# FK Market Commentary

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Editorial

# Dear customers of Finanz Konzept AG, dear readers,

**The interest rates for European government bonds hit rock bottom, the ongoing uncertainties in the trade dispute between the USA and China, to achieve a sustainable trade agreement, and the geopolitical tensions between Washington and Teheran are the topics of this edition's market commentary.**

This year's second quarter is characterized by rising asset prices. In the USA the Down Jones and the S&P 500 are at their all-time highs and in Europe the SMI followed. Nonetheless, the current optimism at the financial markets can deceive the reality. The demand for cyclical asset classes increased at the same time as demand for defensive asset classes such as government bonds, real estate and gold increased.

In response to the risk of a recession, the central banks initiated a more expansive monetary policy in the second quarter of the year, provoking a turnaround on interest rates. The central banks leeway is diminishing and voices for new disruptive concepts, such as that of the Modern Monetary Theory, are getting louder. We will present this concept in more detail.

We hope this edition provides an exciting insight and hope you enjoy reading it.

Yours sincerely,

Daniel Köchli
Director – Finanz Konzept AG

Short summary

## Money and Capital Markets Capital market interst rates in % (10 year bonds)

| | 29.03.19 | 28.06.19 | 3 M | 12 M |
|---|---|---|---|---|
| CHF | -0.373 | -0.535 | → | → |
| EUR (DE) | -0.056 | -0.330 | → | → |
| GBP | 1.023 | 0.828 | → | ↘ |
| USD | 2.419 | 2.010 | ↗ | → |
| JPY | -0.091 | -0,156 | → | → |

- Debt burden increases in companies with poor quality
- The central banks adjust their monetary policies (EU / USA)
- Interest rates in Europe tumble down to an all-time low

**We recommend:**
- Maintain high cash ratios in EUR and CHF
- Hold on to long-term U.S. government bonds
- Reduce Italian government bonds with a maturity > 2 year

## Stock Markets Indices

| | 29.03.19 | 28.06.19 | 3 M | 12 M |
|---|---|---|---|---|
| SMI | 9477.84 | 9898.24 | ↘ | → |
| EUR STOXX 50 | 3351.72 | 3473.08 | ↘ | → |
| FTSE 100 | 7279.18 | 7425.03 | ↘ | → |
| S&P 500 | 2837.80 | 2944.20 | ↘ | → |
| Nikkei | 21205.00 | 21375.00 | ↘ | → |
| DAX | 11526.04 | 12398.80 | ↘ | → |

- Economic recovery rally falters
- Interest rate cut fantasies uphold stock markets (momentarily)
- Economic slowdown as a future burden factor

**We recommend:**
- European equities with potential to catch-up relative to US equities
- Reduce shares during the summer months
- Shares with stable dividends

## Forex Markets Currencies

| | 29.03.19 | 28.06.19 | 3 M | 12 M |
|---|---|---|---|---|
| EUR / CHF | 1.1164 | 1.1125 | → | → |
| EUR / USD | 1.1231 | 1.1390 | ↘ | ↗ |
| EUR / JPY | 124.5250 | 122.8750 | → | ↗ |
| GBP / CHF | 1.2983 | 1.2397 | ↘ | → |
| USD / CHF | 0.9951 | 0.9765 | → | → |

- Upcoming short covering due to large bets towards the devaluation of the CHF
- EUR/USD continue bottom formation
- JPY approaches fair valuation

**We recommend:**
- Buy JPY into weakness
- slightly underweight CHF

## Commodities

| | 29.03.19 | 28.06.19 | 3 M | 12 M |
|---|---|---|---|---|
| Crude oil WTI (USD) | 60.14 | 58.47 | ↘ | → |
| Gold (USD) | 1292.88 | 1409.50 | → | ↗ |
| Silver (USD) | 15.06 | 15.32 | → | ↗ |
| Platinum (USD) | 848.00 | 835.50 | → | ↗ |

- Iran crisis threatens stable oil supply
- Gold/Silver ratio at all-time low (since 1990)
- Gold price surges due to falling interest rates

**We recommend:**
- slightly overweight gold
- Silver with anti-cyclical trading opportunities
- Sale of Palladium

## Crypto Markets

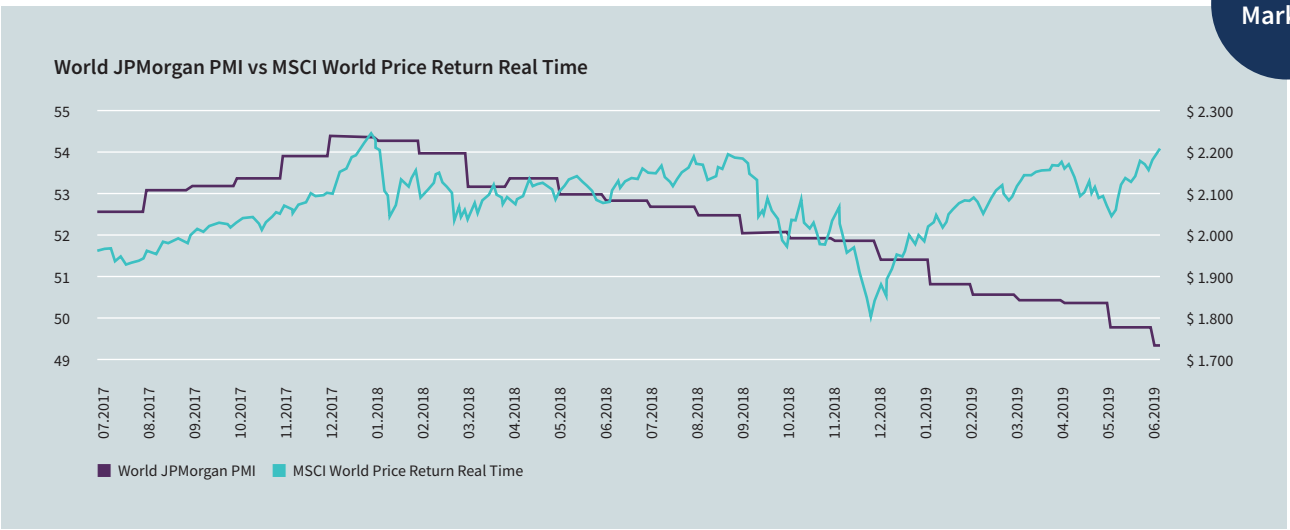
| | 29.03.19 | 28.06.19 | 3 M | 12 M |
|---|---|---|---|---|
| BTC (USD) | 4102.01 | 12379.84 | ↗ | → |
| ETH (USD) | 127.92 | 272.56 | ↗ | → |
| XRP (USD) | 0.3093 | 0.4239 | ↗ | ↘ |
| BCH (USD) | 170.04 | 434.40 | ↗ | → |
| LTC (USD) | 61.460 | 120.047 | ↗ | ↘ |

- Facebook announces own crypto currency
- Crypto-rally 2.0 in full swing
- Bitcoin may reach all-time high

**We recommend:**
- Hold existing positions
- Benefit from larger corrections

# Recessionary fears threaten the stock markets

Stock Markets




Source: Reuters / JP Morgan / Finanz Konzept

The second half of the year will be dominated by the results of the G20-Summit and the Fed-meeting in July, which will have major impacts on the further developments in the markets. The G20-Summit failed to deliver concrete results towards a sustainable trade agreement between the USA and China. Leaving the Fed potentially forced to cut interest rates at their next meeting to counter the risk of a recession, if US-data continues to worsen.

Both the European Central Bank and the US Federal Reserve maintained their interest rate level in June, as part of their monetary policy assessment, but at the same time highlighted that interest rate cuts will become more likely by the end of the year. The latter reflected positively onto investors and favoured towards an ongoing economic recovery rally. This echoed through the SMI and S&P 500 who have reached new highs. However, the prospect of future interest rate cuts will be clouded in the long-run by the expected economic outlook – in Europe and the USA - and by, again, emerging geopolitical tensions in the middle east.

This year's second quarter started off with yet a further escalation in the US-China trade dispute, which caused investors distress and contributed to the poor stock market performance in May. Not only China fell victim to the protectionist calculus of President Trump, also Mexico was threatened with tariffs, at the beginning of June, should Mexico not prevent the migration of illegal refugees into the USA. Mexico drew in and entered an agreement with the USA before the threatened tariffs came into effect. The trade dispute with China will certainly not be quite as simple, as China is a much more powerful opponent.

The chart below shows the evolution of the World JPMorgen Purchasing Managers' Index (PMI) and the MSCI World Index. The PMI reveals the evolution of the global trade and services sector, whilst the MSCI World is a global stock index. Since December 2018, the two indices have constantly diverged. Inevitably, sooner or later, this divergence will close. Whether the positively driven stock market or the rather below average development of the trade and service sectors is going to adjust its direction will depend on the future economic developments.

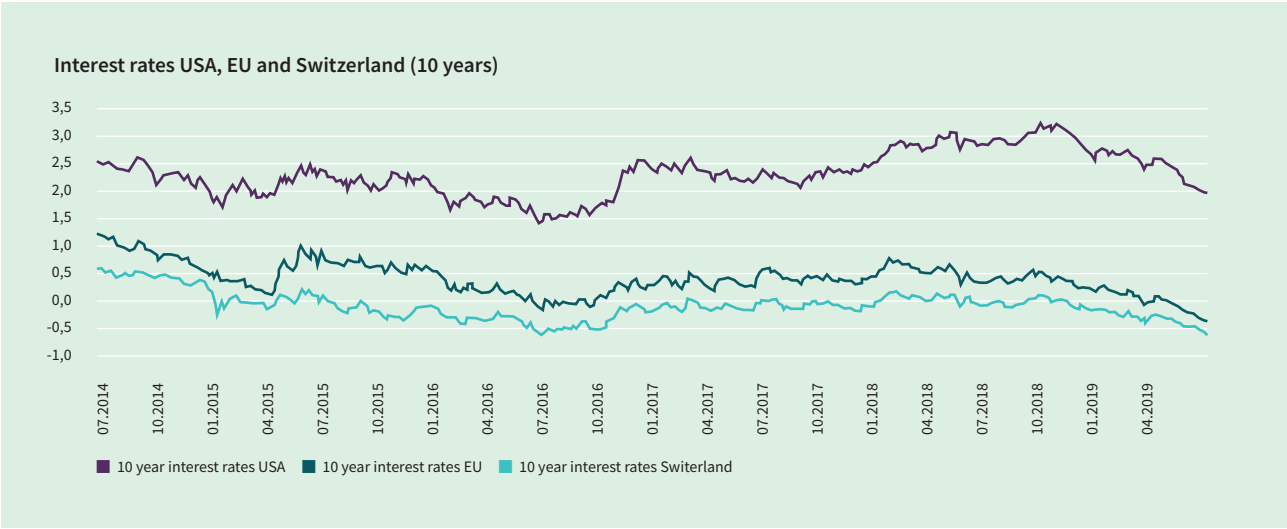
# The global interest rates stagnation is now (again) a hot topic

Bond Markets

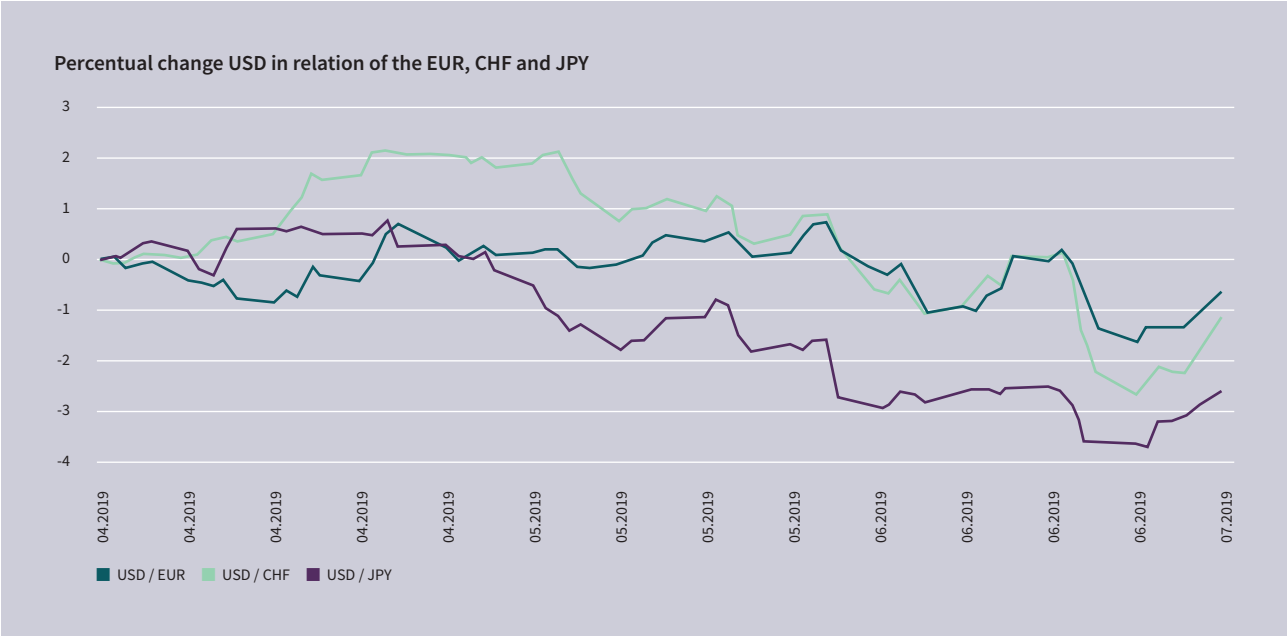
The graph below features the falling interest rates of U.S. government bonds with a maturity of ten years, since late 2018. Following this example, European government bonds hit a new all-time record low. For a good while now it was clear that Europe will not cycle up to rate increases. Now, even the Fed has turned 180-degrees and has announced possible interest rate cuts in the near future. The likelihood of interest rate cuts also dramatically increased in Australia, New Zealand, Japan, Canada and England and are expected by the end of this year. Unlike the USA, Australia, Canada and England, the ability to cut interest rates even further in Europe and Japan is very limited, as these respectively have remained negative for an extended period of time now. Despite this fact, further interest rate cuts are to be expected in both Europe and Japan. Switzerland also set aside their ambitions to increase interest rates in the near future. Currently, the interest rates in these regions are already near or below their historic lows.

Given that conventional measures might become less effective, central banks are required to unveil alternative monetary policies to fight a continued period of economic weakness, to shore up the economy and fuel inflation at all costs. ECB President, Mario Draghi, already stated that the ECB is prepared to exhaust all the necessary resources available to do so. Similar commitments were announced by the Swiss National Bank. This means bad news for savers: The search for positive returns is becoming riskier, either through an increased debt or maturity risk. These increased levels of risk are due to the current disproportional and negative interest rates.

The better alternative, in our judgement, present long-term U.S. government bonds and selected emerging market bonds, issued with a good credit quality. Hereby, it is important to ensure an adequate diversification. Even though the incentive was seldom so high as to make high-risk bets, we strongly advise against it. The economic slowdown may shift the focus on liquidity shortages, causing troubled borrowers to more frequently fail payment defaults and lead to higher risk premiums.




Source : Reuters / Finanz Konzept




Source : Reuters / Finanz Konzept

Forex Markets

# Interest rate discrepancy shortly revaluates the Euro

The discrepancy of interest rates between the USA and Europe strengthens the US-Dollar, making it more attractive. U.S. President Donald Trump then accused the ECB President Mario Draghi, to artificially suppress the Euro low by promising massive monetary eases in the Eurozone should the economy continue to cool down.

**Ceasefire in the USA – China trade dispute: can it sustain?**

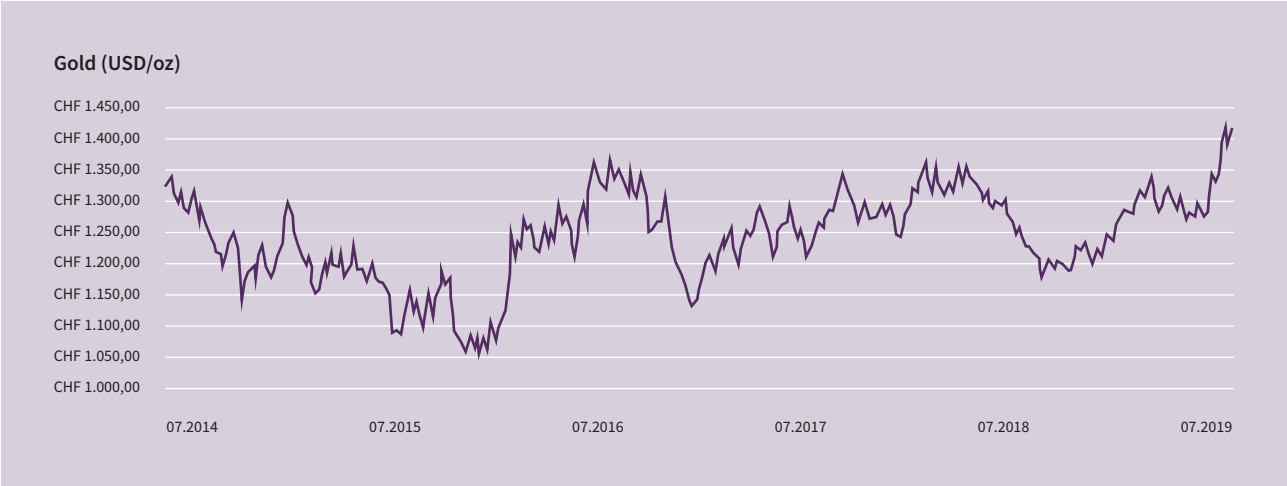
Adding to the discrepancy of the interest rate curve, the results of the G20-Summit are crucial for the further development of the US-Dollar. For now, the USA and China have agreed upon a truce in the trade dispute. The Summit was not able to reach a sustainable agreement to cut tariffs, leaving the continues trade uncertainties to cause central banks to consider easing monetary policies in order to stabilize the economy.

The development of the US-Dollar will be steered by the subsequent dialog between President Trump and President Xi, over the next couple of months. Should these talks advance counterproductive, it could lead to a worsening trade dispute between the two countries. This would in the long-run weaken US-exports and in the short-run force the Fed to lower the interest rates. In this scenario the US-Dollar would depreciate. By contrast, if the negotiations prove constructive, the US-Dollar could profit against the CHF and JPY.

Commo-
dities

# As good as gold – Gold hits five-year high

Gold just had one of its best months in a long time. The mix of falling interest rates, increasing geopolitical tensions and the ongoing trade dispute between the USA and China has helped gold make one of the biggest jumps since 2016. This can be seen in the chart below, that shows the development of the gold price. The hike in the second quarter of this year resulted in a price increase of 6.3 percent.




Source : Reuters / Finanz Konzept

# Geopolitical tensions and the OPEC decision cause oil prices to rise

The second quarter began with an upward trending crude oil price and could be due to tightening tensions between Washington and Teheran. The situation nearly escalated after Iran shot down a US-drone and President Trump immediately responded with an airstrike, which luckily was halted at the nick of time. The fear of further escalations and a possible oil supply shortage has driven oil prices higher.

In early June, oil prices stabilized at a lower rate again due to fears of an economic slowdown. These fears mainly originated due to the trade dispute between the USA and China and the eventual dip in crude oil demand that could follow. Consequently, key economic indicators underperformed shortly. The oil prices stabilized based on an OPEC decision to extend the oil production limit until March 2020 and the current count of active oil rigs in the USA.

# Modern Monetary Theory / Too far-fetched?

News

The standard money market policies are slowly reaching their capable limits. Globally, interest rates reached historic lows, despite the absents of a severe recession. The ability of central banks to stimulate the economy with interest rate cuts is virtually unattainable. Therefore, recently disruptive concepts such as the Modern Monetary Theory (MMT) gained much acceptance and support.

The bottom line of the theory: An independent country with an individual currency and central bank cannot become bankrupt. Note that high levels of national debt within industrialized nations does not trigger inflation. Historically, financing high levels of national debt with the aid of the central bank caused a hyperinflation. This fundamental law found in economic textbooks is now being challenged, as nations such as Japan currently show little inflation despite their relative high levels of national debt. Similarly, the drastic expansion of the U.S. budget deficit under the Trump administration in the White House has no significant effect on the nations inflation rate. Hence, the theory suggests the government should be able to stimulate the economy through fiscal policies, thereby relieving the central banks burden who have historically controlled the economic cycle via monetary policies. In return, the central bank buys government bonds in order to finance the greater government spending. Once the inflation target is achieved, the government will increase taxes and withdraw capital from the economy.

The MMT focuses on fiscal policy to steer the economy. The government budget does not necessarily have to be balanced as it relies on the government's authority to print money at own will and thus finance its fiscal measures. This theory enables and eases the financing of social issues and to combat climate change, but indirect side effects can hardly be conceptualized nor fully understood in theory.

The intertwine of politics and the central bank is very controversial. The independence of the central bank from the government has been indispensable, but the increasing influence of the latter is hard to miss. Central banks nowadays purchase virtually unlimited quantities of government bonds (keyword Quantitative Easing), the election of the IWF chairman Chirstine Lagarde as the ECB president and President Trumps attempt to intervene in the Feds decisions, is becoming apparent that politics and the central banks are increasingly interweaving. The western world must prepare themselves for some unorthodox central bank decisions to come in the future.

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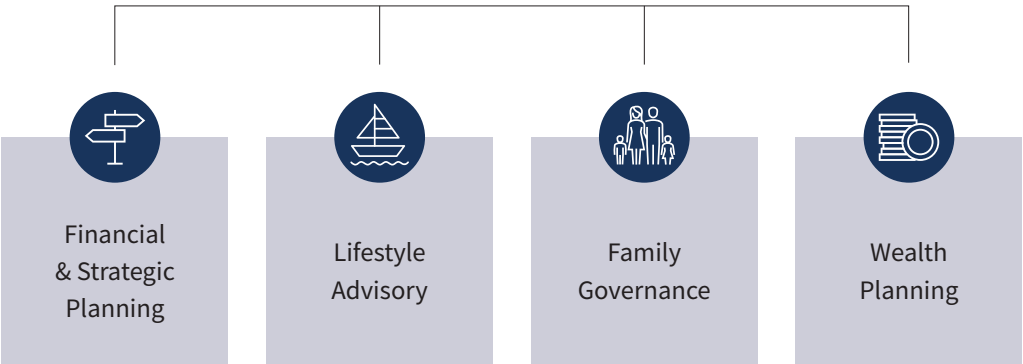

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