May 2016

Brighter mood despite weaker fundamentals

- Share prices underpinned by low expectations
- Tension created by accelerating inflation and decelerating economic growth
- Risk appetite indicator: normalisation at a healthy level

After a very hectic first quarter, the second quarter of 2016 got off to a much calmer start. In April, investors were not unnerved by geopolitical developments or unexpected announcements by central banks, and the latest releases of fundamental data did not deliver any negative surprises either. On top of that, the quarterly results of most companies came in above what were admittedly fairly low expectations. This helped investor sentiment to stabilise as a reasonable level, with equity markets posting a marginally positive performance overall in April, although still lacking any real dynamism. Switzerland's main index, the SMI, gained 1.96% and the Euro Stoxx 0.67%, while stock indices in the USA and Japan finished the month at the same level as at the end of March. There was a fair amount of volatility on foreign currency markets. The Japanese yen in particular posted significant gains. The US dollar fell back again after making tentative gains in recent weeks. In the fixed-income segment, corporate bond prices increased mainly as a result of the European Central Bank's bond-purchasing programme.

Tension created by accelerating inflation and decelerating economic growth

Just a month ago the subindicator "Valuation" turned out to be the new major support for equity markets. The euphoria was only short-lived, however. Already during the course of April the valuation of equity markets rose again – so sharply, that this component is now once again rating our fundamental asset allocation model for equities as a little too expensive. The "Industry" component is also sending a negative signal. The improvement in the manufacturing sector that had been hoped for did not in fact materialise. On the contrary: the situation actually deteriorated again. We are therefore reverting to the same pattern that has prevailed since 2009. Both the valuation and industrial sentiment argue against investments in equity securities, while the monetary environment and consumption continue to provide support for equity markets. It is interesting to see that consumer sentiment is also showing a negative trend and the precursors of rising inflation are having an increasingly negative effect on the monetary component. Sooner or later this could develop into an explosive mixture. For the moment, however, the overall environment for equities remains positive when judged by the fundamental model.

Monetary environment: On the one hand the situation is currently becoming more tense due to the gradual increase in inflation. On top of mounting wage pressure, which could soon be passed on to consumers, there is also the burden of soaring oil prices, which have more than doubled in recent months. On the other hand, the interest rates on capital markets are declining, thereby helping to stimulate certain areas of the economy. Both effects are cancelling each other out at the moment, so that the indicator stands at a positive level, effectively rating equities as worth buying.
Industry: After showing signs of improvement for a month, the figures for US industry are now starting to decline again. Order intake is disappointing and leading indicators are painting a less upbeat picture than a month ago. This component is therefore providing a very clearly negative signal for investing in equities.

Consumption: The biggest problem to date with US consumption has been the fact that the actual level of spending has not reflected the very positive consumer mood. This is unlikely to change for the time being, as disposable incomes have recently suffered a setback. Despite this, consumption in the USA – the world's biggest consumer market – is still increasing, albeit at a modest pace. Consumer sentiment in the emerging markets, on the other hand, has worsened over the course of the past month and is mainly to blame for the negative performance of the subindicator "Consumption". Although the decline was noticeable, as the level had been consistently high for quite some time, the fact remains that consumption continues to provide support for equity markets.
Valuation: Most of the quarterly figures recently published in the USA provided a positive surprise and made a good impression on analysts as far as both revenue and profit growth are concerned. In reality, the surprises were only positive because analysts had significantly reduced their expectations before the results were published. Since the US equity market is once more trading close to its all-time high and corporate earnings are lower than a year ago, the valuation has yet again risen significantly. US equities in particular are looking rather expensive by historical standards, while European, Swiss and Japanese equities rate as neutral or slightly undervalued.

Risk appetite indicator: normalisation at a healthy level

The tumult has died down for the time being. After a turbulent start to the year with investors offloading shares, verging at times on panic selling, the mood started to improve again even more swiftly. The short-lived euphoria sounded a note of caution, according to our risk appetite indicator in March. In the second week of April, investor sentiment normalised again and healthy risk appetite triggered a new buy signal for

Risk appetite indicator: improvement in four out of five groups

	Anzahl Indikatoren	Aktuelle Signale	1 Woche	1 Monat	3 Monate
MONEY FLOW	31	Buy	↘	↗	↗
SURPRISE EFFECT	17	Buy	↘	↗	↗
MARKET BREADTH	24	Buy	↘	↗	↗
HEDGING DEMAND	7	Buy	↘	↘	↗
MARKET RISK	37	Sell	↘	↗	↗
OVERBOUGHT / OVERSOLD		neutral			
RISK APPETITE INDICATOR	**116**	**BUY**	↘	↗	↗

equities from a market psychology perspective. In response, we increased our equities exposure over the rest of the month. Four out of five indicator groups showed a marked improvement over the course of April. Only the hedging demand from institutional investors is already starting to increase again. This alone is not a real cause for concern, as corrections repeatedly occur during every rally, often caused by short-term hedging or profit-taking. If, on the other hand, other components of the risk appetite indicator deteriorate in the short term, this could potentially be a precursor to a more volatile period in equity markets. At the moment, however, the light is still at green. According to the current signals, the upward trend is therefore likely to continue after a "healthy breathing space".

Your Contact at Amplia & Co. AG

Mikael Rosenius
Claridenstrasse 34
CH-8022 Zurich
Tel. +41 44 286 17 41
mikael.rosenius@amplia-co.com

Jennifer Erdin
Claridenstrasse 34
CH-8022 Zurich
Tel. +41 44 286 17 42
jenny.erdin@amplia-co.com