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A few flare-ups don't make a firestorm

- Stock market has worst start since records began
- Some stark differences, but equities still attractive
- Risk appetite indicator: still some upside, despite poor sentiment

The downtrend that roiled global equity markets at the start of December continued through into January. A series of minor "flare-ups" caused stock markets to have the worst start in their entire history. As in the previous year, investors were worried about the state of the world's second-biggest economy, China, and whether its economic downturn would have a negative effect on the pace of global economic growth. The fear of a global economic slowdown increased when the US Federal Reserve (Fed) raised interest rates in December. Given the backdrop of weaker economic data – including figures from the USA – many market commentators thought this interest-rate hike was premature. The sceptics warning of another recession saw their fears confirmed by the tumbling oil price. As always happens in times of uncertainty, emotions gained the upper hand. Pundits interpreted isolated "flare-ups" as the start of a "firestorm", despite the fact that their doomsaying was based almost exclusively on the collapsing oil price. In fact, research shows that historically the price of crude oil has seldom correlated with equity market trends, making it virtually impossible for conclusions to be drawn about the future performance of the economy. In the past, for example, equities have often managed to rally even as the price of black gold has headed downwards. The latest bear run has presumably been accelerated by a sell-off of equities by various sovereign wealth funds and by the People's Bank of China (PBoC), which had to find huge amounts of liquidity to offset the flight of capital.

The rebound after the share sell-off predicted by our systematic processes has only partly materialised. Our calculations reveal, however, that the recovery observed at the end of the month should in all probability continue. History shows that in some 80% of cases equity markets make up most of the losses they suffered during similar price corrections. The Swiss Market Index retreated 5.65% in January. America's S&P500 did slightly better, with a decline of 5.07%, while the main index for the Eurozone, the EuroStoxx, dropped 6.44%. On top of that, the Swiss franc continued to soften a little, while yields fell on sovereign bonds in Europe, Switzerland and the USA.

Some stark differences, but equities still attractive

Judged on the fundamentals, equities are still attractive. Even so, the development of the various components of our asset allocation model couldn't be more different. On the one hand we see huge divergence in the area "Real economy", while on the other hand the two most important components "Valuation" and "Monetary environment" paint a very mixed picture. These tensions appear to be repeatedly unsettling financial markets and are one of the reasons for the high level of volatility in recent months. Given this backdrop, how did the individual components of our fundamental asset allocation model perform?

Monetary environment: Let's start with the good news. Global inflation rates continue to be extremely low. In the Eurozone especially, there are no signs at all of inflationary trends. In fact the European Central Bank has room to loosen its monetary policy even further. On the other hand, our calculations show that the US Fed is likely to tighten its policy further. Although core inflation is currently low, the buoyant labour market could eventually push wage costs higher. While highly qualified employees enjoyed salary rises of around 5%, the increase for people with only average qualifications was limited to the rate of inflation. Given the tight state of the labour market, this situation could well be about to change. Developments on the US labour market are therefore dampening our monetary indicator. However, the values are still significantly positive, thus providing a green light for equities.

Industry: After a brief ray of light at the start of last month, the reading for the "Industry" component measured by our model deteriorated significantly. Both future expectations and the current situation point to a recession in the industrial segment. This component therefore provides a sell signal for equities.

Consumption: In contrast to the "Industry" component, consumer spending is still on a growth path, except in the commodity-dependent emerging economies. Major concerns about recession are not apparent either in consumer confidence surveys or in the current levels of consumer spending. As long as the fear of recession has no impact on consumption, the values for this component will remain in positive territory, supporting the case for investing in equities. As a result, the trends currently observed in the real economy could hardly be more different.

Valuation: Valuations on the equity market as a whole managed to improve again slightly thanks to falling share prices and a further drop in interest rates. Even so, equities are still expensive, especially in the USA.

Risk appetite indicator: Still some upside, despite poor sentiment

It's hardly surprising that investor sentiment has been shaken by such a volatile start by stock markets. The five components of the risk appetite indicator produced by ENISO Partners confirm this impression. Particularly noticeable is the component "Surprise effect", which has fallen to its lowest level for years at an unprecedented rate. The fundamental data published in recent weeks fell well short of expectations, some of which were unrealistic. The reaction of many investors was therefore one of disappointment. But the other four components are also struggling with a strong headwind on a monthly and quarterly perspective. The damage caused by jittery equity markets seems to be considerable. It will presumably take a while for investors to settle their nerves and pluck up courage again. Given the severe and sudden nature of the stock market sell-off, our risk appetite indicator is signalling (as in the previous month) that the markets have

Risk appetite indicator: Palpable headwind

	Anzahl Indikatoren	Aktuelle Signale	1 Woche	1 Monat	3 Monate
Money Flow	31	Sell	↘	↘	↘
Surprise Effect	17	Sell	↘	↘	↘
Market Breadth	24	Sell	↗	↘	↘
Hedging Demand	7	Sell	↗	↘	↘
Market Risk	37	Sell	↘	↘	↘
Overbought / Oversold		Oversold			
RISK APPETITE INDICATOR	116	BUY	↗	↘	↘

overreacted in the short term and it is a good time to buy equities as a contrarian tactic. The current recovery should therefore continue over the next two weeks at least. But unfortunately our model makes it impossible to tell whether investors' optimism will have returned by then.

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