October 2016

Goldilocks gets a trim

- Event and Idiosyncratic risks lead to heightened volatility.
- Global bourses end the month in the red
- Risk appetite indicator: Rises to its highest level since the end of 2013.

The “Goldilocks” rally which ran over the summer months as a result of better than expected macro data and the low interest rate environment took a breather in September. As vacations came to an end and market participants returned back to their terminals, a jammed pack calendar of events awaited.

Investors immediately showed signs of irrationality as event risks beckoned sending markets into a volatile range as concerns were raised as to the limits of global central bank support by the ECB and BOJ followed by worries over a more hawkish Fed and diverging global monetary policy. To a large extent what this month has once again confirmed is that markets have come to expect very accommodating policy as the norm. Away from the central bank meetings, the 1st televised debate of the US presidential took place and global markets wasted no time in declaring Hilary Clinton the sparring winner over Donald trump after the first round. Closing out the month global markets were buoyed closer to the green as OPEC agreed to modest oil output cuts in the first such deal since 2008, leading to a 6% rise in Brent and giving support to oil prices. Nevertheless, the month ended by being rattled over Deutsche Bank’s solvency in a USD 14bn Department of Justice mortgage settlement fine, which in tow grappled with investor’s tired nerves and lead to indices closing lower.

Through September The Swiss Performance Index closed down 0.77% and the EuroStoxx fell slightly. Across the pond, US markets closed the month down with the S&P 500 returning -0.12%. After having risen 50% this month The CBOE Volatility Index closes the month almost unchanged. On the currency front, the CHF has subtlety strengthened this month against its respective currency pairs.

Is the monetary environment approaching a watershed moment?

Our fundamental asset allocation model currently points to a negative trend forming in the “monetary environment” sub-indicator. With the US and Switzerland being the negative drivers of this sub-indicator it can be said that monetary policy may be at a watershed moment with policy divergences priced to gradually take place into the close of this year and into 2017. On the other hand, encouraging signs continue to be given from the “Consumption” sub-indicator, notably from the US consumer.

Monetary environment: Following the Fed’s decision to keep rates unchanged, “Monetary environment” is showing signs of a negative trend as the central bank continues to warn that conditions for a hike are falling into place, with interest rate futures pointing 50% chance of a hike in December. However, the sub-indicator continues to be uplifted by monetary easing from the BOJ and the ECB who are in the frame to start exploring a variety of approaches (yield targeting, negative policy rates) to boost growth and strengthen inflation.

Industry: The “Industry” sub-indicator points to a continual negative trend in global industry. In the US new orders rose for a third consecutive month, which sends a much warranted positive signal to the manufacturing sector. Nevertheless, business spending and manufacturing continues to contract as companies continue their fight against lower oil prices and revise their CAPEX budgets in the face of an uncertain global outlook. Manufacturing data elsewhere showed dull economic performance across Europe and emerging economies.

Consumption: In a world where the European consumer continues to show little strength, the US remains the driver to the "Consumption" sub-indicator even though consumer spending has slowed of late, it has been supported by a tighter labour market and increased household spending which in course has had a positive impact on US incomes. The picture in Europe was one of improvement from previous months as consumer confidence rose and shrugged off Britain's vote to quit the EU, this has potential to change as the UK will formally start its divorce proceedings in 2017.

Valuation: The "Valuation" sub-indicator points to the US market being expensively priced at current levels, with quarterly profits in S&500 declining for the first two quarters of this year, third quarter earnings will be watched closely for an affirmation of this trend. Following another volatile month of trading driven by top-down, short-term factors European equities look increasingly more attractive than they did last month.

Risk appetite indicator: Reaching 2013's heights

The risk appetite indicator continues to point to a healthy psychological backdrop for investing in equities, with 4 out of the 5 sub-indicators pointing to "Buy" signals. Now that the central bank meetings are over, a clear capitulation was witnessed within the "Hedging Demand" indicator over the

Risk appetite indicator: 4 out of the 5 sub-indicators pointing to "Buy"

last week, which confirmed that institutional investor demand for hedging instruments had significantly reduced. The negative trend within the "Surprise effect" sub-indicator has also ceased which reflects that recent economic
figures have beat market expectations. A trend that has strengthened over the last couple of weeks has

	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	Sell	↗	↗	↗
MARKET RISK	37	Buy	↘	↗	↗
OVERBOUGHT / OVERSOLD		Neutral			
RISK APPETITE INDICATOR	**116**	**BUY**	↗	↗	↗

been the willingness of investors to pay higher valuations multiples for stocks, which underlines a healthy, and robust risk appetite.

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