Sparinvest

Monthly comment by
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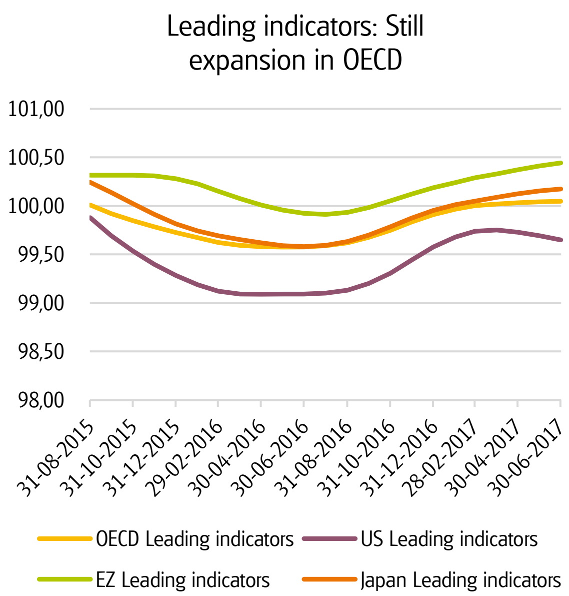
Stay in shares – but don't increase risk

The macro-economic development also shows that one should continue to have an overweight in risk-heavy actives. However, investors should be aware that the imminent phase shift means it is unwise to incur increased risk at the present time.

Revision of OECD's CLI and updating of models

The revised OECD figures for all the leading indicators (CLI) in the OECD area lead us to conclude that there will not be a phase shift in August after all. The reason for this is the indicators are still high and rising (even though the rise is very modest), which means we are still in the expansion phase.



As there were many conditions that pointed towards a continued acceleration last month, the revision does not come as a great surprise. However, it is worth bearing in mind that because of the USA's weak cyclical development, we are still approaching a phase shift.

Due to the leading indicator rise being so small, it is my opinion that a phase shift will most probably occur within the next one to three months. This is almost exclusively due to the fact that the American economy will be facing a deceleration in these months, and this deceleration will gather momentum over the coming 12 months.

"Our model for the USA's leading indicators show a consistent decline over the coming 12 months"

Our model for the USA's leading indicators show a consistent decline over the coming 12 months, although we cannot yet expect a recession. With regard to Europe, our model shows we will most probably experience a continued acceleration in the next half year, followed by a deceleration after the spring of 2018. The same picture can be seen for Japan. There are no signs that we can expect a recession in any of the above examples.

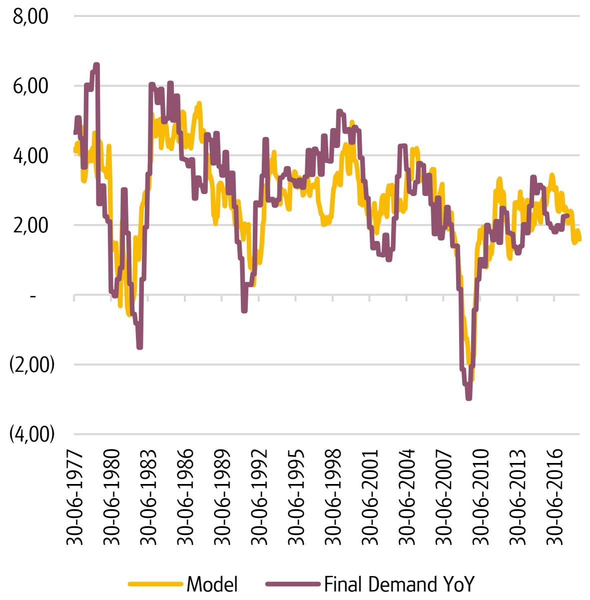
Overall, our models for new orders in both the U.S. and Europe confirm this picture. Deceleration will first hit around the spring of 2018 but it will not yet be serious enough to indicate that we can expect a recession.

Weakest prospects for the U.S.

Our model for broad demand – 'final demand' – confirms that we can expect a deceleration in the rate of growth, but this model also shows that we do not expect negative growth rates over the coming 12 months.

There is much to indicate that we have seen the best of macro-economic development, but this is particularly true of the U.S., who is furthest ahead in the trade cycle. This will have implications for the stock market and other risk-heavy actives that cannot be expected to yield such good returns as they have done since the middle of 2016 where the leading indicators began to rise again. Another phase shift has not yet occurred so, for the time being, the above considerations must be looked at as a warning not to incur more risk.

Deceleration in US growth but no recession in sight
US Final Demand Model



The Eurozone as a growth engine?

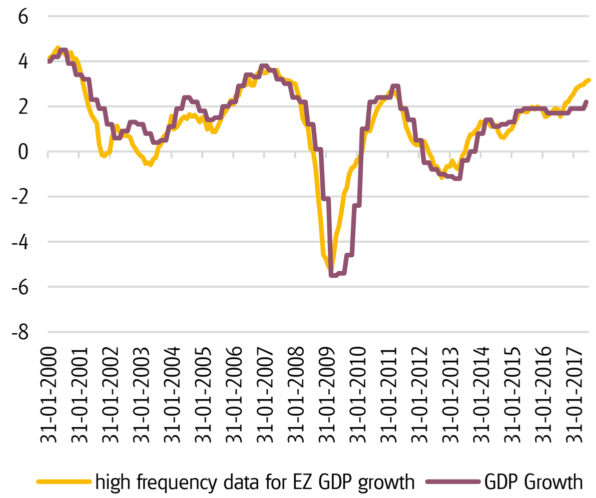
By far the majority of indicators continue to point towards continued Eurozone growth. As mentioned above, the OECD's leading indicator shows that we can expect a powerful acceleration. Our own leading indicator model shows the same results. So-called 'real time' models for the biggest EU countries all show that we can expect higher rates of growth in three quarters. For the Eurozone as a whole, the high frequency data shows that, now, we ought to see a rate of growth of over 3 percent. However, the latest BNP figures for the second quarter released a few days ago were only revised to 2.2 percent.

The PMI, IFO and ZEW figures for Eurozone businesses' expectations and assessments of the current situation are all showing respectable results – and in many cases are higher than they have been for many years.

> *"A picture of solid growth and good prospects for the Eurozone is gradually emerging"*

A picture of solid growth and good prospects for the Eurozone is gradually emerging. This is happening at a time when the American economy is looking like it is decelerating after having been the most significant growth engine among the developed countries for many years. In my opinion, it is an open question whether, despite its many hardships, the Eurozone can take over this role in some quarters.

High frequency data indicates higher rates of growth in the Eurozone



What about interest rates?

If one is to have any hope at all of success with the futile exercise of trying to predict interest rates, in my opinion one should examine the leading indicators that I have already mentioned above.

As the U.S. looks like it will be faced with a larger deceleration over the coming 12 months, and the Eurozone looks like it will cope quite well, the historically large yield spread between American and German 10-year interest will gradually be reduced over the coming six to 12 months.

"Over the coming months, strong Eurozone figures can push long European interest rates up by 20-30 basis points"

There tends to be a very strong correlation between American and European interest rates, so it is difficult to imagine being in a situation where American rates fall, for example, while European rates rise. This is why I expect that over the coming months, strong Eurozone figures can push long European interest rates up by 20-30 basis points, and that American interest rates will rise slightly as a result of this. From the end of the year and into 2018, I also expect that the American deceleration will dominate development and push long interest rates further down.

China's growth in top gear

The real and trade-weighted value of the Australian dollar has renewed its upward tendency in the last three months, as – in no uncertain terms – have industrial metals. This is certainly due in no small part to the fact that Chinese growth has again – after two years – risen to over 7 percent. As the Chinese leading indicators have risen quite dramatically since the start of the year, it looks like with China's help, global growth will still be on the rise for another few months.

"With China's help, global growth can still be on the rise for another few months"

In these months, the 12-month average of China's aggregated loans is setting new records, and the M1 money supply growth is still stable at over 15% per annum. With inflation at only 1.4 percent, there is plenty of surplus liquidity for the Chinese economy, which can also be seen in the price trends of Chinese stocks and property.

As China's economy is increasingly financed by debt, more and more debt is needed to create the same BNP growth. Also, in these years demographic development is starting to peak, and the number of business-active Chinese has in all probability peaked.

Emerging markets

South Korean stocks are currently experiencing increased volatility. This is due to North Korean atom bomb tests and missile launches over Japan, together with accompanying reactions from neighbouring countries. U.S. President Trump has done little to decrease the tension, and the Korean won has fallen significantly because of these geopolitical tensions.

The worst scenario would be if North Korea actually has developed the technology to enable it to carry an atomic bomb to a major American city. The fact that the country's technology is far advanced enough to fire missiles over Japan is already frightening, but it is an open question whether it is sophisticated enough to hit American targets.

"All in all, the disturbances around North Korea have not had any noteworthy effect on emerging markets"

All in all, the disturbances around North Korea have not had any noteworthy effect on emerging markets. MSCI Emerging Markets are dealing at a P/E of 15.8, which continues to be considerably lower than the developed countries' stock markets. At the same time, earning growth is back in the emerging markets, with a 40 percent growth since the middle of 2016.

MomVol indicator

At the end of August, our MomVol indicator showed a value of 0.90, which is lower than in the previous month and still solidly over the threshold value of 0.6, under which one should be underweight the stock market.

Editorial deadline: September 7, 2017