



## ECONOMIC SITUATION AND STRATEGY

May 3, 2019

### **Stock market keeps going despite poor data – what's going on here?**

Let's assume you have just spent six months on a desert island, completely isolated from the outside world. Now, you are flying back to real life and reading the business section of the newspaper for the first time. Soon, you rub your eyes in disbelief and start worrying because the economic data apparently know no direction but down. No matter where you look – the Ifo index is ailing, purchasing manager indexes are falling worldwide, many real-economic indicators are far below their trends of recent years, and the export data of major, heavily export-dependent countries like China, Japan, Germany, and South Korea are showing serious signs of a global downturn, particularly in manufacturing.

And as if that were not enough, the US president is still behaving like a bull in a china shop. At the same time, the German government is tripping up the German auto industry despite recession risks, while prominent politicians rant seriously about nationalizing BMW without threat of expulsion from their party.

Let's further assume that you own a sizable stock portfolio. Presumably, you would very nervously turn ahead to the financial page to see how stocks have performed in this troubling environment. If you had not indulged already, this would be the time for a glass of champagne (or beer) because you would hardly believe your eyes. Many stock indexes are quoting near their all-time highs, having advanced up to 20% (or even a little more) since the beginning of the year.

Why is the stock market playing "bizarro world"? Or is this development actually rational? What, if anything, do fundamental data tell us anyway?

Asset managers who base their decisions heavily on fundamental data, as we do, must consider this question. From a theoretical perspective, one seems to have hardly any choice but to base investment decisions on fundamental data. For, stock prices cannot decouple from earnings in the long term. Earnings simply are closely connected with general economic data. There has never been a very long market phase in which earnings rose while, e.g., capacity utilization fell.

On the bond side, there is also a fundamental connection between yields and macroeconomic data. The worse macroeconomic data are, the lower the risk of rising inflation is. Given rational investors, this should lead in turn to falling yields and hence to rising bond prices. At least according to the theory – and in this case, also practice, since the bond market has been functioning quite in line with established patterns, while the stock market appears to be going wild. Yields on long bonds have fallen in recent months, as one would expect. For example, German government bonds (Bunds) with 10 years to maturity are quoting near 0%, and the yield curve in the United States is partly inverted and thus definitely signals a rising threat of impending recession.

What should one rely on then? Is the bond market more rational than the stock market? Is this the time when it is better to sell all stocks? Is the economy in a regime where old rules and connections no longer apply?

It will never be possible to answer this question perfectly and conclusively. But after 20 years of capital market experience, the author is a little doubtful of the hypothesis that everything really is different this time. There is a saying that the most expensive four words on the stock market are: "This time it's different." And in fact, it is never the

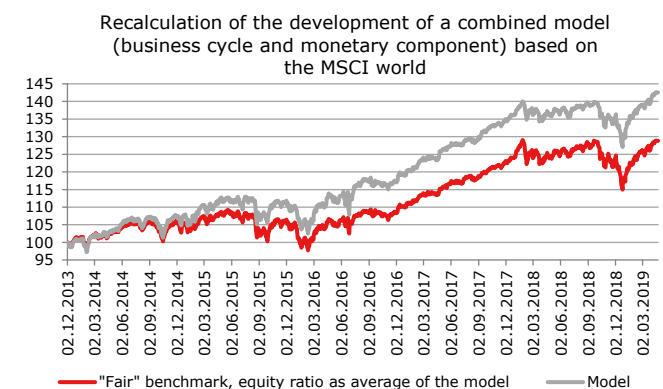
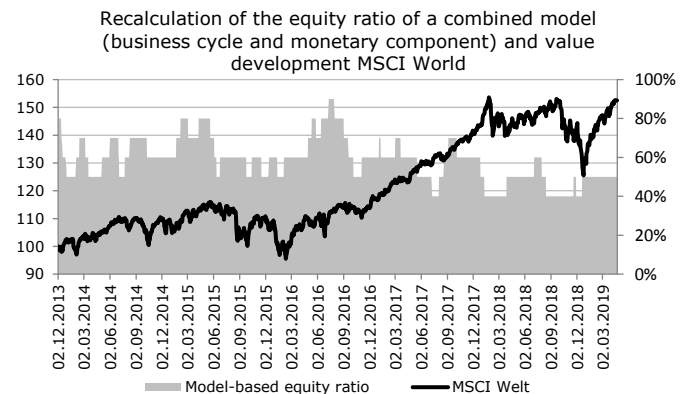
# Economic Situation and Strategy

case that everything is different on the market. At most, tendencies and facets change. Using our own databases, we have made some calculations to detect such changes.

Our macroeconomic research team has developed a business cycle model and used it since 2001 to compact a great deal of economic data into an overall number. This model served us well in the period after the dot-com bubble burst, when stock prices advanced temporarily towards the end of 2001 but the model did not give an all-clear signal from a fundamental perspective. A few months later, stock prices again took a steep dive. So, the fundamental data were ultimately right, not stock prices, which seemed sometimes out of control. A similar pattern occurred again at the end of 2007 and beginning of 2008. Many stocks were quoting near historical highs at that time (as they are now), while our business cycle model was sounding the alarm and pointing to the mounting danger of a recession, which then emerged a few months later and, together with the sub-prime mortgage and financial market crisis, led to a veritable crash on the stock market.

Honestly, however, it has become increasingly difficult in recent years to conduct forward-looking asset allocation based on economic data. It almost seems as if part of the puzzle needed to understand and to some extent forecast capital markets is missing. And here our data come into play again. We have been entering a huge amount of economically relevant model data into our database every day for the last six years. With this "trove" of data, we can bring somewhat more light into the darkness. Looking at the last six years, we can show that economic data often trend very similarly to the stock market (though not in recent months), but seldom run ahead. In sum, it would have become increasingly difficult to achieve significant added value in asset allocation based solely on economic data – the data show that very clearly in retrospect. What could the missing piece of the puzzle be that will enable us to complete the picture better? Monetary policy would be one of the usual suspects. The expansion of liquidity and central bank balance sheets has had a considerable influence on market development in recent years. Our calculations show that this effect has been observable at the global level since 2011, if not earlier, and has continued to gain importance since then. The puzzle piece that we seek would accordingly be a monetary component – or more precisely, the question how the market assesses the trend of future policy interest rates. Changes in that assessment are likely to play a principal role. If so, it should be possible to model that, e.g., by using changes in short bond yields to steer the stock ratio. We have mixed such an approach with signals from our historical business cycle model (50% on the monetary component and 50% on the

fundamental component). The quality of the results confirms that it makes sense to combine the two topic areas.



The result is so convincing that it can hardly be a matter of chance. Evidently, it is the case that monetary aspects make a good "partner" to fundamental data, if one wants to understand and anticipate what happens on the capital market. Even if it is again not the case that this time it is different, there is reason to focus more on the monetary aspect in the future and use it in asset management. But it would be foolish to dispense with fundamental data.

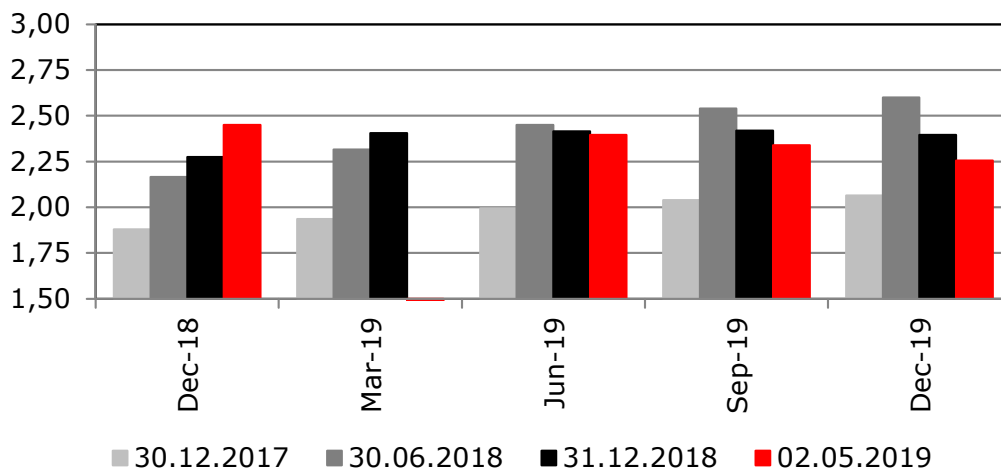
## Weekly Outlook for May 6-10, 2019

	Dec.	Jan.	Feb.	Mar.	Apr.	May	Release
DE: PMI, services, final	51.8	53.0	55.3	55.4	55.6		May 6
DE: PMI, total, final	51.6	52.1	52.8	51.4	52.1		May 6
DE: New orders, m/m	1.0%	-2.1%	-4.2%	0.0%			May 7
DE: New orders, y/y	-4.5%	-3.5%	-8.2%	-8.0%			May 7
DE: Industrial production, m/m	0.8%	0.0%	0.7%	0.5%			May 7
DE: Industrial production, y/y	-3.1%	-2.9%	-0.5%	-1.4%			May 7
DE: Exports, m/m	1.6%	0.1%	-1.3%	-0.2%			May 10
DE: Exports, y/y	1.4%	1.8%	2.8%	1.4%			May 10
DE: Imports, m/m	0.6%	1.4%	-1.6%	0.5			May 10
DE: Imports, y/y	3.6%	4.7%	4.4%	5.5%			May 10
EUR19: PMI, services, final	51.2	51.2	52.8	53.3	52.5		May 6
EUR19: PMI, total, final	51.1	51.0	51.9	51.6	51.3		May 6
EUR19: Sentix	-0.3	-1.5	-3.7	-2.2	-0.3	0.2	May 6
EUR19: Retail sales, m/m	-1.4%	0.9%	0.4%	-0.1%			May 6
EUR19: Retail sales, y/y	0.5%	2.2%	2.8%	1.9%			May 6

MMWB estimates in red

## Chart of the Week: Fed still patient

USA: Fed Funds Futures



Yesterday's FOMC meeting ended without surprises. As expected, the fed funds rate remained unchanged in a range between 2.25% and 2.50%. The Fed says it sees no reason now to change key interest rates in one direction or the other. It intends to remain patient and await future macroeconomic data. Considering the economic risks posed by the trade war, the cyclical slowdown in Europe and China, and the decline of inflation to 1.5%, some market participants were anticipating signals in the direction of a slight interest rate cut. But the Fed has not fulfilled those expectations. Powell emphasized that the Fed feels obligated to its inflation targets. He repeat-

edly said that the low inflation is only transitory, which conversely means that he does not consider an interest rate cut necessary at the moment. He has thus also to some extent reeled in the expectations of market participants who had previously speculated very confidently on a rate cut. An interest rate step is not priced in now until the end of the first quarter of 2020. Before, a rate decrease was expected by the end of December 2019.

## Market Data Overview

	As of 03.05.2019 11:28	26.04.2019 -1 week	02.04.2019 -1 month	Change versus 01.02.2019 -3 months	02.05.2018 -1 year	31.12.2018 YTD
<b>Stock markets</b>						
Dow Jones	26308	-0,9%	0,5%	5,0%	10,0%	12,8%
S&P 500	2918	-0,8%	1,8%	7,8%	10,7%	16,4%
Nasdaq	8037	-1,3%	2,4%	10,6%	13,2%	21,1%
DAX	12393	0,6%	5,4%	10,8%	-3,2%	17,4%
MDAX	25978	0,3%	3,3%	9,4%	-1,3%	20,3%
TecDAX	2889	-0,3%	6,2%	14,8%	7,3%	17,9%
EuroStoxx 50	3505	0,1%	3,2%	10,5%	-1,4%	16,8%
Stoxx 50	3199	0,3%	1,3%	10,0%	3,3%	15,9%
SMI (Swiss Market Index)	9774	0,5%	2,5%	8,6%	9,9%	16,0%
Nikkei 225	22259	0,0%	3,5%	7,1%	-1,0%	11,2%
Brasilien BOVESPA	95528	-0,7%	0,1%	-2,4%	13,0%	8,7%
Russland RTS	1245	-0,2%	2,3%	2,8%	9,5%	16,7%
Indien BSE 30	39061	0,0%	0,0%	7,1%	11,0%	8,3%
China Shanghai Composite	3078	-0,3%	-3,1%	17,6%	-0,1%	23,4%
MSCI Welt (in €)	2161	-0,8%	1,8%	9,5%	12,0%	17,8%
MSCI Emerging Markets (in €)	1079	-0,1%	1,2%	5,7%	0,9%	14,7%
<b>Bond markets</b>						
Bund-Future	165,24	-58	-87	-26	665	170
Bobl-Future	132,86	-22	-29	-12	191	34
Schatz-Future	111,92	-3	-8	0	1	-2
3 Monats Euribor	-0,31	0	0	0	2	0
3M Euribor Future, Dec 2017	-0,31	0	0	-6	-31	0
3 Monats \$ Libor	2,58	-1	-3	-16	21	-23
Fed Funds Future, Dec 2017	2,27	6	5	-11	-36	0
10 year US Treasuries	2,56	6	8	-13	-40	-12
10 year Bunds	0,04	6	9	-13	-54	-21
10 year JGB	-0,04	1	3	-1	-8	-4
10 year Swiss Government	-0,28	12	14	3	-37	-4
US Treas 10Y Performance	592,95	-0,3%	-0,3%	1,7%	6,2%	2,1%
Bund 10Y Performance	644,27	-0,4%	-0,7%	1,4%	6,9%	2,7%
REX Performance Index	491,19	-0,2%	-0,2%	0,4%	2,5%	0,7%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,44	1	-2	-30	-38	-44
IBOXX BBB, €	1,27	-2	-15	-57	-18	-79
ML US High Yield	6,56	1	-14	-55	4	-145
JPM EMBI+, Index	834	0,3%	-0,7%	0,1%	4,4%	5,3%
Convertible Bonds, Exane 25	7314	0,0%	1,1%	4,0%	-1,6%	6,1%
<b>Commodities</b>						
CRB Spot Index	418,41	-1,0%	-1,9%	1,3%	-6,2%	2,3%
MG Base Metal Index	303,83	-2,2%	-4,3%	-1,5%	-13,0%	3,1%
Crude oil Brent	70,29	-2,3%	1,1%	13,1%	-3,4%	32,3%
Gold	1269,40	-1,4%	-1,6%	-3,7%	-2,8%	-0,9%
Silver	14,63	-2,9%	-3,0%	-8,3%	-10,9%	-5,7%
Aluminium	1796,50	-1,5%	-3,5%	-3,4%	-22,8%	-3,6%
Copper	6166,00	-3,6%	-3,9%	0,8%	-9,1%	3,6%
Iron ore	93,60	0,5%	4,6%	7,7%	38,8%	35,3%
Freight rates Baltic Dry Index	1032	16,1%	53,1%	60,0%	-23,3%	-18,8%
<b>Currencies</b>						
EUR/ USD	1,1153	0,2%	-0,4%	-2,8%	-7,1%	-2,6%
EUR/ GBP	0,8576	-0,6%	-0,1%	-2,1%	-2,5%	-4,5%
EUR/ JPY	124,36	-0,1%	-0,3%	-0,4%	-5,7%	-1,2%
EUR/ CHF	1,1384	0,1%	1,7%	-0,1%	-4,8%	1,0%
USD/ CNY	6,7337	0,0%	0,1%	-0,1%	5,8%	-2,1%
USD/ JPY	111,52	-0,1%	0,2%	1,8%	1,5%	1,8%
USD/ GBP	0,77	-0,5%	0,2%	0,7%	4,6%	-2,0%

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