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Investors temporarily unhinged by political events

- Markets overshadowed by US politics and rising interest rates
- Attractive equity markets despite anticipated US interest hike
- Solid investor sentiment should make markets less prone to volatility

The influence of the forthcoming US presidential elections was even more pronounced in October than it had already been in September. The general response in financial markets was either positive or negative, depending on the results of the latest election polls. If the polls moved in favour of Hillary Clinton, the general market trend was upwards. But if voters showed a preference for Donald Trump, share prices dipped. Market participants, who appreciate stable and predictable trends, therefore expressed their scepticism about the possibility of Donald Trump, whose erratic changes of direction are well publicised, becoming America's next president. In addition to the US elections, Italy's approaching referendum on constitutional reform is also likely to have sounded a note of caution among investors. This has been particularly evident in the currency markets, with both the Swiss franc (a safe-haven currency) and the US dollar gaining ground against the euro.

The second dominant theme in October was rising yields on bond markets, led by US Treasuries. As the labour market situation has continued to improve and core inflation has registered another sharp jump, it looks increasingly likely that the US Federal Reserve (Fed) will raise benchmark interest rates by 0.25% at its next meeting in December. Equity markets responded to this scenario with some rotation from stocks paying solid dividends into more cyclical companies, which currently show a massive valuation discount compared with defensive stocks. This trend was particularly negative for the Swiss stock market, which is dominated by defensive heavyweights. Over the course of the month, the Swiss Performance Index fell 3.43%, while the more cyclical EuroStoxx gained 1.20%. The S&P 500 Index in the USA retreated 1.94% due to the uncertain election outcome.

Attractive equity markets despite anticipated US interest hike

It is generally true that politics only tends to have a temporary impact on stock markets. This is certainly likely to be the case in the aftermath of the US presidential elections, at least according to ENISO's fundamental model for asset allocation. Overall our stock market barometer continues to signal a positive environment for equities. The growing concern a month ago that the biggest support for equities – the monetary environment – might significantly weaken has not materialised. Quite the opposite: ENISO Partners' subindicator for monetary policy has actually improved. The valuation of equities still looks expensive, and has risen even further over the past month because of rising interest rates. As far as the components for the real economy are concerned, consumption continues to look extremely robust, while industry is still a major concern and the main reason for the sluggish rate of growth that has persisted over the years. In short, the overall score of our fundamental model is so high that equities will continue to be our favoured asset class in the short term, even if interest rates move higher.

Monetary environment: The probability of the US Fed raising benchmark interest rates before the end of the year is already 70%. The main reasons are certainly the relatively strong labour market and creeping core inflation. In Europe, on the other hand, inflation has already eased back slightly and could prompt the ECB to adopt additional measures to stimulate economic growth.

Industry: The signals both in Europe and overseas are still weak. Even the latest survey results published by the Institute of Supply Management in the USA failed to trigger a trend reversal, even though they were better than expected both in September and October.

Consumption: The USA continues to be the main motor of growth for global consumption. A strong labour market is underpinning a rise in real wages and improving consumer sentiment. On the other hand, end consumers in Asia are currently having a negative impact.

Valuation: Q3 US earnings are seeing their first year over year growth rate since early 2015. However, while results at face value are beating consensus projections, there is still a reduction in forward guidance. The rich valuations of US equities are a major drag for our sub-indicator "Valuation" leading to expansive stock markets overall. Though the regional valuations differ considerably, for example European markets are less expansive in comparison to their US peers.

Solid investor sentiment should make markets less prone to volatility

The conclusion of ENISO's risk appetite indicator is that investor sentiment is currently very solid and there are no signs of euphoria. Four out of five subindicators – with "Surprise Effect" the only exception – have shown a further improvement compared with last month. The main "Surprise Effect" on the economic and corporate front continues to be positive events. The decline in the indicator is therefore attributable to a loss of momentum, which is not as dynamic as it was towards the end of September. The fact that the confidence of market players is essentially intact is visibly supported by the subindicator "Market Risk" as

Risk appetite indicator: Robust sentiment broadly supported

	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	↘	↗	↗

well. Investors are once again prepared to accept higher valuations for equities. Although the equity market may seem to be in a deadlock in the run-up to the US elections and could even head south if Donald Trump unexpectedly wins, a complete reversal of sentiment and consequently a sustained fall in share prices seem unlikely, given the strength of investor sentiment. In the past, negative surprises were absorbed much more easily when the risk appetite indicator was solid than when there was already a climate of rampant uncertainty and risk aversion. With this in mind, we have a positive stance on markets up to the end of the year. In view of the positive signals both in terms of fundamentals and market psychology, we are maintaining the maximum equities quota in funds and mandates, and expect prices to move higher again after a temporary volatile phase around the US presidential elections.

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