

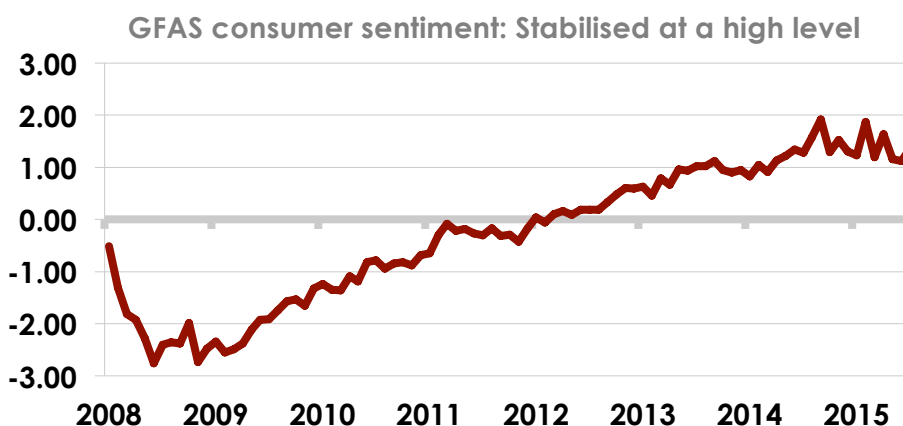
PERSEVERANCE REWARDED

- Markets rally as uncertainties fade
- No serious fall-out from Chinese market crash
- Investors in a summery mood

Judging by the price movements on global bourses in July, there was very little evidence of a summer lull. The only real sign of the holiday period was a steep drop in trading volumes. Given this backdrop, there were inevitably phases of high volatility as well. For example, Germany’s DAX index shed more than 2.5% on 27 July, one of its worst intraday performances for months. This decline was triggered by the dramatic slump in share prices in China, and the resulting insecurities. On the whole, however, July was full of sunshine not only on the weather front, but also in terms of equity market performance. The easing of tensions in Greece gave Eurozone members a little more time to come up with a more permanent solution, at least allowing them to avoid an uncontrolled “Grexit”. This outcome not only helped to drive share prices higher, but caused capital market rates to fall slightly – having risen sharply previously – as well as encouraging a slight firming of the Euro against the Swiss franc and the US dollar. Contrary to expectations, however, the main beneficiary of this trend was not European bourses, but Switzerland’s main index, the SMI. The SMI jumped 7.4%, while the EuroStoxx 50 advanced 4.6%. The performance of the S&P 500 was almost feeble by comparison, at just 2.0%.

NO SERIOUS FALL-OUT FROM CHINESE MARKET CRASH

China’s stock markets have been on a rollercoaster ride in recent months. The price swings in July were so severe that stock markets in the USA, Europe and Japan were affected as well. Many investors fear that falling share prices might have a negative impact on China’s economy and could therefore also undermine the still-fragile recovery of the global economy. There certainly seems to be no shortage of voices warning of a



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

dire ending for global equity markets.

However, careful analysis of recently published data does not reveal any obvious negative impact to date on the fundamental environment for equities. In some cases the sub-indicators of our fundamental asset

allocation model “Global Factor Asset Selector” even improved a little in July. In particular the “Consumption” component improved and still stands at a high level that is positive for equities. Developments on the US labour market were once again responsible for the improvement. As we move closer to the goal of full employment, both consumers and the US Federal Reserve anticipate higher salaries in future and consequently stronger purchasing power for private households. This should bring a corresponding improvement in companies’ earnings situation.

Given developments in China, it might be expected that the sub-indicator “Industrial Sentiment” would be affected as well. This was not the case, however. In fact the uncertainty regarding developments in Greece seems to have slightly reduced the risk appetite of investors in the Eurozone. The indicators for the USA, on the other hand, are even pointing to a slight improvement after the sector had previously suffered from shrinking investment in the oil industry.

The other two key components “Monetary Environment” and “Valuation” were virtually unchanged in July. While there was only a slight dip in the former, indicating only minimal impact from the rise in capital market rates, the latter managed to improve a little. Above all, the first-half results reported by European companies came in higher than the market consensus. On balance, the valuation of equities is still rather high by historical standards.

INVESTORS IN A SUMMERY MOOD

The agreement reached in the Greek crisis helped to offset negative developments such as China’s stock market rout or higher interest rates. Investors are still showing a healthy risk appetite, according to the indicators used by us. Three out of five indicator groups have shown an improvement over recent weeks. The recently published economic data, most of them very positive, have also helped to bolster investor sentiment. In addition, the positive market trend is affecting a larger number of companies than in previous months. The two other important indicator groups “Market Risk” and Money Flow”, which combine 57 from a total of 101 indicators, recorded minor dips in July. Overall, however, the prevailing market psychology continues to be positive. The recent price gains on equity markets should therefore hold firm and not immediately melt away again in the summer heat.

At this point we would like to note that the situation in China will presumably only have a negative impact on the sentiment measured by our model (risk appetite indicator) if the Chinese government is obliged to sell large quantities of US Treasuries in order to shore up its own equity market. As the world’s second-biggest investor in US Treasuries, this would definitely be a negative signal for bond markets, and ultimately for equity markets as well.

YOUR CONTACT AT AMPLIA & Co. AG

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

Jennifer Erdin
Claridenstrasse 34
CH-8022 Zürich
Tel. +41 44 286 17 42
jenny.erdin@amplia-co.com

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