

RISKS RECEDE IN A BENIGN ENVIRONMENT

- Equity markets shrug off bad news
- A healthy cocktail of growth and inflation
- Opportunities outweigh risks

As in previous months, nothing could shake the world's stock markets in October 2017. Equities posted new gains and price volatility was relatively low. Contrary to the pessimistic expectations of many, the dreaded autumn correction – or even a crash like the one that happened thirty years ago – never arrived. One long-standing reason for this was undoubtedly the lack of alternatives. Above all, though, companies' better-than-expected quarterly figures and recent strong economic data from Japan, Europe and overseas provided fertile ground for price gains. In addition, equities benefited from persistently positive investor sentiment, fed by a healthy mix of strong global growth and subdued inflation expectations around the globe. New and existing crisis hotspots were never given a chance to dominate the market. Even the euro suffered no ill effects from Catalonia's efforts to secede from Spain. Eurozone shares rose by an encouraging 2.32% in October, while the Swiss Performance Index advanced just 1.5% in view of weak performance by the defensive large caps Roche, Novartis and Nestlé. The S&P 500 gained 2.22% thanks to impressive quarterly figures from the technology sector. Better-than-expected economic data led to selling pressure for bonds, driving yields slightly higher.

A HEALTHY COCKTAIL OF GROWTH AND INFLATION

Seldom have we seen consumer sentiment and the manufacturing sector in the US, Europe and Japan as closely aligned as we did in October 2017, based on the data series analysed by our asset allocation model. In Europe and the United States, household consumer spending is being fuelled by increasing employment and rising real incomes. Japan's consumer growth on the other hand is modest, but has made up some ground recently. Our "Consumption" sub-indicator shows that such conformity across all regions has not been seen for several years. Industrial sentiment is less steady but increasingly robust. The manufacturing sector thus seems to have settled on a global growth path. This positive trend in the real economy is undoubtedly necessary to ensure that equity exposures remain attractive. After all, support for equities from the monetary policy side is more or less finished and overvaluation has increased again despite encouraging earnings growth.

Monetary policy environment: Money supply growth in the United States is slowing down. At the same time, price pressure is rising at the producer price level. Neither trend is exactly helpful for equities, hence they exert downward pressure on our "Monetary Environment" sub-indicator. On the positive side, US inflation has not yet had much impact on consumers, whereas in Switzerland and the Eurozone, even core inflation is of increasing concern for consumers.

Industry: This sub-indicator is still relatively volatile, but it is tending ever stronger. Japanese industry in particular recorded increases in both orders and production, but order intake for the US manufacturing sector also made up for the previous month's weak figures.

Consumption: In the USA and Europe – the driving forces of global consumption – consumer spending remains buoyant. Falling unemployment in the southern European countries not only helps consumer sentiment, but also boosts actual expenditure. In the USA, not only high employment but also real wage growth is having a positive impact on consumption.

Valuation: Overvaluation of equities increased again, particularly in the USA. Although valuations are reasonably attractive in relation to growth prospects, they are far above historical norms in relation to dividend yield and book value. Valuations therefore remain the biggest factor impacting the fundamental attractiveness of equity markets.

OPPORTUNITIES OUTWEIGH RISKS

Almost daily, one of the stock indices breaks a new record or at least climbs to a new multi-year high. Warnings of a major correction are getting louder. Yet, according to our risk appetite indicator, the risk of equity markets becoming overheated is still some way off. None of the anti-cyclical signals currently indicates that equity markets have risen too far. The “Hedging Demand” sub-indicator, which warns of the need to hedge riskier assets, has recently pointed to increased hedging activity, suggesting a certain reticence on the

Risk appetite indicator: Investors have a healthy risk appetite

	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	→	→	↘

part of investors. On the other hand, the “Market Breadth” and “Surprise Effect” sub-indicators rose month-on-month. More prominently, the “Surprise Effect” lead investors’ risk appetite to increase, given the positive surprise effects from the corporate world are continuing and economic growth among the major economies is turning out more positive than economists expected. To sum up, there are no warning signs to suggest that the bullish trend is coming to an end. We are therefore sticking to our full equity quota and continue to favour equities.

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