BLUE HORIZON
Wealth Partner AG

ECB delays QE to 2015

- The macro data in November were mixed. US non-farm payrolls rose by 321,000, the highest figure since January 2012. The unemployment rate remained unchanged at 5.8% and wage inflation remained low. While the Eurozone PMI fell to a 16-month low in November – to 51.4 from 52.1 – German manufacturing orders unexpectedly climbed by 2.5%, far above the expected 0.5%. This suggests that the German economy, which has been stagnant in recent quarters, may be ready for a growth spurt soon.
- Mid November, ECB's Draghi said that the ECB would take the necessary steps to raise Eurozone's inflation and inflation expectations as soon as possible. Given such dovish comments, markets were disappointed when the ECB's board failed to announce additional monetary easing measures at its 4 December meeting. Instead, Draghi said the ECB would consider stimulus plans in early 2015. We expect the ECB to introduce a quantitative easing program early next year, which would probably also involve purchases of sovereign bonds.
- Markets remained nervous in November. While developed equity markets performed well and rose by 2.1%, emerging markets lost 1.1%, and frontier markets (the least developed equity markets) even fell by 4.6%. Frontier markets had enjoyed a strong rally, outperforming developed and emerging markets over the last 12-24 months. It seems that this outperformance has now come to an end. Frontier markets began to drop late October and have fallen about 12% since then. One reason for the sell-off has been falling oil prices, since many of the frontier markets are commodity producers. The German Dax index was the strongest performer in November (+7%), due to better economic data, followed by the Japanese Nikkei index (+6.4%), due to reflationary policy measures.
- The Chinese equity market has been very volatile. The PBoC (People's Bank of China) cut interest rates on 21 November, which triggered a strong equity market rally. However, in early December China introduced more restrictive rules for repo (repurchase agreements), which led to a steep sell-off of equities and corporate bonds.
- The oil price continued its descent, especially since OPEC at its meeting on 27 November did not decide to cut production. The oil price has fallen by 35% since the beginning of the year. Gold recovered somewhat and was 1.5% higher in November.
- We remain constructive on equity markets despite the currently observable volatility. The US economy has proven to be very robust. Growth and job creation have been strong. This will warrant a first Fed rate hike in the first half of 2015. Despite strong demand for longer-dated US treasury bonds, this should eventually lead to higher long-term yields. The ECB is likely to introduce a more decisive quantitative easing program early next year, which will most likely involve purchases of government bonds. This will lead to a further widening of yield differentials and a stronger USD – following the recent EUR-USD exchange rate pause. Oil prices may bottom out soon but will remain low for quite some time to come.

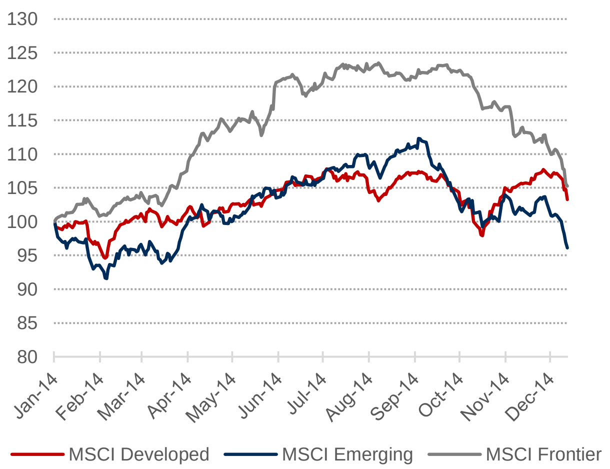
Macroeconomics and financial markets

The US economy is on a good track. In November the US ISM index slightly retreated to 58.7 from 59.0 the month before but has stayed at a high level, indicating robust growth dynamics. The US non-farm payrolls rose by 321,000 in November after 243,000 in the previous month. This confirms the healthy state of US job creation, despite the fact that the unemployment rate remained stable this time at 5.8%.

The European data remained on the weak side. The Eurozone PMI, for example, fell to a 16-month low in November, at 51.4 after 52.1. A figure greater than 50 does indicate growth. The positive surprise came from Germany, where factory orders unexpectedly climbed by 2.5%, far exceeding the expectations of 0.5%. This suggests that the German economy, after remaining stagnant in recent quarters, may be ready for a growth pick-up. Market participants have been particularly concerned about signs of a weakening German economy, since Germany has been the growth engine for Europe in recent years. As a result, the German equity index, Dax, outperformed most major equity indices.

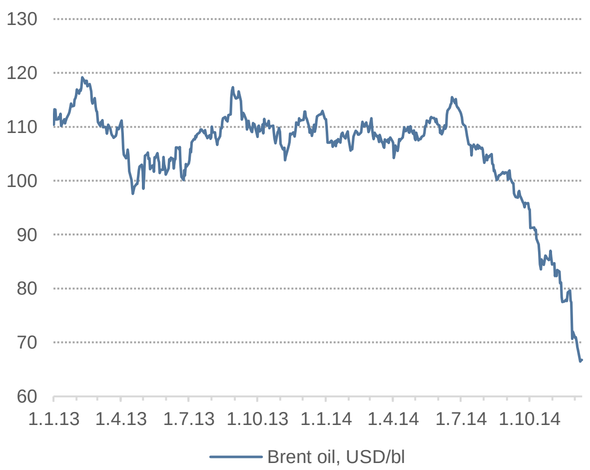
The oil price fell to new multi-year lows, especially after the OPEC could not reach agreement to reduce production. We see lower oil prices essentially as a supply-side phenomenon. Demand was robust and in line with the slight growth acceleration. Supply, however, has risen faster, driven by higher US (shale) oil and gas production and the fact that the OPEC seems to be ready to keep oil prices low, to hurt the shale oil producers in the US. We expect to see oil prices remaining under pressure as long as the OPEC does not decide to lower production. Many

Fig. 1: Broad equity indices in 2014



Source: Datastream, Blue Horizon Wealth Partner AG

Fig 2: Brent oil, USD/bl



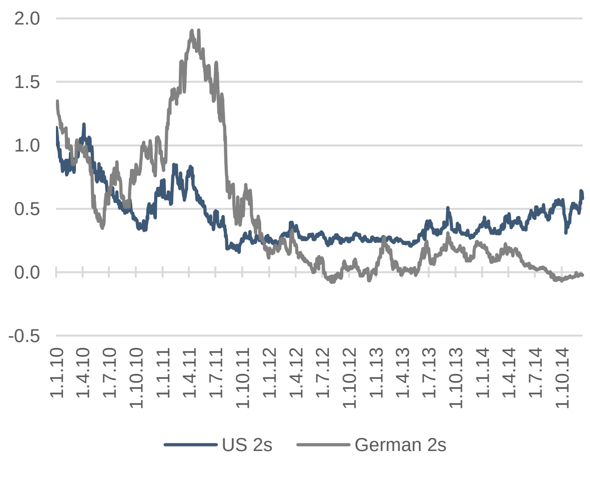
Source: Datastream, Blue Horizon Wealth Partner AG

OPEC producers would need oil prices above USD 90 to make profits. We therefore do not expect oil prices to remain low for very long; rather we see oil prices recovering in the first half of 2015. While oil producers certainly suffer from lower oil prices, the rest of the world clearly benefits. Lower oil prices reduce the production costs of many manufacturers and increase the disposable income of consumers for non-energy products globally. Concern that this could increase deflationary tendencies is – in our view – wrong, since firstly central banks certainly look at core inflation, which excludes energy costs, and secondly greater spending power is as such expansionary.

Outlook

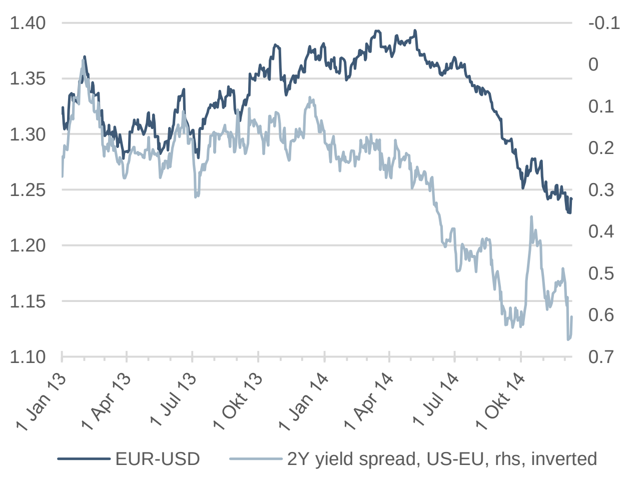
We remain constructive on equity markets despite the currently observable volatility. The US economy has proven to be very robust. Growth and job creation have been strong. This will warrant a first Fed rate hike in the first half of 2015. Despite strong demand for longer-dated US treasury bonds, this should eventually lead to higher long-term yields. The ECB is likely to introduce a more decisive quantitative easing program early next year, which will most likely involve purchases of government bonds. This will lead to a further widening of yield differentials and a stronger USD (see Fig. 4) – after the recent phase of a steady EUR-USD exchange rate. Oil prices may bottom out soon but will remain low for longer.

Fig. 3: 2Y government bond yields



Source: Datastream, Blue Horizon Wealth Partner AG

Fig 4: EUR-USD exchange rate and 2Y spread



Source: Datastream , Blue Horizon Wealth Partner AG

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