February 2017

Transition process fuels tensions

- Markets disconcerted by Trump's erratic behaviour
- Shift from monetary to fiscal policy still not completed
- US stock market hits new highs, but still no evidence of euphoria

2017 got off to a much more promising start than the previous year. In January, financial markets were not unsettled by concerns about economic growth or geopolitical tensions. On the contrary, most macro data painted a very positive picture of the global economic situation. On top of that, existing international crises were pushed into the background by political upheavals in the USA. While financial markets had been fairly bullish up to President Trump's inauguration, the reality eventually hit home at the end of January. The new president's brash style of leadership raises concerns that his entire term of office might be characterised by a policy of extremes. The general consensus that Trump would adopt a much more tactful and conciliatory tone as president than his harsh election campaign rhetoric unfortunately turned out to be misguided. The signing of new executive orders, mostly of a protectionist nature, put investors on edge for the first time as well, and took some momentum out of equity markets towards the end of the month. Despite the gentle headwind, America's S&P 500 Index still achieved a gain of 1.8% in local currencies over the course of the month, while the Swiss Performance Index also advanced 1.0%. Only the Eurozone equities market, which has a heavy export bias, lost ground, posting a decline of 1%. Currency markets were more volatile with the US dollar losing value after Trump's first actions in office.

Shift from monetary to fiscal policy still not completed

US interest rates are heading upwards and the US Federal Reserve is adopting a more hawkish tone. With FOMC members anticipating three interest-rate hikes by the end of the year. International interest rates edged higher in response, even though the European Central Bank continues its easing countermeasures. The braking effects are yet to be felt in sectors and investments that are sensitive to interest rates – the absolute level of interest rates is presumably too low for this. But our sub-indicator "Monetary Environment" is already signalling that monetary policy is soon likely to stop providing support for equity markets. Other subcomponents therefore need to step in to fill the gap. "Valuation" is hardly able to do so: only a huge surge in company profits could restore equity markets to a more attractive valuation level. The burden therefore falls on the shoulders of the real economy. Given that the manufacturing industry is still suffering from lower than average growth, America's future fiscal policy will play a key role. Donald Trump and his advisory staff seem to be aware of this, having announced ambitious plans for infrastructure investment and tax cuts. Opinion polls of private households and companies reveal some initial success in terms of voting intentions. End consumers in particular seem to be looking to the future with a greater sense of optimism and have stepped up their spending. However, robust consumption alone is unlikely to be strong enough to keep the asset class of equities at an attractive level. The industrial components also need to acquire much greater momentum. The growing confidence expressed in surveys now needs to be backed up with more activity in the corporate sector. The shift from monetary to fiscal policy is not yet complete, although the transition is not entirely necessary at the moment as long as monetary policy continues to provide support for equities. The fundamentals for equities still signal a green light at the end of January. The coming weeks and months will show whether markets will succeed in weaning themselves off the support of central banks.

Monetary environment: The monetary policy of the world's central banks has been expansive since 2009 and is therefore providing support for equity markets and risk assets. Even so, rising inflation expectations, and consequently higher interest rates for longer-dated securities, are restricting the tailwind for equities. A lot currently depends on the ECB, which is still pumping generous amounts of liquidity into the financial markets. At present no positive stimulus is coming either from the USA or Japan. Overall, however, the sub-indicator is still in a range that is positive for equities.

Industry: Industry was doing well a month ago, but since then several data series for the prior month have been revised downwards by the statistical authorities. As a result, the strong figures for December have been relativised slightly. Even so, the signs continue to point to recovery at the start of 2017. A more dynamic pace of growth can be seen in the Eurozone especially, while the USA has lost a little momentum.

Consumption: This component already improved significantly in the previous month. End consumers in the USA especially seem to be very bullish. Disposable incomes have increased further, thereby boosting not only consumer sentiment but also consumer spending. Consumer confidence now stands at its highest level for two years.

Valuation: The valuation of global equity markets continued to rise in January. One of the biggest contributors to this increase has been higher US share prices. According to our sub-indicator, the valuation of the US stock market has now reached a 15-year peak. Only a steep increase in company profits could restore valuations to a friendlier level for equities.

US stock market hits new highs, but still no evidence of euphoria

After share prices continued their rally in the USA, there were initial signs of overheating for a while during January. Private investors in particular showed unprecedented optimism in the performance of equity markets over the short term. However, they were brought back to earth by Donald Trump's latest actions.

Risk appetite indicator: Improvement in investors' risk appetite

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

From a market perspective, such a correction is quite welcome. Signs of overheating have therefore vanished again, even though the S&P 500 is trading close to its all-time high, and the environment can once again be described as "healthy" in terms of market psychology. Investors' risk appetite was once again stronger than in the previous month, supported primarily by economic and corporate data which in some cases comfortably exceeded market participants' expectations. According to our Risk Appetite Indicator, equity markets are therefore showing no signs of weakness.

In view of the support provided by the positive fundamentals, we thus maintain the maximum equity quota in our funds and mandates.

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