July 2018

Stay cool and keep your money protected

- Trade disputes unsettle investors
- End of the party also signalled by weaker growth
- High level of uncertainty makes investors cautious

In June, hopes of a swift resolution of the trade disputes between the US and its main trading partners were dashed. The repeated threats and subsequent actions unsettled investors. At the same time, there were potential signs of an economic slowdown, as some leading indicators for manufacturing weakened noticeably, particularly in Europe. The global upturn is certainly under threat, and the decisions of the American and European central banks at the June meetings were all the more surprising. With the Fed announcing two more interest-rate hikes and the ECB allowing its bond-purchasing programme to expire by the end of 2018, the ultraloose monetary policy is a thing of the past. The inflation risks are apparently weighted higher than the risks of an economic slowdown. Anyone who predicted government bond yields would rise as a result was proven wrong. Instead, yields fell and the yield curve flattened to a level last seen in 2007. Some investors apparently prefer to park their money in US Treasuries rather than invest it in the equities market. These conflicting market movements indicate just how unsettled market participants currently are. It's therefore hardly surprising that equity markets overall came under selling pressure during June. The Swiss Performance Index benefited from its defensive characteristics for once, finishing the month 1.60% higher, while the S&P 500 only managed a very modest gain of 0.48%. Worst hit was the export-heavy EuroStoxx Index, which retreated 0.82%.

End of the party also signalled by weaker growth

Investor jitters and the associated sideways movement are definitely attributable to the trade disputes for the most part. But if the fundamentals were otherwise positive, the entire financial markets would not be so vulnerable to negative news flow. So far, investors have been able to draw courage from the broadly supported global economic upturn, but this is now starting to falter according to our subindicators "Industry" and "Consumption". After a handful of indicators already hinted last month at the possibility of weaker growth, other subindicators did the same in June and raised concerns of a greater probability of growth weakening in the second half of the year – mainly in Europe, but also in Japan and the emerging markets. By contrast, the USA seems to be much less affected, according to our data series, hence the reason for the repeated claim that "the economy is firing on all cylinders". At the same time, the effects on inflation can be felt in the USA at the level of producers and consumers. Since inflation is also starting to gather momentum in the Eurozone, the Money Flow subindicator in our systematic asset allocation model has got much worse. Given that the valuation is still too high, this is not good news for investing in equities. Our fundamental model is therefore generating a sell signal for the first time in two and a half years. The party is over for the time being, and a cautious approach is advisable. We will therefore exploit every recovery – the first should come soon after the sharp correction in recent days – to further trim our equities quota.

Monetary policy environment: In June the US inflation rate rose to 2.8%, its highest level since February 2012. Inflation is not expected to flatten out quickly, as producer prices have risen even more sharply, at the rate of 3.1%. No wonder the US Fed is planning another two interest-rate hikes. Core inflation also rose significantly in Europe, requiring action from the ECB. Both developments are chiefly responsible for a much weaker subindicator.

Industry: Europe's export-oriented manufacturing industry is particularly affected by President Trump's threats. The economic barometer published by the Centre for European Economic Research (ZEW) declined again in June and is now at its lowest level since September 2012. Even the emerging markets were affected by the downturn. Overall the indicator is more or less unchanged due to the resilience of US industry.

Consumption: There has been little change in the data series for the subindicator "Consumption". There is no sign of a slowdown in consumer spending. As always in the past, consumers are likely to show a more delayed response than the manufacturing industry. Consumption is clearly a beacon of hope for investors bullish on equities.

Valuation: In the USA, earnings per share have risen an impressive 21.7% over the space of 12 months, not least due to the reduction in corporation tax. Revenues have also been steadily improving since 2016. However, share prices have risen significantly faster than revenue growth, which means higher sales have already been fully factored into share prices. Even though analysts have recently trimmed their earnings forecasts, they are still very high for the next 24 months, so disappointments would not come as a surprise. Overall, the markets still look overvalued.

High level of uncertainty makes investors cautious

In the history of our risk appetite indicator, this is one of the longest phases in which a sell signal has been evident. The indicator has deteriorated further since last month and is now at a lower level than it was both one and three months ago. While it was mainly the more volatile subcomponents of the indicator that were chiefly responsible

Risk appetite indicator: sharp drop in risk appetite

	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	Sell	↘	↘	↘
MARKET RISK	37	Sell	↘	→	→
OVERBOUGHT / OVERSOLD		Neutral			
RISK APPETITE INDICATOR	**116**	**SELL**	↘	↘	↘

for the sell signal in May, it is now the more stable subcomponents "Market Breadth" and "Money Flow". Volumes rise in bear markets, and tech stocks were no longer able to sustain their relative strength versus the market as a whole. In addition, liquidity is still flowing into US Treasuries despite rising inflation and further interest-rate hikes. It seems as though the "smart money" is positioning itself for bad news. We therefore retain a defensive positioning for the time being and further reduce our equities quota in light of the fundamental situation. During the summer months, when trading volumes are low, there tend to be sudden corrections, so we are keeping our money protected.

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