Commentary for the second quarter of 2018

'Mixed feelings', is the key word to describe how markets evolved during the past quarter.

In fact our base macro scenario held up pretty well.

The US expansion continued with good job formation and creeping-up inflation has now reached 2.7%. The GDP growth was also as expected and for the second half we may see growth above 3.2% in the US.

What trade conflicts might subtract in the coming quarters can be counterbalanced by the effects of the first Trump tax cuts and the coming deregulation. Furthermore we see Trump launching a second round of tax reductions in order to help his chances with the coming mid-elections.

The equity market correction was also expected and can linger on until the end of July or mid-August in our opinion. We still foresee a blow-up in the US equity market once the current malaise is over. Our long standing target for the Dow above 32.000-34.000 still stands as a minimum target, before this bull-run that started in 2009 dies.

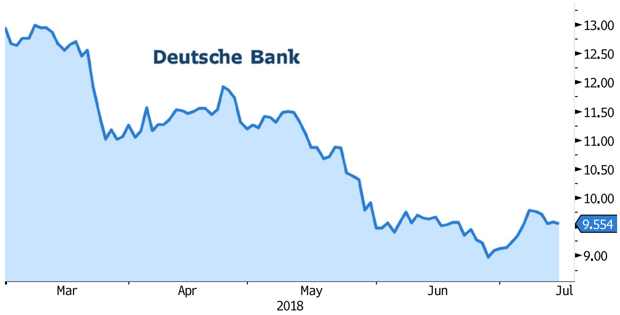
Our confidence in such a scenario is based upon the changed Fed policy. The bond market has turned the corner, at least in the US and in the Emerging markets in general as well. European bonds are not far behind as the end of EU QE was announced for the end of 2018 by the ECB. Indeed, Powell has hiked twice already this year and stresses his aim to continue to normalize – meaning one or two more hikes in 2018 and three in 2019. Fed balance sheet reduction also will stay the course, even if growth stalls around 2%, was the real message from the last Fed meetings.

As the saying goes, do not fight the Fed. The decades old bull market for bonds has ended. Money flow re-allocations will help equity markets in disfavor of bonds – until the bubble bursts somewhere in 2019-2020. On a worldwide perspective, the US should become the most attractive, based on yields, growth expectations, currency appreciation and the "America is great again" meme.

Emerging markets will be further pressured by currency woes as has been the case in Turkey, Argentina, Mexico, South Africa and even India to some extent. They have already felt the first tremors from dollar scarcity – in part due to the start of the Fed balance sheet reduction – as they overextended their financing in US dollars during all those QE years by the Fed and other central banks. So investing in the US will be favored more.

China is seen as a more risky market, as growth rates will stabilize in the best case, and would fall if debt financing and real estate woes become uncontrolled. Trade conflicts are not helping either.

Europe is expected to already have seen its top rate growth in the current expansion phase. Forced monetary normalization – in consequence of the Fed action – can possibly stall euro growth. Further immigration conflicts, undercapitalization in Italian and even German banks (see Deutsche Bank) while bitter discussions on Brexit and European reforms will create more uncertainty in the coming years – again favoring US investments.



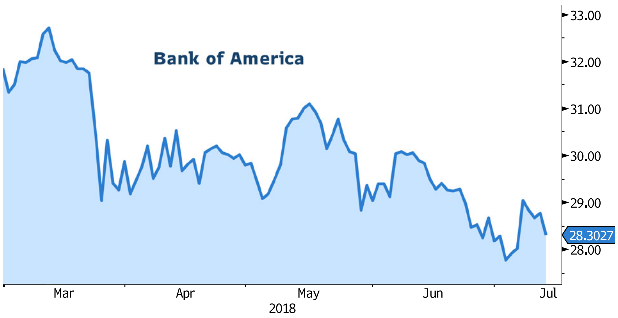
How will euro bonds behave if inflation and the ECB balance sheet reduction strike in 2019? From a global perspective Trump is winning the first set in the trade war while his actions have only increased his popularity with Americans.

A second Trump mandate could be sought after, based on further tax reductions, deficit spending and more trade tariffs as the first wave of such actions are now seen as positive by Americans and foreigners (positive for the US and bad for the rest).

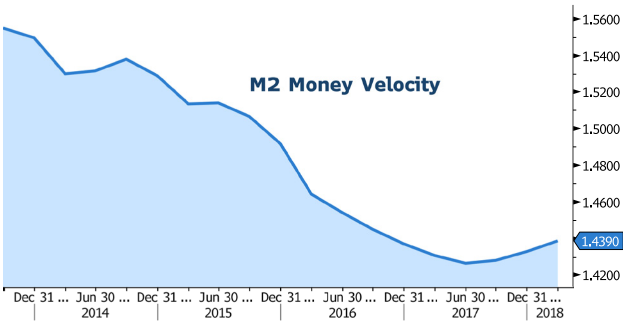
On the other hand we were surprised to hear so much about fearing an equity crash and an immediate recession. This has certainly prolonged and intensified the current equity correction on a global basis. Even our canary, Bank of America became under a bit more pressure than we expected.

Commodities, except energy (geo-politics), also corrected a bit more than expected.

We still believe that those fears will be proven misplaced as we



maintain our vision that a US recession will not start before another 3 our 4 Fed hikes. Money velocity has gone up in the last months. It is showing validation of our base thesis that central bank balance sheet reductions and rate hikes in the current macro environment are inflationary and growth enhancing. As an example, our canary Bank of America ran up 3.64% in one day, when the US Consumer Credit numbers for May were released showing an explosive growth of 24.6 billion and credit card debt hit a new all-time high. This for us is a symptom of the excess in money reserves that begin to roll towards the real economy. Remember again, Greenspan speaking about a tinderbox, waiting for a match.

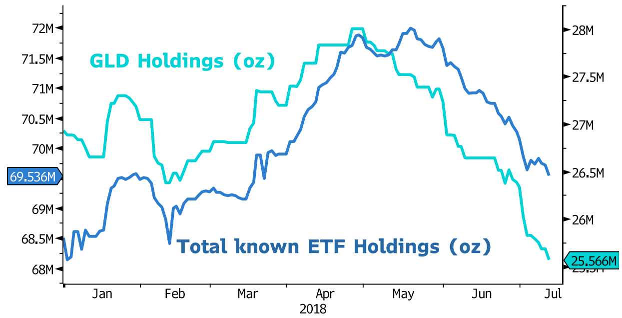


Overkill by hiking rates is not immediately warranted, as creeping-up inflation is still running faster than Fed normalization actions.

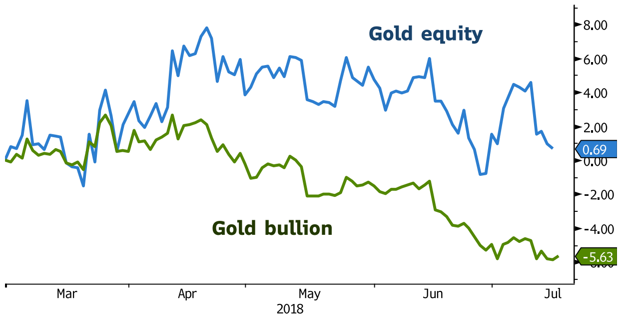
So market fears were especially affected by the dollar run up and the dollar strength surprised us a bit. We are positive on the dollar but see it really flying when the world and the US fall into recession. We think the dollar will still behave well, until the fed nears overkill.

It was the dollar move that choked off the physical demand in bullion during the second quarter. We hoped that bullion would maintain the $1276 level during the month of June – which seasonally is the weakest month with the lowest demand of the year.

Absence of sufficient demand however made gold fall to just under $1240. India was partly culprit as the depreciation of the rupee against the dollar took its toll. Western bullion ETFs also saw big outflows, helping to push gold lower as hedge funds liquidated their speculative positions massively.



But is was a mixed quarter, as miners held up relatively well in face of bullion gold and silver falling. The only explanation we have, is that it was really just the impact from the stronger dollar and not the market fearing an immediate worldwide recession. We believe that miners are anticipating inflation becoming stronger.



When later on, the US dollar gains in a stagflation/recession fear driven market, it should no longer oppress bullion.

If the dollar continues to move up in the current phase, gold could still fall towards $1140 levels, without doing much harm to mining shares. We still see gold move up to $1400-1450 based on more inflation. Seasonally, demand should also start to help from the end of July onwards.

for iW Partners,

the fund manager