

Market Commentary

April 2015

The first quarter of 2015 turned out to be better for the European markets than most investors were expecting. The US markets, however, performed below consensus expectations. We had positioned client portfolios to take advantage of the stronger European markets even though our view went against that of the consensus at the start of the year. The one event which was as much of a surprise to us as it was to the rest of the market was the removal of the Swiss Franc cap by the SNB (Swiss National Bank). Though we had hedged some of the foreign exchange exposure for our Swiss Franc clients, we were not expecting this move by the SNB and our view was that the dollar would continue strengthening. Therefore, initially the dollar exposure produced a large negative impact on the Swiss Franc reference currency portfolios. Fortunately, the dollar has almost recovered completely. For our clients with the Euro as reference currency, we had not hedged foreign currency exposure and this proved to be a substantial boost to performance.

Mr. Draghi's announcement of a trillion Euros worth of QE (Quantitative Easing) was a big boost to the European markets and a big set back for the already weak Euro. The program is to be implemented over an 18 month period starting March 2015 and further extended if necessary. The average European market rose 18% this quarter (Fig. 1) and the Euro fell 13% versus the dollar and 15% versus the Swiss Franc. The US and Swiss Markets finished the quarter more or less flat.

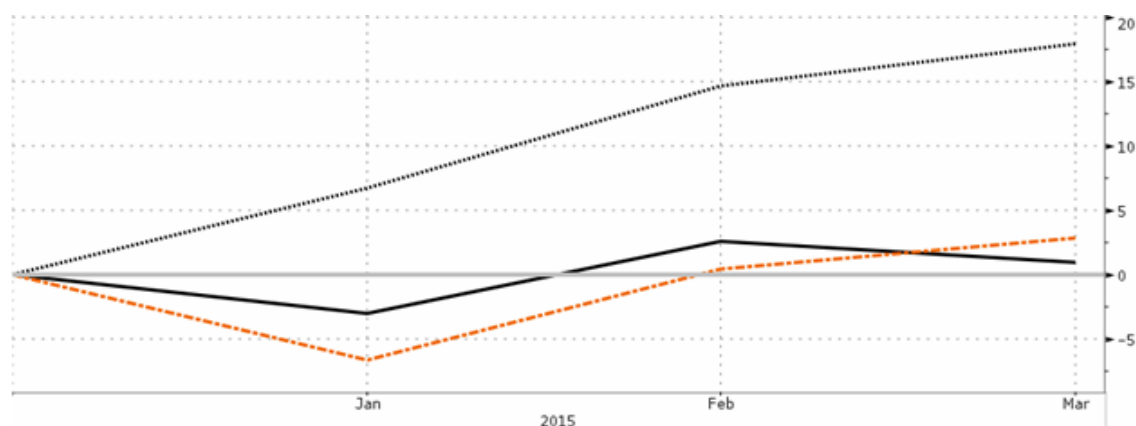


Fig. 1: Q1 Equity Index Performance, European market average (dotted), US (black), Swiss (orange)

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Gold and oil remained volatile and were driven to a large extent by bouts of strength or weakness in the US dollar. The bond market has also been volatile. This is not something that most investors are used to. However, the exceptionally low yields globally and especially in Europe have produced a market environment that is unprecedented and therefore highly sensitive to any news flow.

The US has shown resilience on both the growth and inflation fronts. Capacity utilisation is approaching pre-crisis levels and unemployment is not far behind. In normal circumstances these figures would prompt the FED to start raising interest rates. However, the substantial drop in oil price and the strength of the US dollar have given the FED room to delay raising interest rates for a few months longer than planned. The US stocks markets seem to have discounted most of the good news and are facing considerable resistance at current levels after four years of very strong outperformance. We were expecting this resistance as outlined in our last report "We believe that optimism with regard to the US may be challenged as expectations are high and even slight disappointments could lead to financial market overreactions. At this stage it is our opinion that it is not the absolute levels of growth that will influence the performance of financial markets but rather the surprises or disappointments no matter how small."

As we launch into the second quarter, we believe that volatility is set to rise. In Europe, markets have rallied strongly due to optimism fuelled by the ECB's QE. As a result, they are vulnerable to any disappointments from Greece, the Ukraine or any other as yet unexpected source, however temporary

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they might turn out to be. In the US anticipation of the turn in the interest rate cycle has increased market sensitivity. The oil dependent countries within the Emerging market complex continue to suffer at the current oil price. China is struggling to gain momentum and Japan is in the midst of tackling more headwinds than it bargained for.

However, as bond markets are yielding next to nothing in Europe, we believe that any setback in the European equity market will be seen as a buying opportunity for yield chasing investors. This is especially true for high dividend yield stocks with good balance sheets. We had accumulated these positions last year when they were out of favour and though we have trimmed positions and booked some profits we continue to hold them as part of the core portfolio.

We believe that most of the Euro weakness is behind us and that the price of gold and oil will be influenced substantially by the relative strength or weakness of the dollar at current levels. The Fed is increasingly concerned about the strength of the dollar and is using the weakness in oil price as an opportunity to slightly delay a turn in the interest rate cycle. If the delay turns out to be longer than consensus expects, the dollar should weaken benefiting gold and to some extent oil. However, as the FED will probably raise rates sometime this year, the dollar should return to strength after a short period of weakness which could put renewed pressure on Gold and oil prices.

General Thoughts

As can be gathered from our comments above, markets are at a very sensitive stage when it comes to monetary policy and growth expectations. A lot of good news has been priced into the markets in anticipation of better growth and the avoidance of deflation. Therefore, volatility in all asset classes and currencies may be higher than in the recent past as even small disappointments on the economic or political front unleash large bouts of profit taking. Movements may be sudden and reverse as quickly as they appeared catching investors and speculators on the wrong foot. We have seen one such move in October 2014 during which European markets dropped 15% and then recovered fully. The whole round trip took just six weeks. Those who were too extremely positioned when the correction started were not able to take advantage of the sell-off as they were worried about losses on positions they were already holding. We therefore advise clients to avoid extreme positioning and to rebalance portfolios regularly. This being said, the relative value trade of stocks over bonds continues. In our opinion beaten down commodities, gold and emerging markets will also offer periods of substantial price appreciation in times of relative dollar weakness. We believe that this environment rewards investors who can tolerate volatility in the short term in order to reap rewards in the medium to long term.

Gillian Hollenstein

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