OUTLOOK 2014

The government **bond** markets are facing complex cross-currents. On the one hand, a synchronized global economic recovery and the start of the reduction in asset purchases by the FED are negative for bonds. On the other hand, the whole world is short duration, and the inflation rate in the G7 has fallen to its lowest level since 2010. Netting it all out, risks to the bond market are roughly balanced. This suggests that bond yields will not face continued upward pressure in the next few months. From a secular perspective, the lows in 10-year bond yields were probably reached in the summer of 2012, and the general trend for yields is up, not down. However the rise in yields will be a very slow process which will be coupled with periodic rallies. In addition, with considerable slack in the world economy and very low inflation, it is unlikely that bond yields will surge.

From our point of view the bull market in **stocks** remains intact in 2014. First of all a global resynchronized recovery is good news for corporate profits. Profit growth could very well turn out to be in the double–digit area. This is due primarily to stronger activity both within and outside the US economy. Some investors say that profit margins are already very high in the US and they wondered how companies can boost profit growth even more. There is no question that margins are high, but it is not true that current levels are the highest in postwar history. US domestic profit margins were much higher in the 50s and the 60s. As things stand now, workers still have little bargaining power, and as a result companies will likely reap most of the benefit from global resynchronized growth in 2014. In addition most of the companies are very lean from a cost point of view. When topline growth begins to accelerate the bottom line will explode. This is bullish for stocks. Moreover macroeconomic and financial conditions are conducive for further P/E expansion. First, there is a clear link between equity multiples and the yield curve. The steeper yield curve is indicative of better growth and very easy monetary policy. Second we are only in the very early stages of a broad transition from strengthening asset values to better spending power by businesses and consumers. At this stage central banks usually love to see more asset price gains to consolidate these encouraging trends. Their tool to inflate asset prices is to suppress short rates at zero for a period that is longer than markets anticipate. Furthermore the world has barely recovered from the 2008 recession and there are very few obvious signs of economic and financial excesses. Therefore it is very unlikely that another recession will hit us any time soon.

The **US dollar** seems to have reached its secular bottom in 2008 and its future trend is more likely up than down. It is easy to take a bearish view on the dollar, given the FED's ultra-easy monetary policy. Nevertheless, it appears that many central banks have adopted similar if not more aggressive policies than the FED. As a result the trade-weighted dollar should slowly creep higher.
The next move in the **euro** could be a fall. From an economic point of view, the euro at its current level is clearly too expensive for the majority of euro zone countries, which inevitably dampens the prospect of a euro zone economic recovery. The ECB cut interest rates to 0.25% in November, but more easing via a falling euro is necessary to offset tightening monetary conditions in the euro zone.

The outlook for **commodity** prices remains moderate, especially in relation to other assets. The secular bull market in commodities ended three years ago. The bull market was built on three key pillars: a sustained dollar decline between 2001 and 2008, inadequate supply side response from producers and booming Chinese demand. All of these factors have changed profoundly. As the dollar is expected to appreciate, this bodes ill for commodity prices from a cyclical viewpoint. Even on a short-term basis, commodity market performance is surprisingly disappointing. For instance, the dollar fell during the fourth quarter of 2013, but the CRB index failed to rally. This has much to do with a re-emerging problem of oversupply. Crude production in the US is spiking and is expected to surge even more. Copper output is also rapidly increasing. Meantime, China has become much more environmentally conscious and has tried to reduce the commodity intensity of output growth. All of this means that commodity prices will face downward pressure, even with global growth perking up.

Gesellschaft
Formulafirst Ltd.
P.O. Box 3483, Road Town, Tortola
British Virgin Islands
www.formulafirst.ch

Investment Manager
2trade group ltd.
Baarerstr. 2
CH-6301 Zug
www.2trade.ch

Investor Relations
Dynamics Group AG
Utoquai 43
CH-8008 Zürich
Phone +41 43 268 32 32