CPIC

Management Report
4th Quarter 2018

The period from the first week of October through to Christmas was marked by major fluctuations and declining prices.

As far back as the previous quarter, there had been indications that the mood could turn sour, with the U.S. Federal Reserve's waning generosity causing interest rates to move higher in September. One fallout from this was the weaker growth rates reported by interest-rate-sensitive sectors such as the housing market and the automotive industry in the U.S. In addition, the U.S. yield curve flattened out, which means that short-term interest rates rose more sharply than long-term rates. In the past, this was a leading indicator for a recession. Profit warnings from primarily cyclical companies also had a negative effect. As Fed funds dried up, some market participants suddenly began to wonder whether shares were not too expensive. Equity markets had previously benefited from years of excess liquidity at the key central bank.

The escalating trade conflict between America and China also contributed significantly to uncertainty in the fourth quarter. Meanwhile in Europe, Italy's budget plans and the European Commission's veto darkened the mood and even the subsequent proposal for a compromise did not satisfy anybody. On top of this, there were fears that the UK's planned withdrawal from the European Union could bring about a government and economic crisis. Over the quarter, equity markets around the world reported a loss of 13.5% in local currency (down 8.3% in the second half of the year), including a drop of 8% in December alone.

The oil market was very volatile. In October President Donald Trump allowed some countries to temporarily continue importing Iranian oil. This surprising decision, coupled with strong production figures in the American shale oil industry and growing concerns of an economic slowdown, sent oil prices tumbling. At times, Brent crude was priced at just 50 U.S. dollars per barrel in December, representing a fall of over 35 U.S. dollars from the annual high. The oil slump, combined with the economic slowdown expected for 2019, subdued the inflation outlook. On the bond market, this squeezed yields and caused prices to rise. Government bonds finished the quarter up 2.1% in local currency (up 1.1% in the second half of the year).

In the final quarter of 2018 prices fell in almost all sectors and countries, with energy stocks worst affected after being hit by the oil price slump. Even usually successful technology stocks corrected strongly this time. There was a bit of money to be made only with shares from companies with very defensive business models, such as in the utilities or health care sectors. This meant that stock exchanges such as Switzerland, dominated by major pharmaceuticals, were able to hold their own. Emerging-market equities – which were the losers in previous quarters – performed surprisingly well.

The trend was less clear for bonds. German government bonds were in demand for the most part, with yields on 10-year Bunds sinking to a new all-year low. Demand also grew in the U.S. and so yields on 10-year Treasuries fell under 2.7%. Around the end of the quarter, markets became convinced that the Fed would raise the interest rate at a significantly slower pace than previously expected in 2019 in light of recent economic and political uncertainty.

High-yield bonds suffered larger losses. European corporate bonds also declined, partly as a result of the European Central Bank's bond purchase program coming to an end that has so far benefited this market segment. While most bond markets fluctuated widely, emerging-market bonds remained fairly robust.

As safe havens, the Swiss franc and the Japanese yen generally stand to benefit from increasing uncertainty in the markets. The energy price slump meant that currencies dependent on commodities, including the Norwegian krone and the Canadian dollar, weakened especially. By contrast, currencies in emerging markets were stable.

Gold was sought-after as a hedge in difficult times and picked up from 1,200 U.S. dollars per troy ounce at the beginning of October to 1,280 U.S. dollars.

Since the beginning of 2018:

the value of the A share decreased by -3,53% from EUR 224.38 to EUR 216.47,

the value of the B share decreased by -0.07% from EUR 157.11 to EUR 157.00,

the value of the C share decreased by -4.86% from CHF 120.30 to CHF 114.45.

This report was prepared by René Exenberger, Vontobel Asset Management, Zurich