Analytical View of the Financial Markets

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Are the stock markets (too) highly valued?

Since mid-February 2016 the most important stock markets have risen almost continuously and are now between 25 and 45% higher. Obviously investors are assuming that the general economic recovery will continue and that the market valuation of the companies has been quite right. In fact, the price / earnings ratios rose, but are not increased so much that one could speak of exaggeration! Among the blue chip markets, only Denmark and England showed a high P / E ratio in recent years! Swiss stock corporations can once again look back on successful domestic and international activities. Worth mentioning is the Sonova hearing aid provider which expanded (Continued p. 2)

The inflation, is it coming back?

Over the past 100 years, the changes in the general price level have always caused sleepless nights for the economic politicians, especially the central bankers. If it was not possible to bring the growth of money into line with the real economy, the expansion phase of the GDP ended either in inflation or deflation. In both cases, no desirable condition! To avoid these extreme situations, the central banks had a continuous but moderate (e.g., 2% p.a.) expansion of the money supply in view. This simple rule seemed to calm the situation in most countries. However, as in the last few years the central banks tried to stimulate economic growth with monetary stimulus, the attempt failed miserably. Despite an extreme expansion of the money supply, there was little reaction on the growth front and the price changes remained negative. Instead of inflation, deflation is now the big problem. Admittedly, administered prices (such as for health insurance) continue to rise, but wages are based on the declining inflation rate. A high-tensioned social development and a fast solution is currently not in sight!

Global Inflation: No signs of a trend change!
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Through the acquisition of the company into the Netherlands, Foreign direct investment has been a popular investment variant for Swiss companies already for some time. Beside the USA, Switzerland is now the most important foreign direct investor in the EU. Worldwide, the international financial markets are closely linked today. The majority of them are not over-rated!

Let’s take a look at the Eastern European and Asian stock markets. The Russian market was able to recover in 2016, but in 2017 it again suffered a poor performance. The isolationist trade policy imposed by US President Trump on the Russians trade seems to leave traces. This despite the fact that Putin tried everything to stay with his Asian as well as European trade partners in the business. The Eastern European markets are struggling between the East and the West and have been able to position themselves quite well, with the exception of Croatia. Apart from Venezuela, the markets in South America remained stable. Despite political instability, Brazil and Argentina were able to achieve considerable performances!

How will interest rates develop?

When in December 1973 the inflation rate in Switzerland rose to 11.9%, the central bank saw only one way out: massive increase in money market rates! As a result, the money supply was reduced, the money market rate jumped to 6% and the bond yield to over 7%. The consequence: Economic growth collapsed, but after a few painful years the equilibrium was restored again!

In the meantime, a lot has changed! Although the actions of the central banks are still based on the same central bank laws, the response of the money markets to these measures seems to be breaking up somewhere in Nirvana. In all major industrialized countries money market rates have been massively reduced in the last few years for the purpose of growth stimulation, in CH, in DE and JA even into the negative range! This also had a corresponding effect on the capital market. While in earlier years the interest rate cuts initiated by the central bank caused a revival of demand, today nothing like this happens. Inflation fears that have led to a consumption in the past can no longer be registered.

If inflation does not occur, the interest rates may alone reflect the cost of holding money! As a result of government-imposed negative interest rates, the banks were not allowed to charge interest rates for their money from their customers, but instead they increased the processing charges drastically. No encouraging, but above all also no economically pleasing development! In this way, the central banks have cut the steering function of interest rates! It is hoped that they soon remember one better!
Is there something going on in Japan?

After Japan has hardly provided positive news in recent years, investors are increasingly interested in Japanese developments. In fact, the Japanese stock market has performed more positively than the European and American since the US elections! Obviously, Japanese investors believe again in the economic power of their country! Are they right?

Since 2011 the Japanese bank has increased its money supply by an average of 5.5% p.a. This rather loose monetary policy should provide the basis for stronger economic growth! Roughly about equal the money supply was extended in the UK and Switzerland. In the Euro Zone and the United States, the central banks increased the money supply by more than 7% and 10% a year, respectively! At the same time interest rates remained close to zero and the inflation rate has risen to over 3% only in England. However, the impact on real economic growth was very different!

While the Anglo-Saxon economies in the years 2011 to 2018 increased by about 2% p.a. And also the CH and D are only just underneath it. Japan, according to current forecasts, can not crack the 1% limit! The Japanese stock market does not seem to share this expectation because, despite the modest GDP growth forecasts, the Japanese equities are "looking forward towards the rising sun!" Similar to stock markets in the CH or the USA, the Japanese index TOPIX has increased by almost 40% since February 2016. Of the 340 companies included in TOPIX, 303 posted a positive performance in the period under review. The "shooting star" among the super performers is the company "E-Guardian", which offers Internet solutions for everyone. Since February 2016, their share price has risen by more than 470%. Around one third of all Japanese stock companies were able to double their market value during this period.

Will the Japanese stock market continue to develop so strongly and, above all, continue to be independent of the real economy? If one chooses a conventional analytical approach one would have to answer the question in the negative. But maybe Japan actually follows its own rules! The Tankan business climate index seems to confirm this!

YEN - its weakness supports Nippon!

In the second quarter 2017, the Japanese economy grew at an annual rate of 4%. This surprised not only the Japanese, but above all also the Japanese competitors, they expected a much weaker growth. With a GDP of nearly 5000 billion USD, Japan is today the fifth largest economy in the world!

The Japanese generate a large part of their income with their foreign trade. Their most important export product are cars. They account for almost 15% of the total exports of around USD 650 billion and imports of USD 630 billion. The main foreign trade partners are USA, China and South Korea.

The current massive weakness of the YEN boosted the Japanese foreign trade. Compared to the USD, the YEN has lost some 10% since mid-2016. The devaluation to the EUR was slightly stronger and the devaluation to the CHF slightly more modest. The unexpectedly flowing revenues stimulate the investment activity and thus also the Japanese economic growth!
Where to Invest? Certificate "EV100" Valor 37'209'172

As announced in the last newsletter, Eagle Invest AG, Stebler AG and Golden Hawk AG have launched our current share investment strategy in the form of a certificate under the name "EV100" at Bank Vontobel. The security number is 37'209'172, whereby purchases should be recorded at a limited price. Interested? Please call us in advance.

The month of August was dominated by wobbly exchanges and we were able to benefit from lower buying prices. At the end of August, the portfolio consisted of around 50 positions (including cash and options). 67% in CHF and 33% in EUR. We place emphasis on undervalued stock corporations with acceptable balance sheet ratios. Currently, the most active sectors are industry (eg: Huber & Suhner, ABB), infrastructure & basic materials (eg: Lafarge, BASF) and consumption (eg: Bell, Valora). EV100 stands for "equity value" and as well as "up to 100% shares". Due to diversification, risks are limited to individual positions. This also applies to the performance opportunity! Our target yield is accordingly at 5-10% p.a.!