camps: the pessimists and the optimists. The pessimists would see recent disappointing US growth data as confirmation of their views, especially since the US is supposed to be the global growth engine. Ever falling global bond yields incurred further pessimism on growth and heightened deflation fears. In addition, falling prices for commodities, especially growth-sensitive commodities like energy and industrial metals, created further market-based skepticism. The pessimists have to deal, however, with the conundrum that equity markets have rallied for about six years now, despite disappointingly slow growth. In their view, this is a central-bank-induced market rally, which will need correcting sooner or later.

As we have been in the optimist's camp for more than three years now, we have interpreted the equity market rally as a confirmation of slowly but steadily improving growth data – with temporary setbacks. Since the slow growth has not been sufficient to remove economic overcapacity, inflation has stayed low despite huge monetary stimuli. Slow growth has also created overcapacities in commodities markets and has depressed commodities prices. Also, central bank buying has distorted bond markets and depressed yields further, which explains why bond yields have fallen to such low levels.

What happened in the financial markets in April? In our view, large consensus trades have led to excessive positioning in many markets, and we have observed positon squaring, leading to technical corrections. This may have been especially true for European equities, European bonds, the US-Dollar, and some commodities markets. This is supported, in our view, by the fact that European equity sold off, while most major equity markets performed positively in April and European bonds underperformed even US Treasuries, which should be more vulnerable.

Fig. 3: US ISM index and initial jobless claims



Source: Thomson Reuters Datastream / Blue Horizon Wealth Partner AG

Fig 4: EUR-USD exchange rate

Source: Thomson Reuters Datastream / Blue Horizon Wealth Partner AG

Beyond the above-mentioned reasons for the April market moves, which are more concerned with technical factors and positionings, we do see additional fundamental causes, which we believe support our macro outlook. There is evidence that rising oil prices reflect stronger demand from Europe, China and India. Rising oil prices have helped to reduce global deflation fears and, together with very poor risk-return for global government bonds, have been another major driver for the bond sell-off. It is also noteworthy that the growth-sensitive commodities prices – energy and industrial metals – rose the most. All in all, we see April's market movements as a confirmation of a positive macro outlook: global equity and commodities rallied and global bonds sold-off.

We also think that some macro data are encouraging and may have helped to spark the April market reactions. Leading European indicators have been improving in recent months, US consumer demand has been rising and US labor markets have been improving consistently.

Outlook

As mentioned earlier, we remain optimistic and expect US growth to pick up again in Q2 and growth in Europe to accelerate further. Also, the stimulus packages in Japan and China will succeed in boosting inflation, trigger some real growth in Japan and maintain a reasonable growth path in China. Growth will stay moderate, however, due to structural problems in Europe, Japan and China. Weak foreign demand and a strong USD will generate strong headwind for the US economy and limit its growth potential. The Fed will increasingly acknowledge rising wage inflation and start hiking rates, albeit at a very measured pace since the appreciating USD will tighten monetary conditions. Loose monetary policy in Europe, Japan and China together with the somewhat accelerating economic activity will provide sufficient support for equity markets to continue to perform well. We think that the setback for European equities is rather temporary and outperformance will resume. Global bond yields are poised to go up somewhat. We do not expect a dramatic bond sell-off, however. US bonds will underperform due to diverging monetary policies. This global picture is consistent with rising energy and industrial metals prices. Our outlook for gold, as we have argued a number of times, remains bleak, since perceived systemic risks are declining and the opportunity-costs of holding a non-interest-bearing asset will rise. We remain constructive for emerging market equities and bonds, on the basis that an improved picture for developed markets should also benefit emerging markets and that relative valuations look attractive.

While our outlook is obviously quiet positive, we do see and are closely monitoring the risks to our scenario. The growth dynamics could be less positive than we think. If growth indicators should continue to disappoint, deflation fears could be sparked, which would push down government bond yields even further and would lead to a reassessment of expected equity earnings. We also foresee uncertainties and potentially heightened market volatility when the Fed starts with its first rate hike. There is also a risk in our view that US growth and inflation could surprise us on the upside, which would warrant more decisive Fed rate hikes and, in turn, pronounced equity market sell-offs.

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