



Monthly comment by
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Continued optimism in the market – despite greater insecurity about Trump

In January, optimism about the US elections in November continued. The MSCI World (EUR) saw a return of 0%, but this also covers a large rise in the euro against the dollar (see more below) of 2.5%. Long-term interest rates continued their upward trend from mid 2016, and German 10-year interest rates are now threatening to break above 0.5%. At the end of January, US 10-year federal interest rates are roughly unchanged at 2.5%. The Volatility Index (VIX) was generally low in January, with an average of about 11.5.

There is certainly considerable disagreement about how well Donald Trump has done as president so far. But there is consensus that he has actually been trying to implement many of the promises he clearly communicated throughout his campaign.

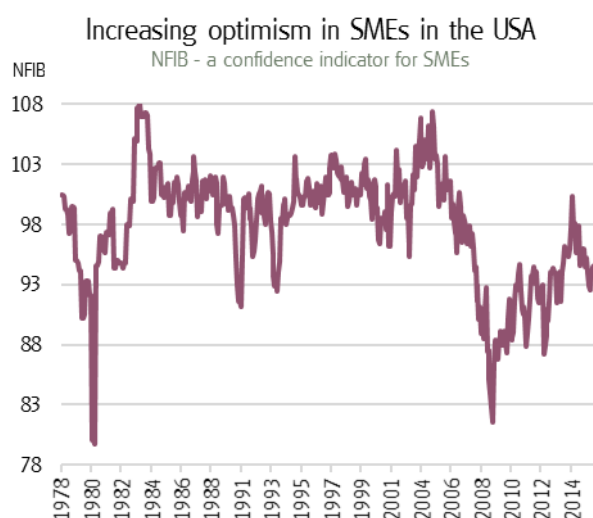
” *Trump has contributed to greater uncertainty in foreign relations*

My overall assessment of Trump's activities since his rise is that he has helped create more uncertainty in terms of foreign policy (including trade policy and immigration), while his domestic policy (and especially business) operations so far have been growth-positive.

Financial companies supported by Trump

During the campaign, Trump promised a review of the Dodd-Frank Act, which regulates how much risk banks and other financial institutions are allowed take in specific areas. The act also provides consumer protection in the mortgage area, which is so restrictive that it is at odds with the US Constitution.

A modification or elimination of the Dodd-Frank Act will be good news for financial institutions in the US as well as companies that need funding. Promises of further deregulation measures and cutting of red tape have resulted in the biggest monthly improvement in the NFIB Small Business Confidence (which is a confidence indicator for SMEs) since 1980, immediately after Ronald Reagan's accession.



It is my assessment that there is reason for optimism among American companies, especially those who manage to avoid the distortions of international trade and protectionism. However, I have difficulty seeing the NFIB Small Business Confidence staying at this very high level (105.8) for months at a time. I expect that within 6-12 months we will see values below 100 again, simply because the current optimism will fade.

Updated models: macroeconomic tailwind for Trump

Our models continue to show that we can expect a very strong acceleration in US industrial production over the next 12 months. This is extremely important for Donald Trump, who has managed to win the votes of disgruntled American industrial workers feeling wage and job-insecurity. From this point of view, the timing of the election was convenient for Trump. 2016 was a big disappointment for US industrial workers, while 2017 seems to be bringing the opposite.

” *Trump has a significant tailwind from the manufacturing industry cycle*

Trump is experiencing a significant tailwind from the industrial manufacturing cycle. It seems likely that in the first quarters or even years of his term, he will be credited for the improvement of industry figures that is under way, even though most of the improvement will be completely independent of Trump's work.

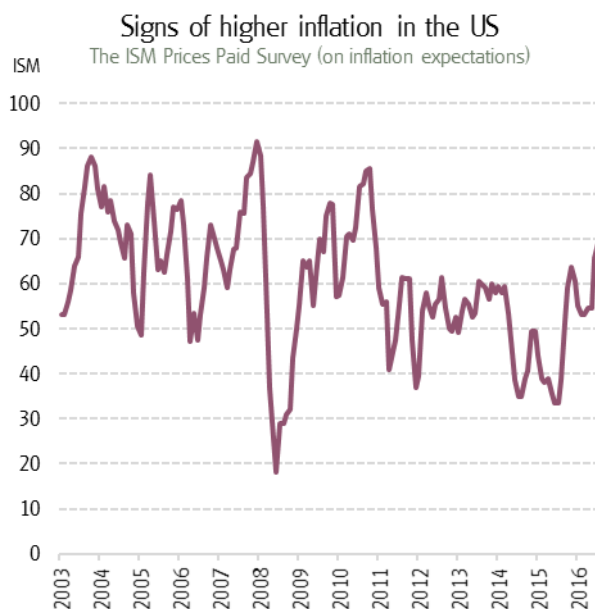
It is my assessment that the improvement in industry will retain or win more support for Trump, and that the optimism that there is for Trump in the United States will spread into other industries and segments of the population. However, the risks related to his personality and ill-conceived opinions, especially in terms of foreign policy, will create uncertainty about his administration and snuff out the tailwind he has from the macroeconomic conditions.

Higher inflation expectations

The general optimism in the market right now along with higher energy prices has resulted in higher inflation expectations. In fact, we have seen a considerable movement toward normalisation, especially in the euro zone, where the long-term inflation expectations (5Y5Y inflation swaps) rose from only 1.3% to 1.8% since September. In the US 5Y5Y inflation swaps are now trading at 2.4%.

” *Overall inflation is soaring in the US*

Several indicators suggest that companies can now track higher inflation. The ISM Prices Paid Survey (on inflation expectations) came out at 69, which is the highest level since 2011. Overall inflation is also surging in the US, where it is currently at 2.1% – 1.4% points higher than 12 months ago.



As the full impact of higher energy prices first occurs in January and February 2017, inflation figures, by all accounts, will be somewhat higher in January and February. For the US, I would not be surprised to see a figure of over 3% over the next two to three months.

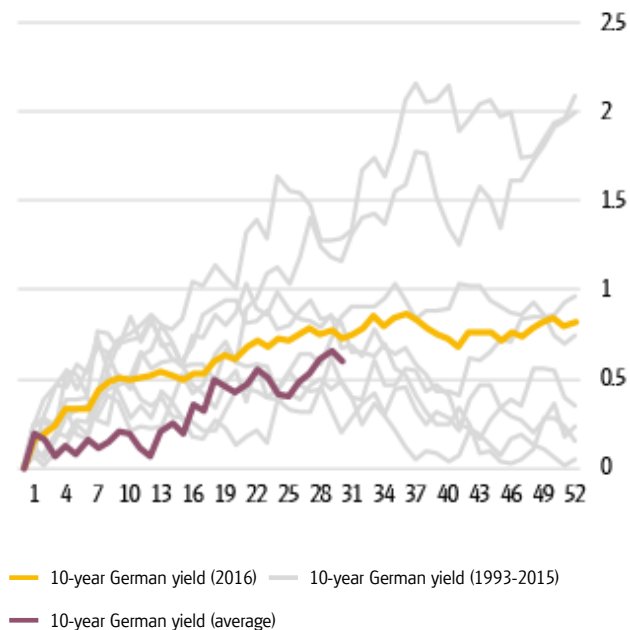
” *My expectation is that we will see higher long-term interest rates*

Higher interest rates – a little longer

My expectation is that we will see higher long-term interest rates – as a result of stronger economic data, and optimism in the market as well as among consumers. Interest rates on German 10-year bonds have already risen by about 50 BPs from the bottom in mid 2016, but I expect they will increase by another 25-50 BPs during the spring.

If we look at the historic benchmark for German long-term interest rates, this would actually be quite normal. Since 1989, there has been a total of nine local bottoms in long-term rates, and each time this happened, the interest rate has averaged 75 BPs higher a half year later (see graph X).

Outlook for higher long-term interest rates 52 weeks interest rate development after an record low in German 10-year bonds



Since its peak in 1980, interest rate development has followed a fairly consistent dynamic – the development has been long and persistent, but flat, and interrupted by temporary and sharp increases. Many positive surprises await us in the in spring, so it is my assessment that we have not yet seen the end of the current surge. After the May-June period, I expect that the increase will be over and that we will see stabilised or slightly declining interest rates again.

Outlook for factors

Our factor models' predictions show that the momentum, value and small cap factors all should give a higher return against the MSCI World over the next 12 months. In recent months, especially the momentum factor has not performed brilliantly, with somewhat lower return than the MSCI World. Our model-expectation was somewhat better, but that is probably because the factor is negatively correlated with the value factor, which has performed significantly better than all other factors from around the end of October until now.

” *Momentum shares will perform much better in the coming months*

My assessment is that the momentum shares will perform much better in the coming months – for the simple reason that momentum funds have started buying into value

stocks, which are now beginning to do well. Value stocks will probably continue to perform well with tailwind from the economic cycle and rising interest rates and inflation expectations.

Currently among momentum funds, there is an increasing sector rotation towards financial stocks (specifically, value stocks, because of their low price/book values after the financial crisis). These will also get the benefit of American deregulation and normalisation of interest rate levels.

The euro is strengthened – because of Macron?

During January, the euro strengthened against the US dollar by about 2.5%. The interest rate differential and the expectations for it are still considerable between the US and euro zone, so I still expect the euro will be under pressure. I maintain my expectation that the EUR/USD in the coming months will hit parity (i.e. 1.00).

When the euro rose in January, it may have been because opinion polls in France showed that Emmanuel Macron has improved his chances of beating Marine Le Pen in the second round of the French presidential election. If this is the case, part of the existing uncertainty about EU cooperation and the euro will be eliminated.

MomVol indicator

Our MomVol indicator assumed a value of 0.75 at the end of January. This is slightly better than at the end of December, but still firmly above the threshold of 0.6. Below this threshold, one should have an underweight in the stock market.

The indicator's signal is also supported by the fact that most of the OECD leading indicators pointing upwards. An overweight to equities should therefore be maintained in February.

Editorial deadline: February 14, 2017