April 2018

Trade war unnerves investors

- When one thing leads to another…
- No sign of the economic motor stalling
- Fears of euphoria have evaporated

March was a very challenging month not just on the weather front, but across financial markets. The tug-of-war between sell-off and attempted recovery phases that had already begun in February, carried through into March. For once, the determining factors were not geopolitical tensions or acute economic concerns, but the escalating trade war between the USA and the rest of the world, and the security of user data at the social media giant Facebook. Suddenly, everything that investors had ignored for months came to a head. The high valuations of the leading Internet companies, which could only be justified by very optimistic prospects, were thought to be unsustainable following the Facebook fiasco. This generated selling pressure that made these companies suffer their biggest monthly losses since January 2016. As the three biggest Internet companies alone make up more than 10% of the US S&P 500 Index, it is hardly surprising that this benchmark also fell, finishing the month with a decline of 2.69%. As always when US stock markets cough, European bourses catch a cold – even though the technology sector plays a far less prominent role in European indices than in the USA. However, the presumed consequences of the threat of protective tariffs for exports to the USA were weighted so heavily that financial markets in Europe and Asia also came under selling pressure. The leading EuroStoxx Index retreated 2.13%, while Switzerland's more defensive SPI only dipped 0.67%. Sovereign bonds were able to benefit from the uncertainty, as much less weight was given to inflationary concerns than in the previous month, even though inflation will definitely continue to be an issue in the mid-term.

No sign of the economic motor stalling

It started with bank fines and algorithms that influenced elections and voter behaviour, and now the USA is also bringing import duties into play. America is undoubtedly engaged in an escalating trade with the rest of the world. Unfortunately the imposition of punitive tariffs has never been a particularly successful tactic in previous trade wars. US President Herbert Hoover introduced customs duties on 20,000 products in 1930, worsening the Great Depression in the process, Richard Nixon imposed a 10% import duty, which underpinned the stagflation of the 1970s, and Ronald Reagan and George W. Bush also tinkered with duties on steel imports. Ronald Reagan later admitted that it was a big mistake he should not have made. We can only hope that the current president will come to his senses in time and that his threats alone will be enough to make the Chinese back down.

This development creates growing uncertainty for investors, which is never welcome on stock markets. But is this uncertainty also reflected in the macroeconomic figures? According to the fundamental asset allocation model, the subindicator "Consumption" shows no sign whatsoever of a potential decline. On the contrary, this subindicator even improved further and is still by far the most favourable signal for equities. Managers in Europe's manufacturing sector apparently reacted more quickly, as the latest surveys on order intake were judged to be slightly less positive than the prior month. The current order book situation is not affected, however, so that on balance the subindicator "Industry" continues to be clearly supportive for equity investments. Two other subindicators, "Monetary environment" and "Valuation", still argue against holding equities. As in the previous month, the latter subindicator signals a further reduction in the overvaluation of equities.

Monetary policy environment: The US Fed is tightening its monetary policy, and two more interest-rate hikes look to be certain this year. A reduced money supply, combined with creeping inflation in producer prices, weighs on the subindicator, which now gives the strongest negative signal against holding equities.

Industry: The figures published for the US industrial sector are still very positive. By contrast, the outlook for Europe and Asia, where America's protectionist tariffs would hit the hardest, is already judged to be less favourable than a month ago.

Consumption: The positive labour market in the USA has brought a further improvement in consumption and the outlook for consumption. According to our model, the prospects for US consumer growth are the best they have been for 12 months. Overall the subindicator has now climbed to its higher level for a year.

Valuation: After becoming much less overvalued in February, equity markets became even cheaper in March. The outlook for equities in Europe, Switzerland and Asia especially is now more attractive thanks to generally strong earnings growth and a further rise in dividend pay-out ratios.

Investor sentiment: fears of euphoria have evaporated

A month ago the risk appetite indicator gave a weak sell signal. This was never confirmed, as prices recovered. Even so, share prices briefly tested their lows, but then rebounded and restored investor confidence. At the end of March, investors' nerves were tested once again, as prices dipped close to, and in some cases even below, their previous troughs. There is no longer any sign of the fears of euphoria that had been repeatedly voiced. Rather, the share price volatility has stretched investors' nerves so much that the risk appetite

Risk appetite indicator: only a weak recovery of subindicators

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

indicator is currently once again giving a (so far) unconfirmed sell signal. Three of the five subindicators are responsible for the sell recommendation, including the important "Market Risk", which shows how much extra yield an investor is demanding in return for assuming risks. One of the factors that contributes to the "Market Risk" illustrates how uncertain and irrational investors have become. The OIS-LIBOR Spread, which is effectively a measure of the banks' credit risk and has received a lot of attention since the banking crisis of 2008, has shot up for USD borrowing over the past two weeks. This immediately raised concerns about a stress scenario in the banking sector. However, the widening of the spread was attributable to a technical effect, as the US Treasury Department is currently issuing more short-dated bonds than usual. On top of that, US companies had invested their capital held abroad in short-dated USD bonds, but this demand was undermined by the new fiscal policy. If the uncertainty and the highly perplexing behaviour of the market persists, we will receive a definite sell signal as early as next week and reduce our risk exposure. In the current environment all that can be done is to continue to wait patiently. Premature action could prove to be disastrous. As the stock market saying goes: “time in the market beats market timing”.

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@amplia-co.com