BLUE HORIZON
Wealth Partner AG

Recession fears spark a further sell-off

- **Equity markets were mixed in September with the majority of the indices somewhat down. This was followed by an accelerated and pronounced fall in major indices in the first weeks of October. Equity, credit and commodities markets fell while government bonds rallied. This looks to us like a typical risk-off and recession-fear market movement. It is fundamentally different from the pattern we often observed in recent market corrections, when risky assets and bonds fell in tandem driven by monetary tightening fears.**
- **While recent growth indicators by and large came in slightly weaker, the deterioration has not, in our view, been so dramatic. Obviously, many macro indicators have disappointed since the beginning of the year, especially in Europe and China, though US data have clearly improved.**
- **In September emerging markets equities fell 7.4%, the US S&P500 index fell 1.4%, while the Euro Stoxx50 rose by 1.8% and the Japanese Nikkei225 even by 4.9%. The current correction has been very significant, with the S&P500 falling 3.3%, the Euro Stoxx50 7.3%, and the Nikkei 5.4%, as of October 13.**
- **ECB's TLTRO (Targeted Long-Term Refinancing Operation) program had a disappointing start. Banks only took up about EUR 83 bn in the first phase of TLTRO out of a possible EUR 400 bn. This has proved those critics right who maintained that a private-sector quantitative easing program would prove toothless, coming at a time when the banking system is already awash with liquidity. According to the old central banker's saying, "you can take a horse to water, but you can't make it drink." If this continues to be the case, ECB's buying of government bonds may prove to be the next best measure to expand its balance sheet. Quantitative easing and especially the central bank buying of government bonds has been hugely controversial and has faced strong criticism, especially from Bundesbank President Jens Weidmann.**
- **The tone of the US Fed's September 16-17 meeting was distinctly dovish. The strength of the USD and the global growth slowdown may have had an impact on the Fed's statement. On balance, we continue to expect a first Fed rate hike in the second quarter 2015.**
- **As already pointed out in recent months, the financial markets may become more volatile and corrections may become more painful. But we still continue to believe in the low-growth scenario, which suggests that equity and credit markets can continue to deliver positive returns. Major equity and credit bear markets usually come about in a recessionary environment. While the risk of a recessionary Europe cannot be excluded, the US shows all the signs of a further growth pick-up. This together with further Euro weakness will, in our view, help Europe to maintain some limited growth momentum and will prevent a major equity bear market. As a result, we would recommend using the currently weak markets to add equity exposure.**

Macroeconomics and financial markets

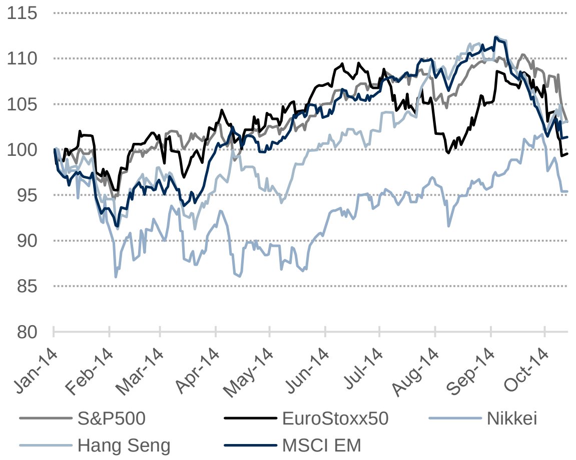
September growth indicators showed some weakness. The US ISM manufacturing index slipped to 56.6 from 59 in August. Since a figure above 50 signals growing economic activity, the reading remains strong in absolute terms and we do not regard this as worrying. All the more so since US non-farm payrolls rose by 248,000 in September up from 180,000 in August. This shows continued job creation in the US economy and led the US unemployment rate to fall to 5.9%. The German IFO business sentiment index, however, dropped to its lowest level since 2012 with a September reading of 104.7, following 106.3 in August (see Fig. 1). Also, Germany's Q2 output fell 0.2% versus Q1, which signals more fundamental weakness in what is usually Europe's pace-making economy.

The USD continued to strengthen with the EUR-USD exchange rate falling to 1.26 at the End of September. In October the EUR rebounded somewhat, which we rather see as a technical correction after the large shift of recent months. Commodities, in general, were hit hard in September. The Dow Jones UBS commodity index fell 6.2% during the month. Almost all commodity prices corrected down, which is consistent with general growth fears. Also, gold prices fell almost 6% in September to retrench somewhat recently. The gold price was very close to break below USD 1,200. We find it truly remarkable that oil prices, despite ongoing geopolitical tensions, sold off significantly. The price of Brent fell below 90 USD per barrel (see Fig. 3).

Fig. 1: German IFO index

Source: Datastream, Blue Horizon Wealth Partner AG

Fig 2: Major equity markets in 2014

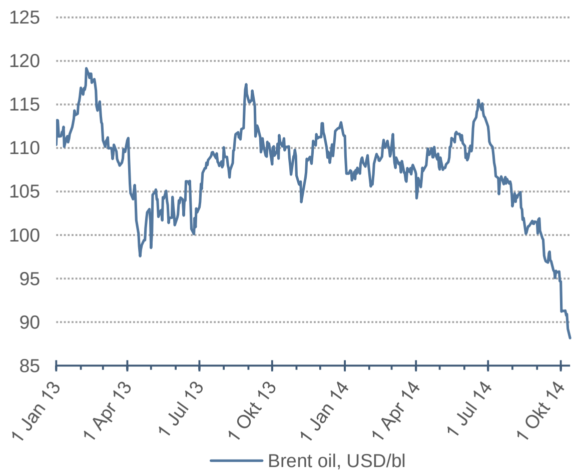


Source: Datastream, Blue Horizon Wealth Partner AG

Outlook

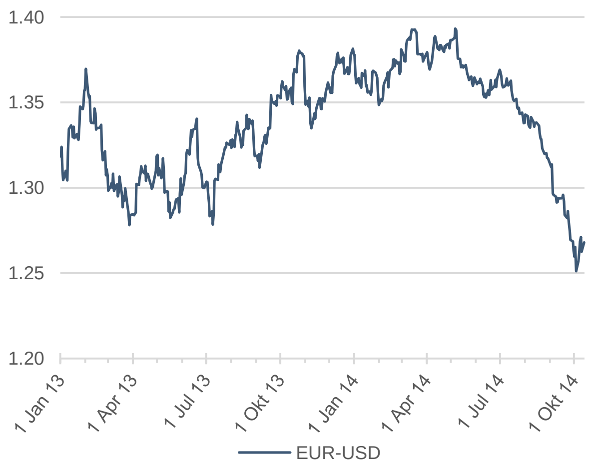
The current market correction proved to be significantly more painful than previous downward moves. The German Dax, the broader European indices, and the Japanese Nikkei index have been pushed to negative year-to-date performances. Based on our view that recession concerns are probably exaggerated and since valuations look more attractive now, we would either stay invested or buy on dips. For US stocks the earnings season has just started. Since earnings expectations look rather moderate there is a good chance for upside surprises, which could support the market. Compared with credit, we still prefer equity. We remain bearish on US Treasuries and bullish on the USD.

Fig. 3: Oil price correction



Source: Datastream, Blue Horizon Wealth Partner AG

Fig 4: EUR-USD exchange rate



Source: Datastream , Blue Horizon Wealth Partner AG

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