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INVESTMENT MANAGEMENT & STOCKBROKING

MARKET COMMENTARY

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Will The Calm Keep And Carry On?

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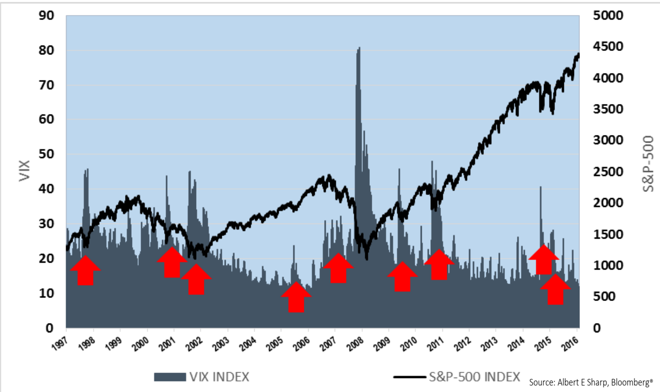
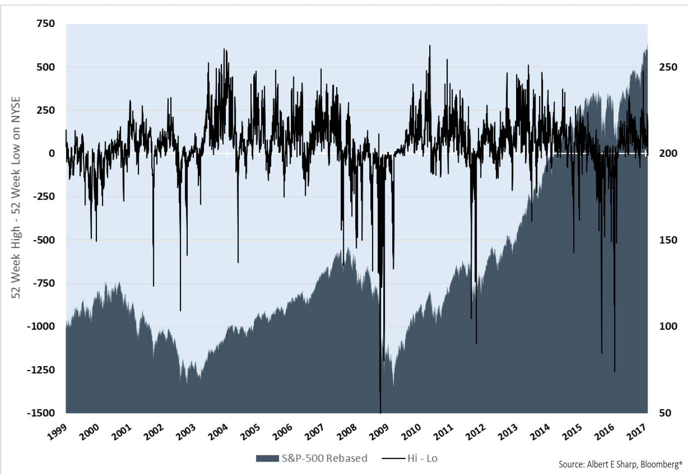
This time twelve months ago, global stockmarkets were suffering the worst start to the year since the Great Recession and the feeling of panic was palpable. Since then, the two big 'nasties' that supposedly worried investors most have actually happened (Brexit and Trump) yet share prices have soared to new highs. Despite the uncertainty as to how EU and global trade deals will play out with the UK, nervousness over how the new US administration is shaping up and fears over the European political landscape, we continue to sense a general feeling of calm among investors. There were no notable signals last month to suggest otherwise, with equities in the UK and Europe fractionally down and in the US and emerging markets fractioanlly up. Gold recovered some of its recent losses, oil slipped marginally and fixed income gave back most of December's gains.

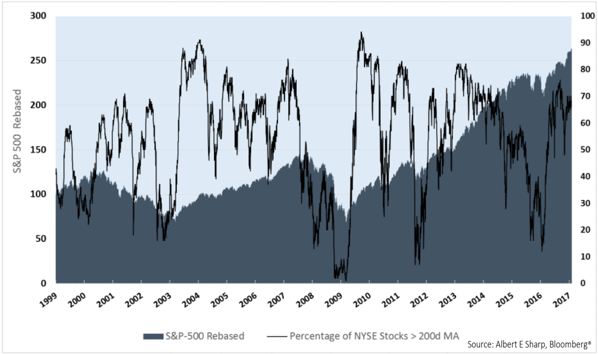
One of the common metrics that analysts use to measure the mood of the stockmarket is the VIX Index, which is technically a complex component of how options are priced but essentially shows expected volatility over the next 30 days in the S&P-500 index. Generally, there is 'calm', if the number is low and 'fear' if it is high. As the chart below shows, we are back down to the lowest levels witnessed over the last 30 years, suggesting that investors are very relaxed about the outlook. However, sentiment can change quickly and a sudden spike in the VIX frequently tends to coincide with sell-offs, as the red arrows indicate. But as is evident, the index can stay at low levels for extended periods of time too.



Another very popular signal used to observe sentiment is the *52-Week Hi-Lo* chart. As the name implies, it is the number of companies with a share price at a new high in excess of those that have just hit a new low over a rolling 1 year period. Intuitively if the number of new highs is comfortably above the number of new lows, this is seen as a bullish indicator. However, it is difficult to draw any conclusion from the chart as seen below at the moment, with the number close to zero. Arguably, if the chart has any proven worth it is for indicating moments of extreme pessimism. In other words, when spikes to the downside have appeared they often tended to have been good short-term buy



A ratio that is usually looked at alongside the *Hi-Lo* chart is the proportion of stocks with a price that is higher than their 200 day moving average, relative to the total number of companies in the index. A rising number suggests that the broader market will follow with the same happening in reverse. The current chart would confirm that is the current position, but it is not at an extreme level.



The point we are arguing is that the mood is calm and not one of over exuberance or excessive optimism that would be consistent with a market peak. Not everyone agrees, and many were alarmed when Barron's, the highly influential US investment weekly ran a front page that read "Next Stop – Dow 30,000" only days after hitting 20,000. The so called 'magazine cover indicator' is seen by many as an excellent contrarian indicator in that what then happens is the opposite of what has just been predicted. Citigroup's research team neatly explain that "the premise behind the indicator is that when a journalist or editor finally devotes a cover to a market trend, company, country or person, the story or theme has been in vogue for some time and is likely past its peak. Positioning and sentiment should already fully reflect the story on the cover of the publication and the story should be fully priced in. In other words, by the time a journalist writes about the trend, a majority of the move has already happened."

The most infamous example is probably BusinessWeek's August 1979 cover entitled "The Death Of Equities: How inflation is destroying the stock market". Inflation went on to peak only a few months later at 14% and by 1983 had fallen to 3% and the Dow Jones was 50% higher, going on to enjoy one of the biggest bull markets in history. In other examples, Fortune and Time inadvertently called the top of the housing market in 2005 and in 2009 when the Economist suggested that 'Brazil was taking off' – more than seven years later the country's main stockmarket index, the BOVESPA, is still below where it was at the time of the article. It seems obvious now that these should have been reasons to panic, to sell up and to get out..

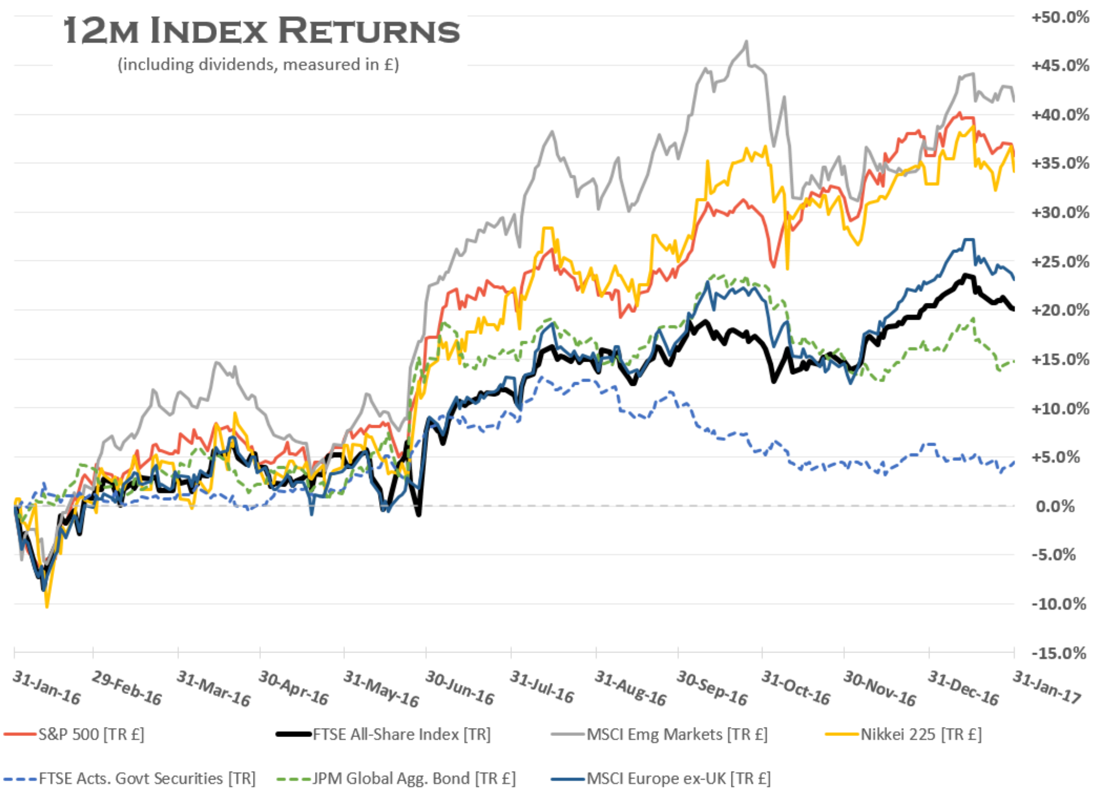
However, the Barron's 30,000 story shouldn't be put into the same 'over the top' category, because it isn't. It suggests that if Trump can avert a trade war or actual war – and the writers don't rule out such events – then expect a 50% rise by 2025. This equates to a rise of just 4.7% each year, which is lower than the number achieved in the last 10 years, including the huge fall in 2008. So the headline could have read 'expect below average returns for the next 7 years'.

Nevertheless, we continue to look for signals and just because many are false or misleading it doesn't mean that they won't have future value. We are constantly bombarded by new data, and picking out what is useful from what is irrelevant requires a combination of experience, attention to detail and cynicism. The time will come when it is prudent to rein back exposure to equities, but until we get clearer signals, 'keep calm and carry on' seems alike the right advice.

INDEX RETURNS

Index	Region/Asset Class	31-Jan-17	Monthly Change	1 Year Change	2 Year Change
UK 100	UK	7,099.15	-0.6%	+16.7%	+5.2%
UK Mid Cap	UK	518.30	-0.1%	+8.4%	+5.4%
UK Small Cap	UK	5,207.06	+1.2%	+19.3%	+17.8%
Dow Jones Ind Avg	USA	19,864.09	+0.5%	+20.6%	+15.7%
S&P 500 Index	USA	2,278.87	+1.8%	+17.5%	+14.2%
NASDAQ Comp.	USA	5,614.79	+4.3%	+21.7%	+21.1%
Nikkei 225	Japan	19,041.34	-0.4%	+8.7%	+7.7%
Euro Stoxx 50	Europe	3,230.68	-1.8%	+6.1%	-3.6%
CAC 40 Index	France	4,748.90	-2.3%	+7.5%	+3.1%
DAX Index	Germany	11,535.31	+0.5%	+17.7%	+7.9%
Milan Index	Italy	18,590.73	-3.3%	-0.4%	-9.3%
MSCI Emg Mkts (£)	Emg Mkts	475.68	+3.6%	+41.4%	+18.4%
IBOVESPA Index	Brazil	64,670.78	+7.4%	+60.1%	+37.9%
MICEX Index	Russia	2,217.39	-0.7%	+24.2%	+34.6%
S&P BSE SENSEX	India	27,655.96	+3.9%	+11.2%	-5.2%
Shanghai SE Comp.	China	3,159.17	+1.8%	+15.4%	-1.6%
Hang Seng	Hong Kong	23,360.78	+6.2%	+18.7%	-4.7%
Conventional Gilts	UK Gilts	3,463.24	-1.7%	+4.4%	+4.0%
JPM Glob Agg. Bond (£)	Global Bonds	804.59	-1.0%	+14.8%	+19.4%
WTI Crude	Oil	52.81	-1.7%	+57.1%	+9.5%
Gold Spot $/Oz	Commodities	1,210.65	+5.1%	+8.3%	-5.7%
£1 = US$	Currencies	1.26	+1.9%	-11.7%	-16.5%
£1 = €	Currencies	1.16	-0.7%	-11.4%	-12.7%
£1 = Yen	Currencies	141.89	-1.8%	-17.8%	-19.8%

Source: Albert E Sharp, Bloomberg®



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