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# Equity markets: monetary policy overshadows geopolitics

- Markets hanging on the Fed's next move
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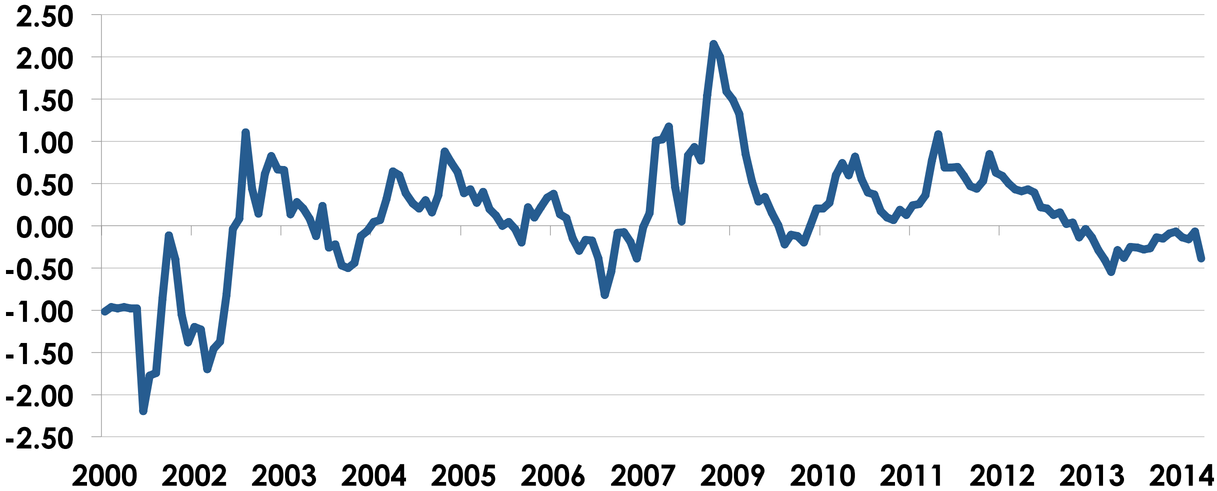
The dominant themes at the start of March - a potential "Grexit" and the Ukraine crisis - gradually faded into the background over the course of the month. Instead, investors focused their attention on the FOMC meeting, where the future direction of monetary policy was discussed. Yet again the subsequent statements of the Fed's Chair fuelled volatility on currency, equity and bond markets. According to Janet Yellen, the pace of economic recovery will not be quite as strong as originally expected in January. Given this assessment, the timing of the first interest-rate hike could be deferred for a while. The US dollar's response to the news was instant, falling sharply against the euro and eventually against the Swiss franc as well, after a bull run lasting almost 12 months. Returns also fell in all the major regions. In the short term, currency fluctuations had an impact on equities as well, which were forced to give up the gains achieved at the start of the month. But once the markets had a chance to digest the Fed's decision about not raising interest rates, their carefree mood returned. Overall gains in Swiss franc terms ranged from 0.60% (S&P 500) to 4.40% (Nikkei 225).

## Overvalued markets – a global phenomenon

Already last month we noted that the headwinds were noticeably picking up for equities, mainly due to the slower cyclical growth momentum in the industrial sector. The latest data also show a very subdued rate of expansion. On top of that, US consumer spending - traditionally a major contributor to economic growth - is falling sharply. On balance all the components of the "Consumer sentiment" indicator are showing lower readings than a month ago. One of the reasons for this is that Americans are currently displaying an usually

**GFAS Fundamental (equity market valuation): Global overvaluation of equities**




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

strong propensity to save, putting a limit on their personal spending or only allowing a modest rise. But other components such as "Disposable income", "Job prospects" and "Expectations of future consumption" are also acting as a drag on the sub-indicator. Even though the general economic environment is still clearly supportive of equities, the significant weakening of these components in our analysis model is still a cause for concern, especially when the rich valuations are taken into account in the overall assessment.

The climate is still very positive for equities as far as monetary aspects are concerned. There was virtually no shift in the individual determining factors compared with the previous month. Only US core inflation, which moved a little higher recently, is slightly detrimental to the data series. On the other hand we have seen a major change in the valuations of individual equity markets: given the fact that the US equity market has looked overvalued for some time now, we felt that the euro zone and Japan looked the most attractive regions in the developed world. But following the sharp hike in share prices up to the end of March, coupled with persistently anaemic earnings growth, we now think European and Japanese equities look overvalued as well - although to a slightly lesser extent than US equities. The overvaluation of equities is developing into a global problem. The monetary environment is acting as a strong driver, so that equities look attractive from a fundamental perspective - notwithstanding their expensive valuations. Equities are therefore still our favourite asset class.

## Broadly supported rally - risk appetite indicator at new high

During March investors were reminded once again of just how rapidly the mood can turn on financial markets and how quickly the driving forces can change. While the dominant themes at the start of the month, as we already remarked, were Greece's potential exit from the euro ("Grexit") and the Ukraine crisis, these factors were forced into the background (though far from being resolved) by the discussions about the timing and extent of the first interest rate hike by the US Federal Reserve (Fed), the tragic air disaster in the French Alps and the start of the ECB's hugely ambitious bond-purchasing programme. The prospect of interest rates staying low for many years in the euro zone helped equity investors to regain their carefree spending attitude. This development is also reflected in the risk appetite indicator produced by ENISO Partners. All five market psychology subcomponents improved over the course of the month, driving the risk appetite indicator to its highest level since the start of 2014. Particularly strong support is currently coming from "Market Breadth" and the decrease in "Demand for the hedging of equity market risks". It is reassuring to see that the rally is being supported by a large number of equities and sectors - a clear sign of the strength of the rally. The two most important sub-indicators "Money Flow" and "Market Risk" also picked up after a temporary weak phase and are both positioned once again in an area that is positive for equities.

In conclusion, the overall mood is clearly positive, without the threat of overheating. Given this positive base scenario, we are optimistic on stock markets for the first two weeks of the second quarter.

## Your Contact at Amplia & Co. AG


Mikael Rosenius
Claridenstrasse 34
CH-8022 Zurich
Tel. +41 44 286 17 41
mikael.rosenius@amplia-co.com

Jennifer Erdin
Claridenstrasse 34
CH-8022 Zurich
Tel. +41 44 286 17 42
jenny.erdin@eniso-partners.com