JUST AROUND THE CORNER: WHAT DOES 2018 HOLD?

We ask independent asset managers what they expect from the markets in 2018, which opportunities they are planning to seize and what challenges they foresee

ALEXANDRE CAVÉ
Senior researcher, Citywire
acave@citywire.co.uk

JANIS KLENK
Senior researcher, Citywire
jklenk@citywire.de

THORSTEN ERBELDING
eCapital Management
Bern

This year, equities were the main performance drivers in almost all portfolios, but this is likely to change in 2018. There will be disappointments in the stock market. I think the probability of a major correction is very high. I see opportunities in well-positioned companies and certain sectors. The gap in interest rates between Europe and the US will also continue to widen, although monetary policy will continue to be dominated by generally lax signals. The volatility of the markets will increase.

Stock-picking is becoming more important again. We are interested in security and electrical engineering firms and companies that supply metals such as lithium for the manufacturing of batteries. The precious metals, gold and especially silver, are favourable. I think mining companies are promising. In addition, CTAs should pay off again in 2018. As we expect markets to be more volatile, CTAs should ensure portfolio stability and performance.

At eCapital Management, we aim to achieve meaningful diversification across all asset classes, and that is always client-dependent. Due to our investment approach, the focus is on quality companies (hidden champions, often mid caps). The date of implementation is based on our proven quantitative and technical approach. In addition, we are increasingly using uncorrelated CTA strategies, especially as our many years of experience and our access to this area enable us to offer our clients attractive conditions.

Unfortunately, geopolitics (particularly in the Middle East and North Korea) will probably continue to be our greatest concern, but the forthcoming elections in Italy could also have a negative impact on the markets. In addition, we will see at least one event that hardly anyone is currently expecting. In the event of major distortions in the markets, the high correlations between various asset classes, driven by many years of ultra-loose monetary policy, will be very surprising for many investors. One area we are steering clear of entirely is all of the cryptocurrencies.

GLEN NEUKOMM
CATAM
Schaan, Liechtenstein

Things are looking good in the land of the rising sun. Shinzo Abe's ruling Liberal Democratic Party (LDP) and his coalition secured a large majority in October's snap elections, paving the way for Abe to lead his party through to 2021. This should see Haruhiko Kuroda, the head of the Bank of Japan, get re-elected when his term runs out next spring. All of these factors will provide political stability and ensure ongoing ultra-easy monetary policy and continuing 'Abenomics', which have lifted equity prices to their highest levels in more than 25 years. Their target is to bring back inflation of around 2% and to spur economic growth.

Corporate Japan is cash rich; dividend payouts have hit a five-year high and M&A transactions have risen to a nine-year high. EPS growth should be around 18% for the next three years and valuations are rather cheap, with P/E for 2018 expected to be around 14x.

Unemployment is at a 23-year low and this should see wages increase in the future, boosting spending and economic growth. The average USD/yen rate for corporates this fiscal year is around 110, which is another tailwind for earnings as the yen should weaken further. Both consumer spending and capital expenditure are showing signs of acceleration.

Foreigners started buying Japan towards the end of the year, but global investors are still underweight. 2018 should see them coming back as the outlook is very positive.

ANDREW PORTMANN
GPA Portfolio Management
Zurich

The global economy is set to grow steadily in 2018. But we doubt there will be much potential for positive surprises. The US economy is currently in a late-expansion phase. Overall, the global economic cycle is less advanced than that of the US. This makes us believe that cyclical assets such as stocks and commodities are still attractive.

In 2017 investors were fairly complacent regarding political developments. Neither the failure of the Trump administration to fulfil its promises on economic reforms nor the pending issues within the EU had any substantial impact on financial markets.

Equity markets will have a bumpier ride in 2018. Valuations remain stretched, but in a low-yield environment with loose central bank policies there is no immediate pressure for a decline in price/earnings ratios.

That said, German and Japanese equity markets look most favourable to us. Japan just posted its longest economic growth streak in many years.

Bonds remain relatively unattractive. Low yields and low credit spreads limit the potential for returns over the medium term. We expect only a gradual increase in interest rates.

We are convinced the commodity cycle has not reached its top and we therefore like this asset class. Base metal prices still offer upside potential. Rather than buying the metal, we prefer the mining companies. With rising earnings, copper miners offer interesting potential at current valuation levels.

Gold continues to be part of our portfolio as it normally benefits when inflation is rising and the Fed raises rates. Additionally, it is our risk insurance that lets us sleep at night.

PETER NÜNLIST

Peter Nünlist Investment Management & Services
Zurich

The world's economies are doing just fine. Without any further political upheavals we can expect moderate gains for equities, while bond yields will tend higher. The fact that Europe still has an expansive monetary policy leads us to rethink our asset class allocation and possibly switch an additional proportion out of bonds to the equity quota.

Moreover, the tax reduction for US companies in 2018 will certainly support investor sentiment towards stocks.

We continue to focus on growth at a reasonable price through careful stock selection within our value style. We therefore prefer mainly European and Asian stocks. In addition, we are reducing our US investments as we go about profit-taking.

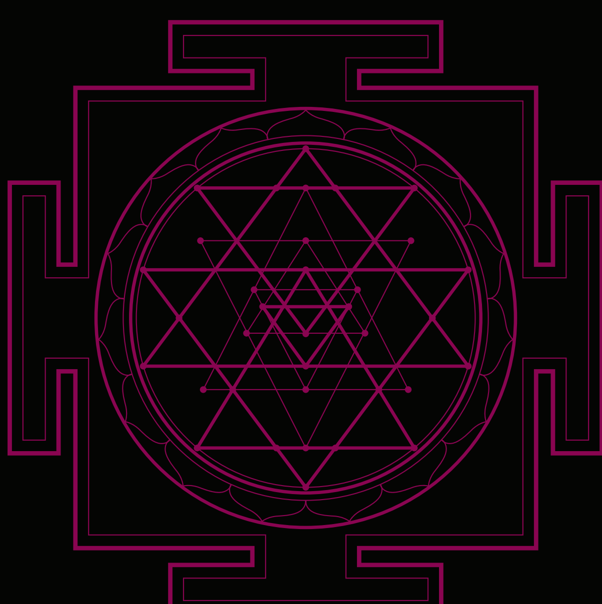
As we expect markets to be stable, we will prefer cheaper stocks versus the indices, even though the P/E ratios are already high.

After a very good year for equity portfolios and the prospect of a far more moderate year ahead, we will encourage our investors to rebalance their portfolios: if your benchmark is 50% and your actual holding is above this, cut it back to 50%.

This rebalancing gets you close to 'constant proportion portfolios', a numerical asset allocation with very good long-term risk/reward characteristics.

Unexpected changes in central bank policies could be a game-changer. China should revalue its currency, or else a surprising recession could take place.

A year ago, nobody was overweight emerging markets. Maybe this time it will be different, as the US dollar becomes stronger.



WILLIAM JACCARD

Penta Asset Management
Geneva

While we remain positive on the economic outlook for 2018 – despite the length of this cycle – we forecast lower returns in most asset classes given the general high level of valuation. That said, the risk appetite could stay elevated as long as inflation remains subdued and interest rates are low. Investors continue to chase yields but spreads are tight, and as there are no real alternatives to equity, valuations could extend further. A resolution on tax reform in the US could provide some additional support. The party is not completely over but we think the risk/reward ratio is becoming less attractive at a time when central banks have hinted about the end of their ultra-accommodative monetary policies.

Outside European equities, where we remain positive, the recent synchronised improvements in global growth should continue to support earnings and cyclical assets in emerging markets and Japan. We are also interested in thematic investments that will have a disruptive effect on the world economy in the years to come, but some of these themes are currently crowded. In fixed income, we avoid government bonds as their prices are still distorted by central banks' actions. Besides our core positions in corporate bonds, we hold satellite positions in European financial subordinated debt, emerging market debt and senior loans.

In terms of positioning, we are consuming 80% of our 'risk budget' in our multi-asset class mandates and, going into year-end, we have started to buy protection and raise the level of cash in our equity portfolios. As a multi-family office with conservative DNA, our first goal is to preserve the wealth of our clients. That could be particularly challenging in the year ahead as valuations are elevated, investors are somewhat complacent and global debt is rising to record high levels, with interest rates still at rock bottom. One of our major concerns will be the ability of central bankers to normalise their aggressive monetary policies without triggering a market dislocation. In other words: there are big challenges ahead.