August 2017

Accelerating growth fuels hopes for an autumn rally

- North Korea crisis and euro's strength unsettle markets
- Stronger manufacturing sector boosts the appeal of equities
- Solid risk appetite despite sabre-rattling

In August stock indices initially stayed within narrow bandwidths and volatility indices remained at historical lows. Only the Dow Jones Euro Stoxx, the Eurozone's leading blue-chip index, struggled a little due to the gradual strengthening of the single currency. Even the erratic statements of the US president did not manage to disturb the peace. Global economic data came in line with expectations, and quarterly figures reported by companies were also impressive. Only the increasingly threatening spat between North Korea and the USA made investors more cautious and put downward pressure on share prices. The mood was also spoilt by a further depreciation of the US dollar and by Hurricane Harvey, whose real economic damage is difficult to quantify for the moment. Following a strong rally, it was time for the top performers to pause for breath. Overall, only a few stock indices retreated in August. The biggest fall came from the Swiss Performance Index which was down -1.3%, followed by the Eurozone which lost -0.4%. In the USA the S&P 500 stayed closed the month unchanged. Both gold and interest rates benefited from investors' waning risk appetite. Yields on 10-year US Treasuries fell to their lowest level for two months, while the price of gold managed to break through the resistance level of USD 1300 per troy ounce.

Stronger manufacturing sector boosts the appeal of equities

Data published for the industrial sector especially in the USA were not particularly impressive at first sight. However, America's manufacturing industry seems to be in a better state than widely reported, with data repeatedly revised upwards retrospectively. Together with the European industry's dynamic pace of growth, the sub-indicator reading comes in significantly higher. In regard to the industrial sector, its performance is not usually particularly important for stock market performance, nevertheless, it now merits greater attention in view of its current strength. After years of only modest growth, the manufacturing industry, along with the subcomponent "Consumption", has managed to settle along a clear growth path. According to our asset allocation model, this development signals that equities have greater fundamental appeal. Support continues to come from the monetary environment, whose stimulating effect has clearly waned over the past 12 months. By contrast, the "Valuation" component of equity markets remains unattractive.

Monetary policy environment: The US Federal Reserve (Fed) is planning to shrink its balance sheet – even though the inflationary pressure on consumer prices is continuing to fall. Only in the industrial sector are there still sporadic signs of mounting inflation. In Europe, by contrast, inflation is still ticking upwards across a broad front. The marked appreciation of the euro is only likely to have a slightly dampening effect on inflation in the coming months.

Industry: In Europe, the industrial sector continues to build on its strong growth. France and Italy, whose industries have been dogged by recession for years now, are now contributing to the positive expansion as well.

Consumption: Spending by America's households continues to be robust, while continuing to pick up sharply in Europe. Consumption is therefore still providing the strongest support for equities.

Valuation: Although trends in company earnings come as a positive surprise, prompting analysts to raise their estimates, the valuations of stock markets are still too high. Less surprising, however, is that US dividend-bearing securities are the most overvalued. The Japanese stock market the most attractive valuation at the moment.

Solid risk appetite despite sabre-rattling

The overbought situation that prompted us to reduce our equities quota only lasted a couple of weeks is a constellation that has only occurred very seldom in the past. Investor risk appetite therefore rebounded to a healthy level quicker than expected. The hedging process was cost-neutral for the most part, and in some markets there was even a small gain from hedging.Despite the sabre-rattling between North Korea and the USA, the risk appetite indicator has continued to strengthen over the past week. The improvement was also down to the component "Market Breadth", which in previous months had been noticeably weak for some time. With a further increase in the number of shares participating in the market rally, the downward trend of the sub-indicator now appears to have been halted. On top of that, institutional investors have shrugged

Risk appetite indicator: Normalisation provides a fresh "buy" signal

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

off their reservations about equities in the short run, and reduced their hedging transactions. Overall, the risk appetite for investors is on a solid level, so that prices may well rise quickly once the North Korean conflict has calmed down. For this reason, given the strong fundamentals, we therefore retain our full equity quota and expect share prices to rise further over the coming weeks.

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