February 2017

Upbeat mood despite unsteady fundamentals

- Positive surprises and political developments trigger investor buying spree
- Fundamentals are starting to look precarious
- Climate still sound in terms of market psychology – no evidence of overheating

Rising stock indices, low volatility and a slight downtick in interest rates – this best summarises financial markets over the course of February. Seldom before in the recent past has a month been so uneventful. The main reasons for this were the better-than-expected macroeconomic data and company results that heightened the upbeat mood already exhibited by investors for some months now. Very little attention was paid to hotspots of international conflict: instead political developments in the USA once again grabbed investors' attention. The rhetoric of the new US president regarding public spending and tax reform plans continues to fuel hopes for an acceleration in the pace of economic growth and corporate earnings. The only fly in the ointment was Europe, where the forthcoming general elections in the Netherlands, France and Germany are creating a climate of uncertainty. The imminent danger of a swing to the far right in France in particular poses the threat of a collapse of the Euro, which would inevitably send shockwaves through financial markets. Nevertheless, the latest polls once again provided hope that the right-wing populists would eventually attract far fewer votes than the more moderate parties in the second run-off ballot. Given the political uncertainties, it is hardly surprising that European stock markets are less popular with investors than US and Swiss stocks. Despite all the risks, however, they still achieved a gain of 2.61% in February. The Swiss Performance Index posted an impressive performance of 3.35%, while the main US index, the S&P 500, once again finished in top place with a return of 3.72%. Dogged by worries about election outcomes, the Euro once again lost ground against the US dollar and Swiss franc. In addition, the US dollar firmed against the Swiss franc.

Fundamentals are starting to look precarious

The newsflow on the consumer and manufacturing fronts was generally much better than expected and signals a further acceleration in the pace of global economic growth. Even so, support for equity markets – especially from the industrial sector – is still far weaker than during the boom phase from January 2005 to December 2006. On top of that, the tailwind that monetary policy has provided to equity markets over the past eight years has almost completely vanished. Our fundamental sub-indicator for the monetary environment has fallen to its lowest level since November 2008. Back then, central banks had started to flood huge amounts of liquidity into the system in a bid to cushion potential shock waves produced by the Lehman Brothers crash and to safeguard the stability of the global financial system. Both sub-indicators are rocking the foundations of the bull run that that has been fairly solid for the past two years. If there is no imminent trend reversal in one of these two sub-indicators soon, equity markets would be unattractive for the first time since 2009 as far as the fundamentals are concerned.

Monetary Environment: This sub-indicator has continued to weaken compared with January, even though central banks are still providing enough money to financial markets. The sub-indicator is coming under particular pressure due to the existing and predicted level of inflation in the USA. As before, Europe is still the only region supporting the sub-indicator and consequently arguing for equity securities, thanks to the consistently expansive monetary policy and low rate of inflation.

Industry: The manufacturing industry is following a volatile, but upward trajectory. While this sub-indicator is being supported especially by sentiment in European industry, it has been dragged down over the past few months by the slight loss of momentum in US manufacturing. However, the first rays of hope can be seen overseas as well, where industrial production in particular has picked up pace again lately.

Consumption: Consumer sentiment is no longer quite as positive as in January. In particular, US consumer polls have been less upbeat than a month ago. Even so, consumption, more than any other sub-indicator, continues to provide the strongest signal for investing in equities.

Valuation: The sharp rise in share prices dampens the positive effects of the better-than-expected corporate results. The valuations of shares in Europe and the USA have become even more expensive. Only the Japanese equities market still provides a positive signal for equities based on valuation metrics.

Climate still sound in terms of market psychology – no evidence of overheating

The US equities market climbed to record highs in February, driven by a further improvement in investor sentiment. Four of the five sub-indicators of our Risk Appetite Indicator rose over the course of the month. Only the volatile subcomponent "Hedging Demand" signalled a slight dip in risk appetite. This is hardly

Risk Appetite Indicator: Solid risk appetite among investors

	Number of Indicators	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**	↘	↗	↗

surprising, considering the fact that the S&P 500 in the USA has posted gains over 10 consecutive trading days. Some investors took this as an opportune moment to increase their hedging and thereby reduce portfolio risks.

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