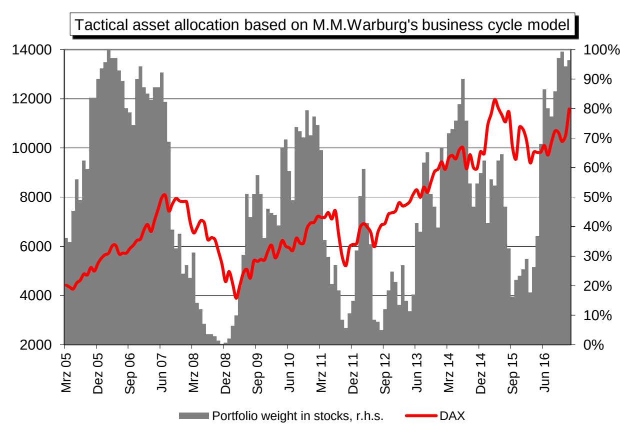
ECONOMIC SITUATION AND STRATEGY

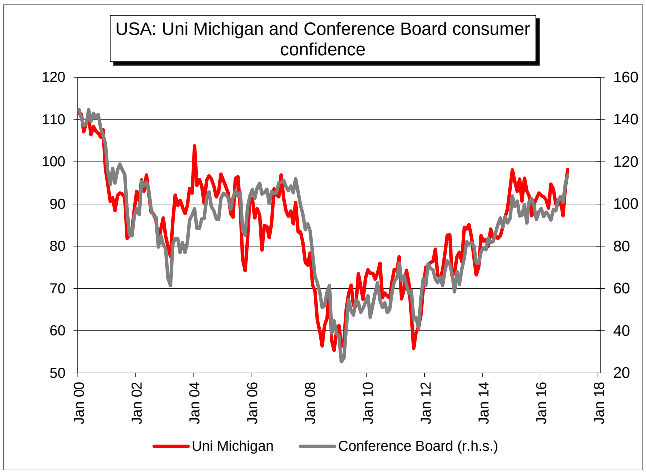
Made-to-order start

What a difference 12 months can make! While the start of 2016 saw severe price declines, most international stock markets have posted gains in the first trading days of 2017. A year ago, it was mainly economic fears arising from China and the United States that led the DAX to lose almost 10% in the first week of trading alone. In contrast, the current economic environment is extremely positive. Our long-used M.M.Warburg Business Cycle Model, into which many leading indicators and financial market variables enter, has been very high since autumn 2016. The investment recommendation we derive from it is therefore to implement the highest possible stock weighting.



The wave of very good economic data has also continued in the first few days of the new year. The majority of purchasing manager indexes (PMIs) from the manufacturing sector shows a respectable increase in December. The global PMI, which is based on data from 28 national economies, has reached 52.7 points, its highest level since February 2014. Momentum is currently higher in the industrialized countries (54.0 points) than in the emerging countries (51.2 points). That is because the Netherlands, Austria, and Great Britain, three developed economies, are among the four countries with the best PMIs. On the other hand, Brazil, Malaysia, Turkey, and Indonesia, the economies with the weakest PMIs, are all emerging countries. Nevertheless, economic prospects have also continuously improved in the emerging countries in recent months, so the world economy will register robust growth in 2017.

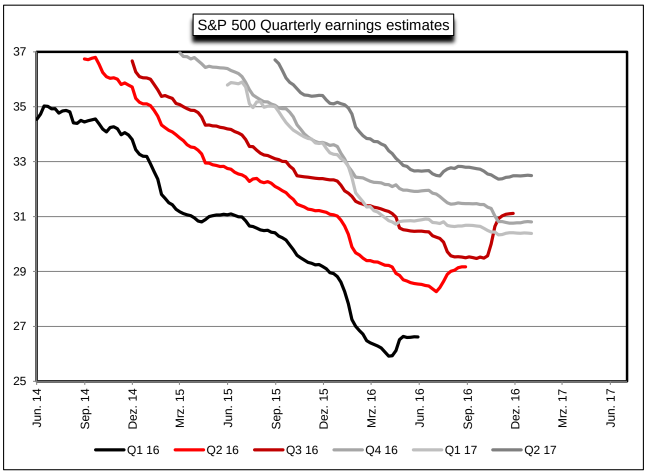
The better global growth prospects are attributable not least to the strong improvement of sentiment indicators in the United States. That has something, but not solely, to do with the election of Donald Trump as US president. The improvement of most leading indicators began already early last summer and has continued to the present. The "Trump effect" can be most easily detected in consumer sentiment, which improved significantly after the election. Both the Conference Board and the University of Michigan consumer confidence indexes are at their highest levels since 2001. This suggests that consumption will retain its function as the most important driver of US economic growth this year. Although the economic upswing in the United States is now entering its eighth year, there is no end of this positive trend in sight. On the contrary, US economic growth could come to about 2.5% in 2017, after a rate of only 1.5% last year.



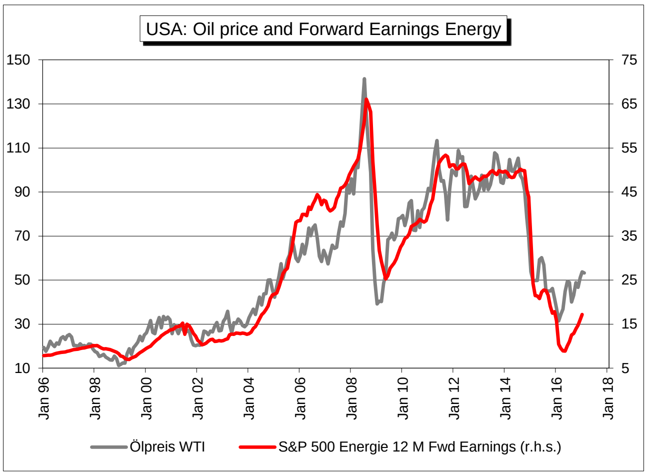
Whether this growth rate will actually be achieved or even surpassed depends greatly on whether and in what form Donald Trump keeps his campaign promises. Tax cuts and tax code simplification, less regulation, and more infrastructure spending are the kind of measures that could significantly stimulate economic growth. The stock markets are also betting that Trump will succeed and thus put more pep into the US economy (and hence into the world economy). Stock prices on most exchanges – apart from some emerging countries – have advanced sharply since November 9, 2016, the day after the election. Consequently, some disappointment potential has built up in case Trump does not "deliver the goods." However, that is unlikely given the majorities enjoyed by the Republicans in both houses of Congress. Greater trouble threatens to come from possible trade fights that Trump might pick with China, for example.

However, if it does not come to a trade war and the new US president actually manages to increase US economic growth to near 3% with his policies, the bull market in stocks is likely to continue. For, the most important driver of stock prices is corporate earnings. True, US stocks are comparatively expensive. The S&P, with a price-earnings ratio of 17 based on expected earnings in the next 12 months, is valued significantly higher than the average of the past years. Nevertheless, a "growth renaissance" could cause earnings to rise more than expected, which would put the market's high valuation into perspective. But that effect would probably not become noticeable until the second half of the year at the earliest.

Even without the new US president's growth-promoting measures, conditions are better for rising earnings in the United States than they have been in a long time. That is also likely to be evidenced by the reporting season for the fourth quarter of 2016, beginning next week. While corporate analysts usually revise their earnings expectations significantly downward ahead of reporting and then make it easier for companies to surpass their lowered estimates, earnings expectations have remained stable this time. In fact, earnings expectations have been raised in the past four weeks in the energy, technology, and industrial sectors, while slight downward adjustments of profit estimates have only been made in the raw materials and utilities sectors.

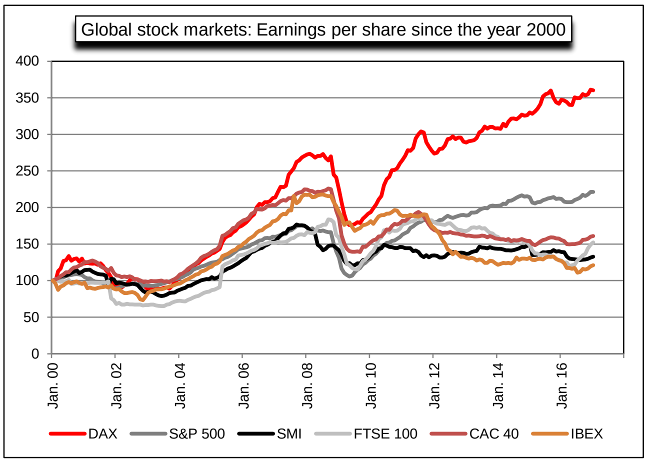


Overall, earnings of S&P 500 companies should show an increase for the fourth quarter of 2016 by 4.3% year-on-year (after 4.6% in the third quarter). Analysts expect earnings growth rates of 14.1%, 11.4%, 9.3%, and 14.0% for the four quarters of 2017, respectively. Although these growth rates seem ambitious, they are mainly due to one component, the energy sector. After earnings there plunged last year as a result of the sharp oil price decline, a quadrupling of earnings is now forecast due to the oil price's recovery. That would put earnings roughly back at the level of 2003 and 2015. However, the average oil price was only USD 31 in 2003 and USD 49 in 2015. If one assumes that the oil price will be about USD 60 on annual average in 2017 and that companies are now producing more cost-effectively, then earnings estimates might still be too low. But that would mean that earnings of the entire S&P 500 might turn out higher in 2017.



Instead of an increase of 12%, the potentially higher earnings of energy companies might make growth of 15% possible. If one then assumes possible positive effects from Trump's tax reform, infrastructure spending, and deregulation, the increase could even reach 20%. That would reduce the market's high valuation somewhat, and the price-earnings ratio of the S&P 500 would then be just under 16. Conversely, we might raise our price target for the S&P 500 from 2,450 to 2,700 points, if all these positive effects were to occur. But at the moment, such a price target adjustment would be based too heavily on assumptions and hypotheticals and not enough on hard facts. Our price target therefore remains unchanged for the time being, even though these considerations show that US stocks are undoubtedly still attractive even at present price levels.

Nevertheless, investors with an affinity for stocks should also not lose sight of the European market. The substantially better performance to be achieved with US stocks compared with European stocks, particularly since the financial crisis, has had to do mainly with the better earnings trend in the United States. Compared with summer 2009, when the recession was at its worst, the earnings of S&P 500 companies have roughly doubled, while remaining more or less unchanged in Europe. That is due, in particular, to weak development in Spain and Italy. However, it appears that earnings in Europe will also finally start to grow more strongly in 2017. There seems to be comparatively great catch-up potential there in comparison with the United States, so performance of European stocks should recover. And there is one European stock market whose earnings momentum cannot be said to lag in any case, and that is the DAX. The 30 German blue chips in this index have even increased earnings since mid-2009 somewhat more strongly than US companies have. The comparison is even more impressive when one takes 2000 as the base year. The German stock market leaves all other comparable indexes far behind in this comparison. And that is one reason why the DAX could break its April 2015 record of just under 12,000 points this year.

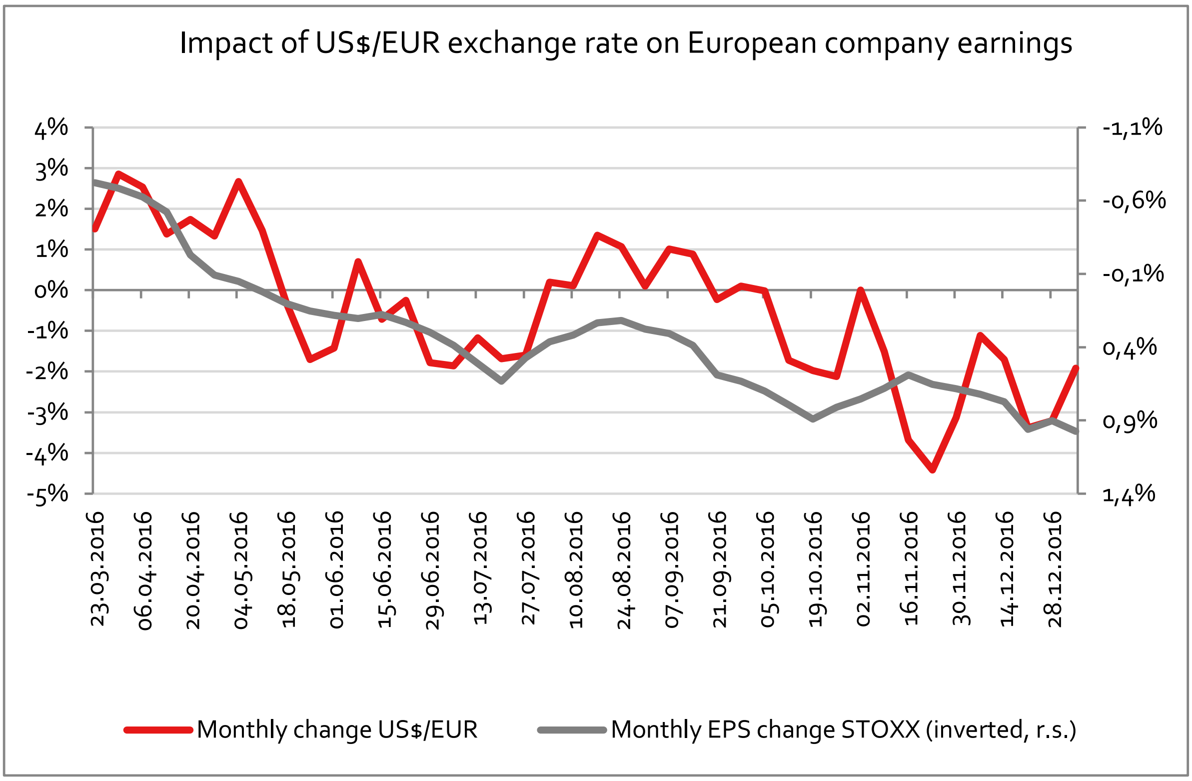


Weekly outlook for January 9-13, 2017

	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Release
DE: Exports, m/m	3.6%	-1.0%	0.5%	1.2%			January 9
DE: Exports, y/y	4.4%	0.5%	2.0%	2.1%			January 9
DE: Trade balance, in EUR bn	21.6	21.1	20.7	21.3			January 9
DE: Industrial production, m/m	3.0%	-1.6%	0.3%	1.4%			January 9
EUR19: Sentix Index	4.2	5.6	8.5	13.1	10	13	January 9
EUR19: Unemployment rate	9.9%	9.9%	9.8%	9.7%			January 9
EUR19: Industrial production, m/m	2.0%	-0.9%	-0.1%	0.8%			January 12
EUR19: Industrial production, y/y	2.5%	1.4%	0.6%	1.7%			January 12

MMWB estimates in red

Chart of the Week: Weak euro bolsters earnings



Last spring, the euro exchange rate relative to the US dollar was still just under 1.15, but since then the euro has more or less continuously lost value against the dollar and stood at 1.04 at the end of 2016. The euro's devaluation and corresponding revaluation of the dollar has been advantageous for many businesses in the euro zone, as a considerable share of their revenue is generated in dollars, particularly in the case of export-oriented companies, and a devaluation of the euro accordingly leads to higher euro revenue. However, since many payment flows are hedged by means of currency futures, the net effect of a euro devaluation is not easy to quantify. To approach this topic, we have calculated for all euro stocks in the STOXX 600 how earnings estimates changed in the course of last year as a function of the exchange rate. The result shows that earnings rise on average by 0.18% when the US dollar revalues by 1% against the euro. However, this relationship varies widely at the level of individual stocks. According to our calculations, for example, stocks like BASF or Lanxess as well as Hugo Boss and Covestro benefited especially from the exchange rate last year.

Stock marktes	As of 06.01.2017 16:05	Change versus 30.12.2016 -1 Woche	05.12.2016 -1 Monat	05.10.2016 -3 Monate	31.12.2015 YTD
Dow Jones	19905	0,7%	3,6%	8,9%	14,2%
S&P 500	2265	1,2%	2,7%	4,9%	10,8%
Nasdaq	5488	1,9%	3,4%	3,2%	9,6%
DAX	11581	0,9%	8,4%	9,4%	7,8%
MDAX	22256	0,3%	7,6%	3,2%	7,1%
TecDAX	1837	1,4%	8,0%	1,5%	0,4%
EuroStoxx 50	3307	0,5%	8,3%	9,3%	1,2%
Stoxx 50	3041	1,0%	7,6%	6,3%	-1,9%
SMI (Swiss Market Index)	8381	2,0%	6,8%	2,3%	-5,0%
Nikkei 225	19454	1,8%	6,5%	15,7%	2,2%
Brasilien BOVESPA	61687	2,4%	3,1%	2,4%	42,3%
Russland RTS	1175	1,9%	9,9%	17,8%	55,2%
Indien BSE 30	26759	0,5%	1,6%	-5,2%	2,5%
China Shanghai Composite	3154	1,6%	-1,6%	5,0%	-10,9%
MSCI Welt (in €)	1782	1,6%	5,2%	10,0%	10,5%
MSCI Emerging Markets (in €)	882	2,1%	4,7%	2,3%	14,5%
Bond markets					
Bund-Future	163,10	-105	265	-113	518
Bobl-Future	133,34	-29	215	155	267
Schatz-Future	112,27	-3	3	16	75
3 Monats Euribor	-0,32	0	-1	-2	-19
3M Euribor Future, Dec 2017	-0,31	-5	-6	4	0
3 Monats $ Libor	1,01	1	6	14	40
Fed Funds Future, Dec 2017	1,11	-2	9	36	0
10 year US Treasuries	2,40	-5	1	69	13
10 year Bunds	0,28	17	3	36	-36
10 year JGB	0,06	1	4	12	-20
10 year Swiss Government	-0,20	0	-9	29	-13
US Treas 10Y Performance	572,82	0,6%	0,2%	-4,5%	1,5%
Bund 10Y Performance	610,02	-0,5%	0,8%	-2,1%	5,4%
REX Performance Index	483,62	-0,3%	0,2%	-1,2%	2,0%
US mortgage rate	0,00	0	0	0	0
IBOXX AA, €	0,72	5	-9	27	-57
IBOXX BBB, €	1,52	2	-18	22	-75
ML US High Yield	6,31	-15	-46	-21	-259
JPM EMBI+, Index	782	1,3%	3,0%	-3,9%	11,1%
Convertible Bonds, Exane 25	6969	0,0%	3,9%	3,0%	0,1%
Commodities					
CRB Index	429,12	2,0%	0,8%	2,5%	13,1%
MG Base Metal Index	284,33	1,6%	-4,3%	9,6%	22,4%
Crude oil Brent	56,77	0,1%	3,1%	9,3%	59,0%
Gold	1176,36	1,6%	1,1%	-7,4%	10,7%
Silver	16,66	3,8%	-0,4%	-5,6%	20,3%
Aluminium	1709,75	0,3%	-1,5%	2,5%	14,0%
Copper	5560,50	0,7%	-6,5%	16,4%	18,2%
Iron ore	77,50	-3,1%	-1,9%	36,0%	76,9%
Freight rates Baltic Dry Index	983	2,3%	-17,8%	13,1%	105,6%
Currencies					
EUR/ USD	1,0557	0,2%	-1,4%	-5,8%	-3,0%
EUR/ GBP	0,8568	0,4%	1,5%	-2,5%	16,2%
EUR/ JPY	123,03	-0,3%	0,6%	6,4%	-6,1%
EUR/ CHF	1,0709	-0,3%	-0,8%	-2,3%	-1,2%
USD/ CNY	6,9176	-0,5%	0,5%	3,7%	6,5%
USD/ JPY	115,36	-1,3%	1,3%	11,4%	-4,1%
USD/ GBP	0,81	0,3%	3,2%	3,5%	19,7%

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