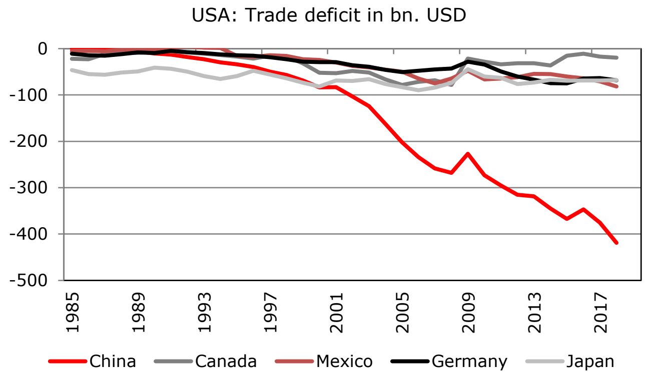
M.M.WARBURG & CO
BANK

ECONOMIC SITUATION AND STRATEGY

April 24, 2019

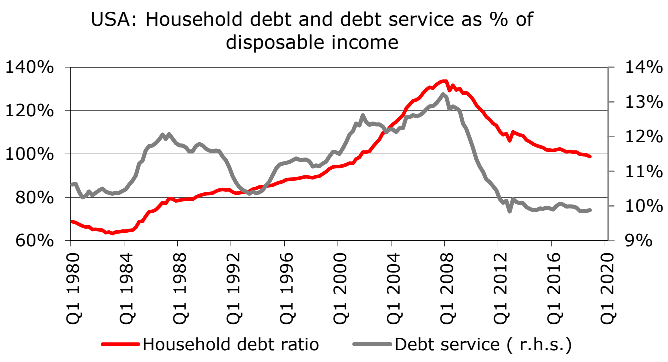
Chasing the record books

Unlike most other countries, the United States achieved stronger economic growth in 2018 than in 2017. Real GDP grew at a rate of 2.9% and thus almost reached Donald Trump's target of 3%. And Trump would not be Trump if he had no one immediately to blame for not quite keeping his "growth promise," so he has cast the Federal Reserve in that role. That the United States was able to decouple in its economic trend from the rest of the world is mainly due to two things. The first is the tax reform, which gave businesses significant relief. That prompted many of them to create new jobs, thus transferring the fiscal stimulus from businesses to consumers. Moreover, the trade disputes that Trump has instigated with China, Mexico, Canada, and other countries primarily have hurt export-oriented economies like those of the euro zone, Japan, and many emerging markets, but not the United States itself.



For, domestic demand, not foreign trade, is the crucial factor for growth in the United States as a "great" economy. So, what happens this year will depend on whether consumer spending, which accounts for about 70% of total US economic output, will continue to grow. Economic momentum has also diminished in the United States in recent months, but current data does not indicate anything worse than a moderate slowing of growth in 2019.

Although consumer spending has weakened significantly from its previous levels since the end of last year, there is much to suggest a recovery in the months ahead. Retail sales growth, which was still above 6% last summer, was only 2% in February, with the slowdown affecting all retail segments. However, there are more jobs than ever before thanks to the booming labor market, so wages are also rising more strongly. Since, at an annual rate of over 4%, disposable incomes have increased more strongly than consumer spending, Americans have accumulated a comparatively thick cushion of savings. One may observe generally that US households are in extremely good financial shape. That is because, for one thing, debt relative to income is lower than at any time since 2001. For another, and more importantly, debt service, i.e., the share of disposable income spent on interest and principal, is less than 10% and has seldom been so low – thanks to the Federal Reserve. So, there is at least no risk of a new crisis coming from households.



A new recession for the United States is therefore not in sight now. The current economic upswing, which began in June 2009, is thus certain to set a new record in June 2019, having lasted by then 121 months. The longest upswing in modern US history was from March 1991 to February 2001. This sends a very important message to investors, i.e., not to position oneself too defensively as long as no recession is foreseeable.

This is also the main reason for the stock market's very good performance since the beginning of the year. While highly cyclical stocks suffered double-digit percentage losses in the fourth quarter of 2018 on worries of a severe economic slowdown, they have been the big winners of 2019. The US indexes have nearly reached the records they set in autumn 2018, and we consider it likely that they will continue to rise. So, not only the US economy, but also the US stock market are close to new record levels. This is also likely to draw other stock markets along. Even if the world economy develops more weakly than in 2018, it is no longer in free fall. Above all, the better economic data from China suggests that the implemented monetary and fiscal policy measures are bearing fruit. Not everything in Chinese data that glitters is gold, but the stabilization observed there should eventually benefit the euro zone, Japan, and many emerging markets.

Besides better (or less negative) economic data, the reporting season for the first quarter should also benefit the stock market. The number of companies that have already submitted their quarterly results is still small, but a quite clear picture emerges nevertheless. In the United States, it appears that more companies will manage to beat earnings expectations than did in the preceding quarter. So far, about 80% of companies from the S&P 500 and NASDAQ 100 indexes have beaten earnings forecasts, while the comparable number in the fourth quarter of 2018 was just over 70%. On the other hand, the share of positive surprises in respect to sales is about 50% and thus significantly lower than in the preceding quarter and on long-term average. This is an unmistakable sign that the economy has slowed. In Europe, only a few companies have released their figures. This very small sample shows, as in the United States, that the positive earnings surprises predominate and sales figures are turning out better than expected.

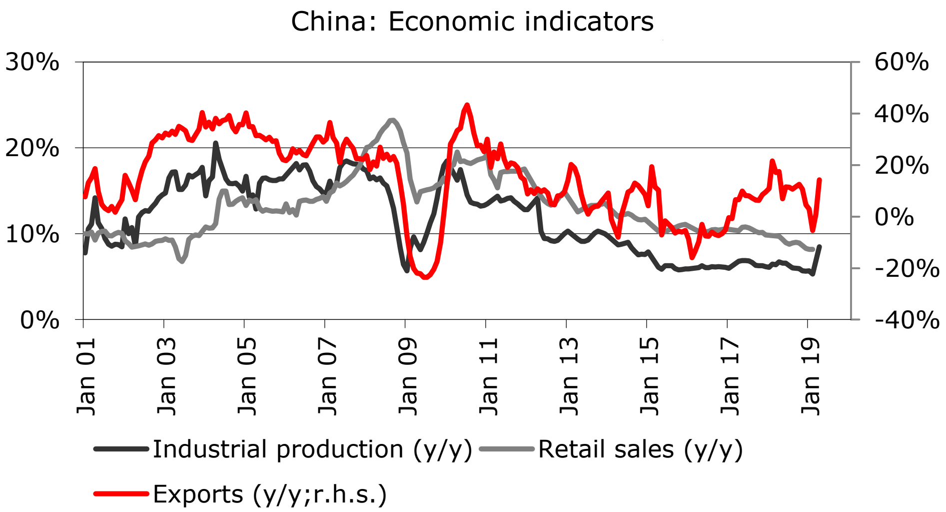
The rally on the stock markets might continue with this tailwind. However, there is a catch to this way of looking at it. Corporate analysts have sharply lowered their expectations for the first quarter and in some cases for the second quarter, but they still foresee a significant improvement of the earning situation. At the moment, however, this expectation is based more on hopes than on facts. Moreover, one wonders how far stock prices can still advance. There is little room for further price gains from the standpoint of valuation. The P/E ratio of the S&P 500 based on expected earnings in 12 months has risen from 14.3 at the beginning of the year to 17, while the long-term average is only 15. Assuming that the earnings expectations are realistic, we obtain a price target of 3,000 points on a P/E of 16, and one of just under 3,200 points on a P/E of 17. The P/E of the DAX index has recently climbed to 12.9. If current earnings expectations are credible, then the DAX could increase to 12,900 points on an unchanged valuation multiple. However, earnings forecasts are very optimistic, since they assume rates of increase of about 10% for each of the coming two years. On more cautious assumed rates of 5% and 9%, we obtain a DAX target of 12,600 points.

Weekly Outlook for April 22-26, 2019

	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	Release
DE: Ifo business climate index	102.3	101.1	99.5	98.7	99.6	99.9	April 24
DE: Ifo business expectations	98.8	97.3	94.8	94	95.6	95.8	April 24
DE: Ifo current conditions	105.9	105.1	104.5	103.6	103.8	104.0	April 24
EUR19: Consumer confidence – flash	-6.6	-8.3	-7.9	-7.4	-7.2	-7.0	April 23

MMWB estimates in red

Chart of the Week: Stabilization in China



China's economic momentum has seemed to weaken increasingly in recent months due to the trade dispute with the United States and poor economic data in Europe. Growth in the fourth quarter was "only" 6.4%, and exports, which still benefited initially from anticipatory effects in 2018, dropped sharply in February (-20%), and industrial production increased by only about 5% in the same period. Consumer spending lost momentum, and the survey-based unemployment rate rose above 5%. As it has before in similar cases, the government in Beijing announced tax cuts and investments in the billions to stem an emerging lull and achieve the growth target of 6.0-6.5%. And in fact, the numbers for the Chinese economy have stabilized recently. Besides the leading indicators, the "hard" datapoints have also turned out better than expected. According to official figures, Chinese GDP grew by 6.4% in the first quarter, while industrial production rose by 8.5% and retail sales by 8.7% in March. However, as we noted a few weeks ago, economic data from China often fluctuate greatly due to New Year's celebrations in the first few months of the year. The better data in March are therefore probably not due solely to the stimulus measures. Questions also remain about the economic situation in China, as shown by the unemployment figures, for example. The Chinese government appears to share this view. It is reportedly working now on further measures to stimulate purchases of automobiles and electronic devices. On the one hand, that should further stabilize the economic trend in the second quarter. On the other, however, the measures also show the economy's current fragility. Moreover, one should not forget that the price of stabilization is a further increase of debt, which will raise longer-term credit risks further.

Market Data Overview

Stock marktes	As of 24.04.2019 10:42	Change versus 17.04.2019 -1 week	22.03.2019 -1 month	23.01.2019 -3 months	23.04.2018 -1 year	31.12.2018 YTD
Dow Jones	26656	0,8%	4,5%	8,5%	9,0%	14,3%
S&P 500	2934	1,1%	4,7%	11,2%	9,9%	17,0%
Nasdaq	8121	1,6%	6,3%	15,6%	13,9%	22,4%
DAX	12256	0,8%	7,8%	10,7%	-2,5%	16,1%
MDAX	26052	1,0%	5,4%	11,2%	0,0%	20,7%
TecDAX	2874	2,1%	8,8%	10,8%	8,6%	17,3%
EuroStoxx 50	3495	0,5%	5,7%	12,3%	-0,5%	16,4%
Stoxx 50	3181	0,6%	3,2%	11,3%	4,1%	15,2%
SMI (Swiss Market Index)	9664	0,7%	3,7%	7,9%	9,7%	14,6%
Nikkei 225	22200	-0,3%	2,6%	7,8%	0,5%	10,9%
Brasilien BOVESPA	95923	2,8%	2,3%	-0,7%	12,1%	9,1%
Russland RTS	1270	0,3%	4,6%	7,0%	10,9%	19,1%
Indien BSE 30	38697	-1,5%	1,4%	7,2%	12,3%	7,3%
China Shanghai Composite	3202	-1,9%	3,1%	24,0%	4,4%	28,4%
MSCI Welt (in €)	2174	1,4%	4,6%	11,3%	13,1%	17,8%
MSCI Emerging Markets (in €)	1090	0,1%	3,6%	9,2%	2,6%	15,2%
Bond markets						
Bund-Future	164,94	64	-80	37	714	140
Bobl-Future	132,82	22	-1	4	216	30
Schatz-Future	111,91	2	0	0	6	-3
3 Monats Euribor	-0,31	0	0	0	2	0
3M Euribor Future, Dec 2017	-0,31	0	-2	-7	-35	0
3 Monats $ Libor	2,58	-1	-3	-19	22	-23
Fed Funds Future, Dec 2017	2,25	-5	2	-20	-36	0
10 year US Treasuries	2,55	-5	9	-21	-43	-14
10 year Bunds	0,02	-6	5	-15	-61	-22
10 year JGB	-0,04	-3	3	-5	-10	-4
10 year Swiss Government	-0,30	3	19	-5	-44	-6
US Treas 10Y Performance	591,38	0,2%	-1,0%	2,1%	6,0%	1,9%
Bund 10Y Performance	643,18	0,4%	-0,6%	1,8%	7,3%	2,5%
REX Performance Index	490,54	0,2%	-0,1%	0,5%	2,6%	0,6%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,48	-4	-1	-36	-39	-39
IBOXX BBB, €	1,35	-4	-14	-63	-11	-71
ML US High Yield	6,55	1	-20	-69	11	-147
JPM EMBI+, Index	835	-0,1%	-0,3%	1,8%	2,9%	5,5%
Convertible Bonds, Exane 25	7297	0,0%	2,0%	4,3%	-1,5%	5,8%
Commodities						
CRB Spot Index	422,61	-0,6%	-0,4%	2,7%	-4,9%	3,3%
MG Base Metal Index	313,42	-1,1%	-0,8%	4,4%	-13,4%	6,4%
Crude oil Brent	74,21	3,2%	11,5%	21,4%	0,1%	39,7%
Gold	1273,58	0,0%	-3,0%	-0,7%	-3,8%	-0,6%
Silver	14,82	-1,0%	-3,9%	-3,3%	-11,0%	-4,4%
Aluminium	1850,50	0,9%	-1,4%	-2,4%	-19,4%	-0,7%
Copper	6394,25	-2,2%	1,3%	8,0%	-7,3%	7,5%
Iron ore	93,29	0,4%	8,6%	25,1%	43,1%	34,8%
Freight rates Baltic Dry Index	821	7,0%	19,0%	-16,4%	-37,1%	-35,4%
Currencies						
EUR/ USD	1,1218	-0,7%	-0,7%	-1,3%	-8,3%	-2,0%
EUR/ GBP	0,8673	0,1%	1,6%	-0,4%	-1,0%	-3,4%
EUR/ JPY	125,45	-0,8%	0,7%	0,6%	-5,2%	-0,3%
EUR/ CHF	1,1422	0,2%	1,6%	0,8%	-4,3%	1,4%
USD/ CNY	6,7162	0,4%	-0,1%	-1,1%	6,3%	-2,3%
USD/ JPY	111,87	-0,2%	1,8%	2,1%	2,9%	2,1%
USD/ GBP	0,77	0,9%	2,3%	1,0%	7,9%	-1,5%

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