June 2018

An explosive mix

- Prices fall on concerns of another euro crisis
- Broadly supported price pressure weighs on markets
- Sentiment undermined by lack of clarity

The past month would provide an ideal subject for someone studying "political stock markets". Investors were bombarded with a potent mix of opinions, facts and eventualities. President Trump announced America's withdrawal from the nuclear deal with Iran, while tensions mounted between Israel and Iran. This led to higher oil prices and fears that producer prices would continue to rise. At the same time, there have been repeated and unexpected twists and turns in the trade war between the USA and China (and Europe) and the plans for a US summit with North Korea. Most of the market players with very short-term horizons interpreted the news as positive, although the higher oil price might well have put pressure on financial markets. Eventually it was the political turmoil in Italy and renewed concerns about the future of the EU that rocked stock markets and the single currency. The euro fell by almost 5% against the Swiss franc in a short space of time and European bourses gave back their gains. The US stock market, which was the least affected by these trends and had underperformed in the previous month, was able to advance 2.16%. By contrast, the Dow Jones EuroStoxx had a strong start to the month but then fell away, finishing with a loss of 1.50%. The Swiss stock market could not capitalise on its defensive strengths and finished 3.42% lower.

Broadly supported price pressure weighs on markets

The general clamour from geopolitical events drew almost all the attention away from the fundamental data. But these data also provided some useful signals – although not always in favour of equities, unfortunately. The global economy is definitely expanding, but the escalating economic and geopolitical imponderables are starting to drag down growth prospects and are causing a slight decline in the subindicators "Industry" and "Consumption". It comes as no surprise that Europe's export economy in particular is characterised by a more cautious attitude. But consumers also seem to be less certain about their situation and have either trimmed their budget or plan to spend less freely in future. On the other hand, the labour market continues to support consumption, due to the general labour shortage, especially in the United States. What helps the real economy, however, is negative for the subindicator "Monetary policy environment". The tight US labour market is leading to wage increases, which are increasingly being passed on to customers. Price pressure is mounting in the transport, industrial and construction sectors. These were the findings of the latest business surveys conducted by the US Federal Reserve, providing clear indications that inflation is rising on both the producer and consumer price front – certainly at a faster rate than central banks across the Atlantic would like. The pressure of further US interest rate hikes USA remains high. These must be judged against valuations that can only be justified in an environment of strong corporate earnings growth. Overall, our fundamental model is almost in neutral territory and currently leaves very little potential for equities.

Monetary policy environment: Inflation continues to be the dominant topic for central banks. The comments from the US Fed that it wants to watch inflation for a while before raising interest rates again therefore came as something of a surprise. The markets might also be wrong-footed if interest rates were to be raised earlier than expected. Our subindicator therefore looks negative.

Industry: Production is currently showing signs of weakness, while order intake is improving again in the USA. By contrast, concerns about trade tariffs seem to have grown in Europe, dampening future prospects. The subindicator is still at a level that is favourable for equities.

Consumption: The consumption components in the subindicator had already deteriorated for the USA in the previous month. In May, US consumers were once again responsible for the decline in the indicator, while consumption in Europe remained stable. On balance, the subindicator is still supportive of equities.

Valuation: Equities are still overvalued, although to a lesser degree. The valuation of Japanese stocks in particular has become more attractive. The US stock market is still the most heavily overvalued.

Sentiment undermined by lack of clarity

The sell signal triggered by our Risk appetite indicator in April is still valid. There has been very little change in sentiment overall compared with the previous month. The most striking development, however, is that the subindicators "Hedging demand" and "Surprise effect" were especially volatile. Investors appear to be extremely unsettled and unable to decide which direction prices are heading in. This development is having a negative impact on sentiment and reducing investors' risk appetite. But it is also surprising that the "Market breadth" indicator continues to be relatively stable. In the current environment, it is usually aggressive stocks and small caps that tend to come under selling pressure. For once this is not the case – in fact America's Russell 2000 Index even climbed to a record high. In short, most market players seem to have no clear picture about the future direction of markets. As a result, our Risk appetite indicator remains defensive. Our current positioning is therefore suitably cautious.

Risk appetite indicator: sentiment still shaky

	Anzahl Indikatoren	Aktuelle Signale	1 Woche	1 Monat	3 Monate
MONEY FLOW	31	Buy	↘	→	↘
SURPRISE EFFECT	18	Sell	↗	↘	↘
MARKET BREADTH	24	Buy	↘	↗	↗
HEDGING DEMAND	6	Buy	↗	→	↗
MARKET RISK	37	Sell	↘	↘	↘
OVERBOUGHT / OVERSOLD		Neutral			
RISK APPETITE INDICATOR	**116**	**SELL**	↘	→	↘

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