



NOVEMBER 2015

CALM HAS BEEN RESTORED

- Pessimism is unwarranted
- Equity markets supported by monetary environment and reversal of valuations
- Sustained period of calm following panic selling

This year October did not live up to its traditional reputation as a “dangerous” month for stock markets. Quite the opposite: the past month produced excellent returns for investors. The MSCI World, for example, advanced 7.83% in USD terms – the seventh best monthly result during the past 10 years. The European stock index EuroStoxx and the main US index S&P 500 did even better, posting gains of 9.28% and 9.25% respectively. By contrast, Switzerland’s main index, the SMI, failed to match this performance. This was down to the defensive index heavyweights – Novartis, Roche and Nestlé – whose performance was below par.

Overall, equity markets therefore performed exactly in line with the signals of our Risk Appetite indicator. The initially extremely negative investor sentiment rapidly improved over the course of the month in response to market-friendly statements by the European Central Bank. In particular, Mario Draghi’s intimation that the ECB might prolong or even step up its existing bond repurchasing programme had a noticeable impact and combined with the diminishing likelihood of a rapid rise in US interest rates due to weaker industrial production figures, triggered a positive response from global markets. This in turn forced short sellers who had bet on falling prices to close their positions and stock up on securities. A large number of so-called “momentum” investors who responded to developments by jumping on the bandwagon finally helped the rally to get under way.

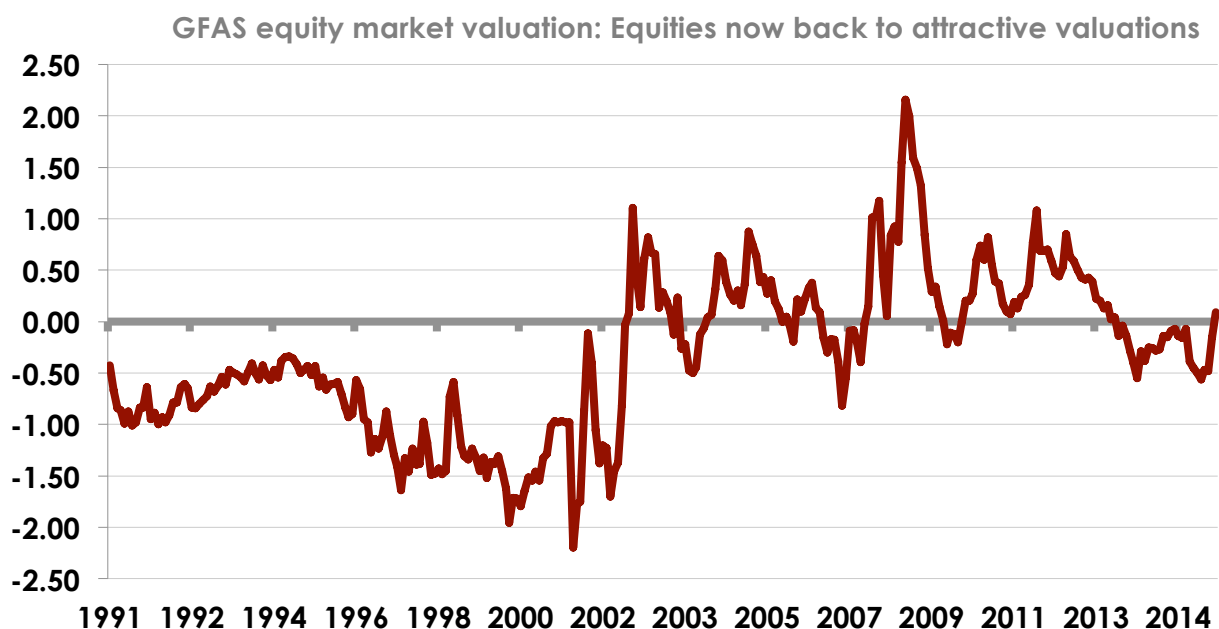
On the currency front, the US dollar strengthened a little against both the euro and the Swiss franc. In the year to date, the US dollar has only depreciated by around 1% against the Swiss franc. Bond markets were also major beneficiaries of the statements made by central banks. Prices rose across all maturity segments. European investment grade spreads tightened as did total returns, having their strongest month to this year.

EQUITY MARKETS SUPPORTED BY MONETARY ENVIRONMENT AND REVERSAL OF VALUATIONS

The scenario that already existed in October for the fundamental equity market model will carry over into the following month. In fact, the pattern has become even more distinct in two of the four sub-indicator groups.

The sub-indicator “Monetary Environment” continues to provide the strongest support for equity markets, just as it did during the financial crisis of 2008. The global inflation outlook in both the industrial and consumer sector continues to be very subdued. This gives central banks the breathing space they need to keep interest rates low. On top of that, money supply in the Eurozone continues to swell – cheap money is trying to find its way into financial markets, among other things. It remains to be seen whether this is a good or bad development in the long run. Whatever the case, the extra liquidity provides a strong boost to equity markets in the short term. In addition to the “Monetary Environment”, the subcomponent “Consumption” continues to show its positive side. On the one hand, consumer spending and consumer confidence has recently dipped a little in the USA. On the other hand, however, the disposable income of US households has risen at the same time, which is good news for future consumption trends. The confidence among end consumers in Europe also improved, despite the VW scandal.

Movements were more accentuated in the subcomponents “Industry” and “Valuation”. According to the calculations of our sub-indicator, “Industry”, the most cyclical component of the US economy, cooled down significantly, signalling a more subdued pace of economic growth in the fourth quarter. The less dynamic pace of economic growth was offset by the improvement in the “Valuation” component. Thanks to lower share prices in emerging markets and improving earnings estimates, this sub-indicator moved into positive territory (i.e. favourable for equities) following an extended phase of overvaluation.



* From a fundamental perspective, indicator readings above zero signal a positive climate for equities

On balance, the components “Monetary Environment”, “Consumption” and also – since October – “Valuation” are all supportive of equities. The situation for fundamentals – which looked rather precarious until recently – appears to be improving. Equity markets therefore remain attractive from a fundamental perspective.

SUSTAINED PERIOD OF CALM FOLLOWING PANIC SELLING

Investors’ behaviour over the past three months could be taken from a Psychology textbook. In an almost carefree stock market environment characterised by favourable fundamentals there was suddenly a wave of selling. Unnerved by the unexpected volatility, investors searched for the reasons for falling prices, eventually identifying the weaker pace of growth in China’s economy and the probability of an imminent end to the low interest rate environment in the USA. Unsettled by the latest market gyrations, an increased number of market participants lost sight of the overall picture and offloaded their shares, eventually triggering a wave of panic selling. The risk Indicator used by us recognised these exaggerated trends and signalled a massive “oversold” situation in equity markets for the period from the end of August to mid-October. During the entire period Amplia & Co therefore retained the maximum equities quota. The sharp rise in share prices in October proved that our model was right. But now the crucial question is: were the price hikes merely a reversal of the panic selling during August and September, or were they also driven by a more sustained improvement in investor sentiment? Three of the five indicator groups in our Risk Appetite indicator showed positive trends compared with the previous month’s readings. This is a clear sign that investors’ risk appetite has steadily improved over the past weeks. As result, the Market Psychology indicator switched seamlessly from an “oversold” situation into a Buy signal, driven by a healthy risk appetite. It is good to see that the positive signal for equities is broadly supported at the end of October. Four of the five sub-indicators are providing a Buy signal and therefore support a maximum equity exposure.

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