April 2017

Tilting politics against policies

- "Trumponomics" takes a back seat
- Everything relies on a further strengthening of the real economy
- Healthy consolidation of risk appetite

Closing out this month and 1st quarter the global economy and subsequently financial markets have enjoyed a firm start to year. Market participants have ignored and somehow muted the uncertainty surrounding economic policy and the geo-political backdrop. Whether it was Mario Draghi's confusing tone on the subject of future monetary policy, the FED raising rates by 0.25bps, Trump's failure in repealing and replacing Obamacare or the UK formally submitting its article 50 letter to the European council.

Over the course of March and in the run up to the vote aimed at repealing Obamacare an evidence of fading optimism towards "Trumponomics" crept into US financial markets, US real yields have reversed more than half of their rise and the dollar has lost close to half of its gains since the election. The loss of momentum was also witnessed on US equity markets as they closed flat to slightly positive for the month, a measly performance relative to the stellar 4.6% in local currency terms generated by the EuroStoxx 50 and the 2.8% by the Swiss Performance Index. On the currency front, the Swiss franc weakened against the euro but strengthened against the US Dollar and the British Pound.

Everything relies on a further strengthening of the real economy

The big driver to the equity bull market over the past 8 years - the monetary environment - has generated more headwinds for global equities. The tightening in the USA, with the FED having risen the benchmark interest rate by 0.25bps at the beginning of March, as well as rising inflation expectations and long-term interest rates pulled the sub-indicator into negative territory for the first time since 2011. Even though there remains some accommodative monetary policy from the ECB, Mario Draghi could not stop the negative trend. With valuations still being stretched, support was not upheld from the "Valuation" sub-indicator either, although higher earnings growth expectations at least partially compensated for rising stock prices. On an independent region basis Emerging Markets still lie in green territory from a valuation perspective, while US stocks are trading at their highest levels since early 2002 or at the end of the Nineties, where stock markets showed a historical run.

From a fundamental perspective everything now relies on a further strengthening of the real economy. The recent tied of macroeconomic data showed evidence that global growth has modestly picked up in Q1, driven by a further improvement in business and consumption. While manufacturing in the USA has shown the fastest expansion since August 2014, the situation also improved in the rest of the world. European managers expressed the highest level of confidence since summer 2011 and in China the industrial production had the highest year-on-year-increase of the past 12 months.

The big stronghold of the fundamental environment still proves to be the consumer, especially in the USA and Euroland. While the US household continues to show its strength with personal income and expenditure trudging ahead and consumer confidence at 16 year highs amid a blooming labour market, the optimism of the consumer in Euroland consistently increased since 2013. A significant improvement was seen in recent data of the behemoth China. A strong wage growth has helped to strongly boost consumer confidence in February.

In sum the fundamental environment remains supportive for equities. But only a rising dynamics of the manufacturing sector will be able to preserve the green light in the coming month.

Monetary environment: The sub-indicator with the largest weight in the fundamental model for equities. After more than 5 years of constant support for equities, the “monetary environment” lost its equity-friendly appeal in February. Monetary conditions in the US further tightened as a result of the improvement in the labour market and continued strength in the manufacturing sector, as well as the uptick in core inflation. The improved growth outlook also witnessed across the Euro-area in February and the stabilisation of oil prices around $50/bbl, propped up Euro-area inflation.

Industry: US manufacturing continues to bounce back from the drag of lower oil prices and the stronger dollar that was observed last month. Support to US manufacturing has continued to feed through from Trump’s promises and business-friendly policies that have had a positive impact on business sentiment. The upbeat sentiment of manufacturing was also supported across the pond in Germany with the IFO climbing to levels not seen since June 2011. Surprisingly this upbeat sentiment has bucked the trend of rising fears of protectionism arising since Brexit and Trump’s election and shows a revival of global trade.

Consumption: The continued improvement in US consumption can be attributed to the underlying momentum in the US as well as the global economy. Strong US consumer confidence has lead to an improvement in economic prospects which in due course have boosted business investments and created wealth gains. The peaks of US consumption could be tested in the coming months if any other Trump reforms fail, such as his proposed tax legislations. European consumer confidence will look to keep its positive trend from this month following the strength shown in manufacturing and the improvement in business climate.

Valuation: Through February the “Valuation” sub-indicator continues to point to a toppish US equity market. After 10 years of underperformance, Europe remains the sweeter pick. The advantage of lower valuations is accompanied by an increasing economic momentum, rising inflation expectations and potential fiscal easing support. One should note, that on a valuation metric European stocks are currently trading at a 47% discount to P/B relative to their US counterparts. Elsewhere, Japanese equity markets remain sensitive to shocks from the yen but strong demand from domestic investors searching for yield and rising corporate profits offer an attractive equity investment.

Healthy consolidation of risk appetite

After ENISO’s Risk Appetite Indicator had reached a 4-year-high at the beginning of March and the sentiment among investors had almost shown euphoric traits, a consolidation set in during the course of the month. Investors turned towards more defensive equities with a stable cash-flow stream and increasingly hedged their portfolios vs. the risks of a bigger correction. But to see the decline as a harbinger of a sharper turning point would be premature and is lacking any market-psychological basis. The phase of weakness must rather be viewed as a welcome respite in an intact upward trend.

The risk appetite among market participants in sum remains very robust and therefore equity-friendly. Three out of the five components of ENISO’s Risk Appetite Indicator that are monitored every week even improved within the last month. The “Surprise Effect” currently sits in a favourable position within the Risk Appetite Indicator, as Economic and company results exceeded analysts and consensus expectations.

In view of the weak but still positive support provided by the positive fundamentals, we thus maintain the maximum equity quota in our funds and mandates.

Risk appetite indicator: Sentiment remains equity-friendly

	Number of Indicators	Current Signal	1 Week	1 Month	3 Months
MONEY FLOW	31	Buy	↘	↘	↘
SURPRISE EFFECT	17	Buy	↘	↗	↗
MARKET BREADTH	24	Buy	↘	↗	↗
HEDGING DEMAND	7	Sell	↗	↘	↘
MARKET RISK	37	Buy	↗	↗	↗
OVERBOUGHT / OVERSOLD		Neutral			
RISK APPETITE INDICATOR	116	BUY	↘	↗	↗

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