February 2015

Increasing divergence sounds alarm bells

- Central banks throw stock markets into turmoil
- Despite extra liquidity, real economy still in poor shape
- ECB's QE programme no guarantee for rising prices

The new year certainly got off to a very positive start. Both the fundamentals and investor sentiment – as reflected in ENISO's indicator of risk appetite – were in positive territory. Things suddenly took a turn for the worst on 15 January 2015, when the Swiss National Bank (SNB) removed the exchange-rate floor with the euro. The announcement took financial markets completely by surprise, making for even more volatility in the following days of trading. As we had already mentioned on several occasions, the room for the European Central Bank (ECB) to loosen the monetary policy for the eurozone had steadily increased in the past few months. The prospect of further ECB easing then encouraged a rapid improvement in market sentiment. On 22 January 2015 the ECB finally presented its comprehensive QE programme of sovereign bond purchases. The total volume turned out to be even higher than expected. This was not only beneficial for the eurozone equity markets, but it also helped the single European currency to recover a little from its initial weakness. The equity markets started the new year on a positive note overall. The EuroStoxx rose 7%, and the DAX by more than 8%. By contrast, the S&P 500 retreated 3%, and the Swiss Market Index followed suit with a decline of almost 7% due to currency factors. Investors in euros were therefore content, while investors in Swiss francs suffered from the strong appreciation of the Swiss currency.

Despite extra liquidity, real economy still in poor shape

While central banks in the eurozone, the UK, Japan and Switzerland will continue to follow a very loose monetary policy in the near future, the US Federal Reserve (Fed) is making it known that it is considering whether (and when) to tighten its monetary policy again. However, the monetary component of the asset allocation model produced by ENISO Partners shows that the Fed is more likely to tighten rates later than widely expected. Core inflation especially as well as the leading inflation indications currently stand at a low level, or are actually in decline to some cases. The sub-component "Monetary Environment" continued the rise it initiated in May 2014 and has now reached its highest level since the crash in 2003. From a fundamental perspective, this component represents by far the strongest driver for the stock market. As already discussed in prior months, however, we think the valuations of both Swiss and US equities especially are currently too high. We believe the share of companies in the Eurozone and the emerging markets are attractive buys at the moment. A number of multinationals in the USA are already starting to suffer from the stronger US dollar, while this trend is more likely to have a positive impact for European companies.

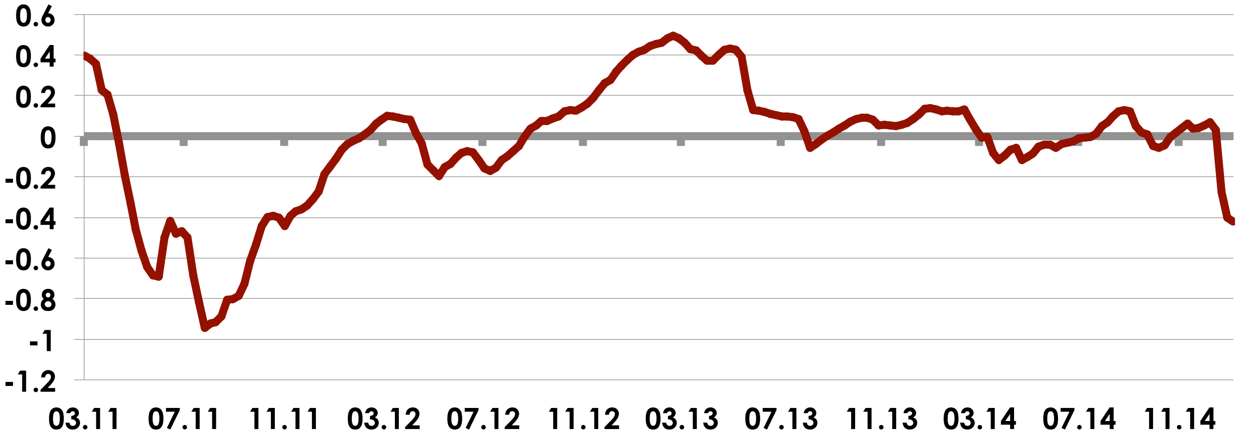
For some months now the two factors that are important for the real economy, "Consumption" and "Industry Sentiment" have hardly moved at all, and actually declined a little over the course of January. The main reason for this trend is that the pace of global growth is not currently strong enough to stimulate demand for industrial goods. It would take a sudden lift in demand to produce a significant improvement in capacity utilisation which would in turn provide a boost to capital investments in plant and equipment.

Overall the gap between the very equities-friendly component "Monetary Environment" and the other three components "Valuation", "Industry" and "Consumption" has widened further. At the moment the weight of the markets therefore rests mainly on the shoulders of the various central banks. We think these shoulders should be broad enough to ensure that equities will remain attractively valued in fundamental terms.

ECB's QE programme no guarantee for rising prices

So where is all the newly printed money being channelled? Not into the real economy, it would seem. The extra liquidity is therefore likely to find its way into financial markets, which effectively means that the ECB's QE programme will have almost a bazooka-like effect. Even so, the parallel is not quite as straightforward. When the USA resorted to quantitative easing, for example, equity markets were climbing sharply beforehand, but then lost momentum relatively quickly afterwards. Furthermore, equity markets subsequently corrected several times – quite sharply on occasion. The risk appetite indicator of ENISO Partners has also been declining for some time, and was already doing so both before and after the

Risk appetite indicator (money flow): money flows increasingly towards safety



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

turbulence created by the SNB. The decline in recent weeks has been so great that our model sent out a sell signal. An important driver for this event was the sub-indicator "Money Flow", which showed that money had been flowing for quite some time into more defensive investments. For example, more and more investments are being switched from emerging markets into developed markets. In addition, investors are demanding even higher risk premiums for riskier investments or new commitments – measured by the component "Market Risk". Another indicator that sounds a note of caution is the so-called "Surprise Moment". In particular, investors were not very inspired by the recently published figures for the US economy. The values produced by these three components therefore prompted us to reduce the equities quota in our mandates and funds by fifty percent on 26 January 2015. The divergence between the positive fundamental environment and the negative risk appetite therefore increased over the course of the month.

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@eniso-partners.com