August 2017

Low trading volumes in summer months could create buying opportunities

- Pace dictated by the ECB and company results
- USA and Europe moving in opposite directions
- Increased volatility fuels uncertainty

Global stock markets were not as calm in July as they had been in previous months. While US equities once again climbed to new historical highs, European bourses posted what were in some cases heavier losses. The latter are being increasingly affected by statements made by the President of the European Central bank hinting at an end to ECB's bond-purchasing programme before long, coupled with reports of a higher rate of core inflation in Europe. Both aspects have kindled fears of a sharp increase in interest rates in the Eurozone. This helped to push up the value of the Euro against the US dollar, and also against the Swiss franc, amongst other currencies. This appreciation, which was more than 4% in the case of the Swiss franc, put selling pressure on the export-oriented stock indices in the Eurozone. Nevertheless, the EuroStoxx still managed to finish July with a modest gain of 0.43%. By contrast, the domestic equity market benefited from the currency constellation, finishing the month 1.78% higher. US stock markets followed suit, boosted by a tailwind from company results, most of which came in much better than expected. The S&P subsequently climbed to a new end-of-month high of 2470 points. This equates to further gain of 1.93% compared with the end of June.

USA and Europe moving in opposite directions

The global economy is certainly travelling along a path of healthy, albeit subdued, growth. In contrast to recent years, all the world's major regions are contributing to this growth. Even so, current trends in Europe and the USA seem to be diametrically opposed. Although both regions are experiencing growth, the pace is falling off in USA and picking up in Europe. This is clearly illustrated by our sub-indicator "Consumption" and also by the "Industry" component. Europe's performance is helping to push up both indicators, while the data series released for the USA is having a dampening effect. US consumers especially currently seem to be reluctant to spend. In sum, both sub-indicators covering trends in the real economy are showing a positive signal for equities. The monetary environment continues to favour equities. But here too, there is a big difference between the developments in the world's two major regions. While inflation currently seems to be easing off in the USA despite the tight labour market, inflationary pressure continues to build up in Europe. The only clearly negative sub-indicator continues to be (as in previous months) "Valuation", which is signally a marked overvaluation for equities. However, the real economy and the monetary environment are able to more than compensate for the high valuation. As a result, the fundamental indicator for guiding the equities quota is still showing a green light for equities for another month.

Monetary policy environment: Core inflation continues to rise in Europe and Switzerland. Very low and in some cases even negative, real interest rates suggest a scenario of rising interest rates and tightening of monetary policy by the ECB. In the USA, however, inflationary pressure is dropping surprisingly, despite the already very advanced stage of the economic cycle and the tight labour market. Both regional effects are more or less cancelling each other out, and so the sub-indicator reading is barely unchanged and continues to be favourable for equities.

Industry: The leading economic indicators paint a picture of uninterrupted growth. The pace of growth in Europe continues to be stronger than in the USA. Germany's IFO business sentiment indicator has even reached its highest level since records started.

Consumption: US consumers especially seem to be reluctant to spend at present. The personal spending of private households has dropped to its lowest level for over a year. Despite this, surveys of the very same households reveal that they are very positive about their prospects for the future. This is not least attributable to the rude health of the labour market.

Valuation: The very encouraging quarterly results help to reduce the overvaluation of equity markets in the USA and Europe. Since expectations for Europe were set lower, the valuation multiples in Europe especially fell significantly. Even so, equity markets as a whole still have to be rated as expensive.

Increased volatility fuels uncertainty

As in the previous month, three of the five indicator groups that make up the Risk Appetite indicator fell in July. In particular, the sub-indicator "Market Breadth" struggled again. Less and less regional equity markets, sectors and individual stocks contributed to the rise in stock indices. The heterogeneous performance of stock markets in the USA and Europe was therefore especially disconcerting. The on-going hike in US share prices created an overbought situation for a short while, and as a result the Risk Appetite indicator generated

Risk appetite indicator: Overbought constellation triggered a sell signal

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

a sell signal on 24 July. We therefore trimmed our equities quota. Since then, the overbought situation has been neutralised. As always in the summer, when trading volumes tend to be low, stock markets can be vulnerable to sudden swings relatively frequently. Although an overbought situation can materialise very quickly, it can be reversed just as rapidly. It remains to be seen whether this will immediately produce another buy signal. With this constellation of Risk Appetite indicator, however, a significant correction is historically very unlikely.

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