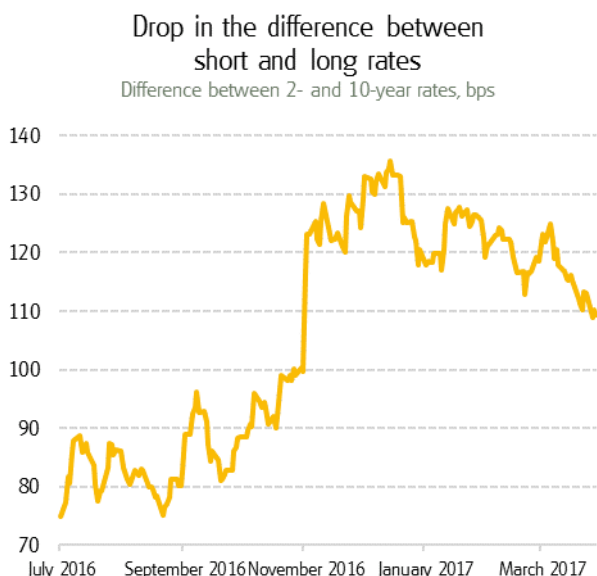




Monthly comment by
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Stocks believe in Trump - bonds are sceptical

Momentum in the stock market continued in March. The MSCI World global stock index in euro terms rose 0.5%. Additionally, the euro also strengthened against the dollar by 0.5%, as the stock market continued to deliver positive returns in March. The stock market was characterized by violent optimism at the start of the month because of announcements from the Federal Reserve. Subsequently, optimism has slipped slightly in the background, especially in the bond market, where the steep curve of rising long-term rates relative to short-term rates, in the wake of the Trump election, gradually shrunk to around 10 bps (compared to a top-out of 25 bps at the end of December).



In other words, scepticism is gradually thriving in bond markets on whether Trump's campaign promises will materialise. This is probably partly because it was not possible to abolish Obamacare/ACA and find a worthy replacement that would be acceptable to the Republican-dominated Congress.

In my opinion, we should still give Trump a chance to deliver on his campaign promises

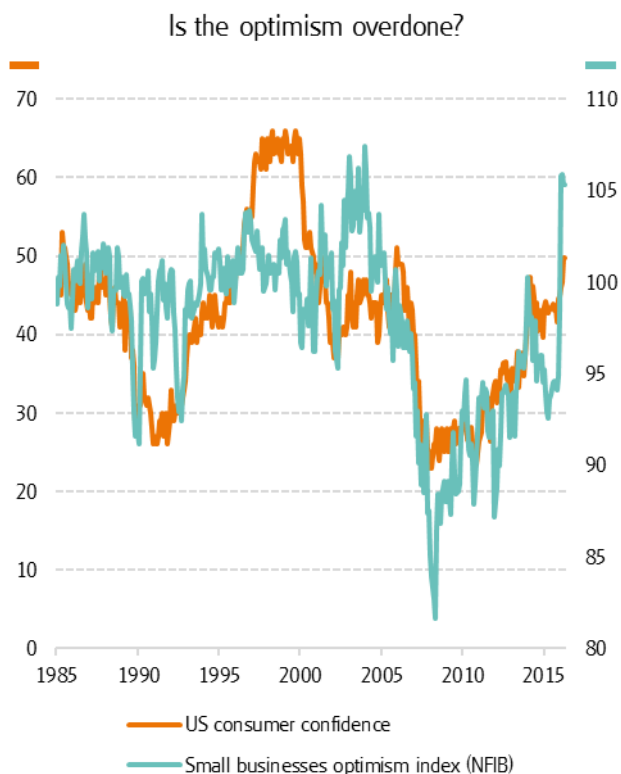
As Trump has previously indicated that tax cuts were on the program only after a successful abolition or reform of Obamacare/ACA, there is now great uncertainty about whether and when tax cuts and other election promises can be fulfilled.

This may be part of the explanation for why the US interest-rate curve flattened during December. However, the most important reason is probably that short-term rates are rising in anticipation of a tighter monetary policy from the Fed, despite largely unchanged, long-term inflation expectations in USA.

In my opinion, we should still give Trump a chance to deliver on his campaign promises.

There is good reason for newfound optimism

As described in last few monthly reports, we have seen a greater number of months with continuous improvements in macroeconomic data. Some surveys (both from businesses and from consumers) surpassed the previous highlights from the financial crisis, and it starts to resemble overoptimism.



I maintain that there is a strong momentum in the global economy right now, and very good reason for the newfound optimism. Several years after the financial crisis, consumers and businesses have become accustomed to half-depressive economic conditions, with both the labor market and general market opportunities. Surveys are showing a dramatic improvement in expectation levels right now.

I maintain that there is a strong momentum in the global economy right now

My assessment is that this is because consumers and businesses are pleasantly surprised by even a slight bit of better-than-average growth.

Against this backdrop, I do not think one should be surprised if the macroeconomic indicators will improve even further in the coming months – until the summer. The leading indicators for the US, Eurozone, Japan and China are still pointing upwards, which indicates that growth figures will improve further towards summer. Currently, there is no indication of over-optimism, but as the economy after the summer of 2017 decelerates slightly, one should also expect that the survey data and other indicators will land on a more normal level.

Is there a bubble in the stock market?

As the stock market continues to rise, you will hear more criticism about how expensive stocks are priced. In the last 12 months alone, the MSCI World in EUR generated a total return of 23%. Yet, over the past 10 years, equity investors received an annual return of 7%, which is said to be close to what one can expect in the long term.

If we look at the pricing of the MSCI World, a P/E (price/earnings ratio) of 22 admittedly seems high. For the MSCI Emerging Markets, the P/E is 15.7 – significantly cheaper and still a rather large historical discount to developed countries' shares.



Looking at CAPE (Cyclically Adjusted Price Earning), which is the price relative to average earnings over 10 years, MSCI World is now trading at about 23. Developed countries' shares are relatively expensive, but we should remember that it's not more than six months ago that investors would lend to the German state at a below-zero interest rate over a ten-year horizon. A bubble is characterized by manic investors who believe that the asset they invest in cannot fall. This can hardly be said to be the case at present, when, firstly, we are hearing so many critical voices on the pricing, and, secondly, there is willingness to invest in alternative asset classes (such as German government bonds) at very low expected returns.

Long-term investors should have a high exposure to emerging market equities

In any case, the above pricing figures indicate that long-term investors should have a high exposure to emerging market equities.

European elections and the euro

With elections in the Netherlands successfully accomplished – although without a government formation as of yet – the market's eyes are now on the French presidential election. Since last month's report, the probability of a victory for Marine Le Pen dropped slightly to 20% (according Predictwise.com). The probability of a victory for Emmanuel Macron (the EU-friendly candidate) is approximately 60%, while Francois Fillon (the market-friendly and pro-EU candidate) increased slightly to 16%.

In my assessment, the US economy and interest-rate perspectives are increasingly more attractive than the European economy

If we look at the German elections, which will take place in August or September, the probability of a victory for Angela Merkel is approximately 49%, while the social democrat Martin Schultz has a probability of victory of 31%. Frauke Petry from Germany's Alternative party (the EU-critical candidate) is only 4% likely to become Chancellor.

The EU-critical candidates have not been able to achieve enough momentum to become realistic alternatives to the status quo, which results in a stronger euro.

In my assessment, the US economy and interest-rate perspectives are increasingly more attractive than the European economy. It is still my expectation that the euro and the dollar will hit the same value in the coming months.

Economic indicators update

Our models of economic indicators continue to show that we can expect nice growth over the coming months. Leading indicators will probably continue to rise, which, with a delay of 3-9 months, will mean that growth will rise even further.

Industrial production models show that over the summer we can expect continued acceleration in all regions. Yet the models of car sales show a flattening or declining in the US and especially in Europe over the next 12 months.

The MomVol indicator

Our MomVol indicator assumed a value of 0.92 at the end of March. This is an increase from the end of February and still firmly above the threshold of 0.6, below which, you should have an underweight in the stock market.

Most of the OECD leading indicators are pointing upwards

The indicator's signal is also supported by the fact that most of the OECD leading indicators are pointing upwards. An overweight in stocks should therefore be maintained in April.

Editorial deadline: April 7 2017