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Don't be put off by expensive valuations

- Germany's coalition debacle barely makes an impression
- Growth dynamic relativises high valuation
- Don't always rely on a gut feeling

The start of the normally strong seasonal year-end rally was modest in November, although the prices of some share indices trended slightly stronger within the month and the US indices all closed at new highs. Political developments were once again different than people had hoped for and generally predicted. Following the Brexit vote and the US presidential elections, the failure of German parties to form a working coalition government has been another political fiasco. Like the previous events, however, this only marginally spoiled the mood of market players. The impact was inevitably felt most strongly in Europe, due to the increased uncertainty surrounding the future German government. The Dow Jones EuroStoxx 50 comprising the 50 biggest companies in the euro zone temporarily lost more than 4% and closed the month with a loss of 1.98%. The US stock market and Swiss equities paid more attention to the overall positive global economic news and gained more ground. The Swiss Performance Index rose by 0.67%, while the US benchmark index S&P 500 advanced 2.81% over the month on hopes of an early adoption of the tax reform bill.

Growth momentum relativizes high valuation

Just recently, one of the leading US investment banks pointed out that share valuations were as high as in the Roaring Twenties or the Golden Fifties of the last century. A severe correction is therefore imminent. Similar assessments have appeared recently, and while their sensational tone has gone down well with the media, they are completely worthless for investment decisions. According to our quantitative analyses, stock markets have never been more expensive in the last 16 years than they are today. But it would be both premature and wrong to conclude from this that a harsh correction is about to happen. For several years, the valuations before the turn of the millennium were unattractive - in some cases even significantly less attractive than they are now. Despite this, the world's major stock markets were able to enjoy strong price gains for years due to the robust economic performance. At present, all developed regions of the world are growing in terms of both consumer spending and manufacturing. Today the economic momentum is thus as high as it was then, even though the absolute growth levels are somewhat lower. Our analyses, which are based on historical data, show that in such an environment investors attach greater importance than usual to growth dynamics in their decision-making. Accordingly, equity market valuations receive less attention. These findings are reflected in ENISO's fundamental model for managing asset allocation. As long as the real economy can sustain growth momentum, equity exposures are preferable to bonds or holding liquidity. This strategy will only become dangerous if one of the two real economic components tends to weaken.

Monetary policy environment: Our sub-indicator "monetary environment" was able to improve slightly compared with the previous month. While input numbers from the USA hardly changed at all, the figures for the euro zone and Switzerland improved. Despite the strong economic momentum, core inflation rates and the inflation outlook in Europe have recently fallen back. As a result, pressure on the European Central Bank has surprisingly eased a little.

Industry: Surveys of US companies have been showing a cautious picture for months. However, the real production and sales figures are more gratifying than the surveys suggest. In addition, the data published for the manufacturing sector were subsequently revised upwards.

Consumption: The USA, as a world consumer, is once again gaining momentum. Consumers see the prospects as very good. This is underpinned by effective spending and a strong labour market.

Valuation: The US stock market in particularly overvalued. However, we are still a long way off the valuations of 2000.

Don't always rely on a gut feeling

The US stock market rally is about to complete its ninth year, making it one of the longest in stock market history. At the same time, volatility has remained at historically very low levels for quite a while. It's hard to shake off the feeling that the stock market is facing a major downturn. At the same time, it must be admitted that this feeling has been around for some time. Those who gave in to the feeling at an early stage missed one of the best stock market years. It should also be borne in mind that US dividend-bearing securities did not actually peak until 13 years after the dotcom bubble, i.e. in the spring of 2013. Maybe that's why the upswing has longer to run than investors' gut feeling might suggest.

What certainly argues against a major correction in the immediate future is the fact that the sentiment indicators of ENISO's Risk Appetite Indicator do not signal any excesses. On the contrary, investors' appetite for risk is still very solid. Over the course of the month, two of the five sub-indicators were even able to improve again, following a weaker trend at the beginning of November. The sub-indicators "Market risk" and "Market breadth" were unable to sustain their high level. In terms of market breadth, the fewer companies

Risk appetite indicator: Solid investor sentiment

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

reaching new highs and the weak performance of European stock markets against the US indices play a major role in the decline. Overall, the market psychology assessment remains positive. We therefore see no reason to question our positive stance on equities.

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