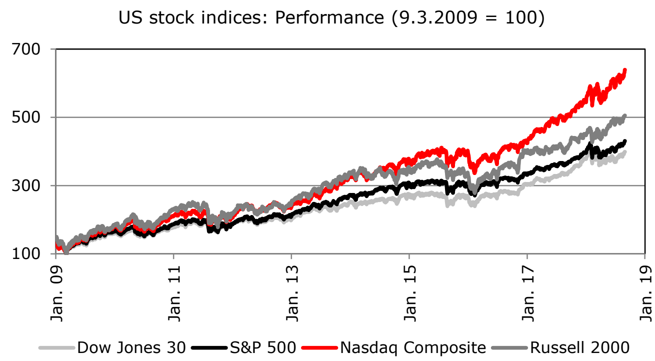
ECONOMIC SITUATION AND STRATEGY

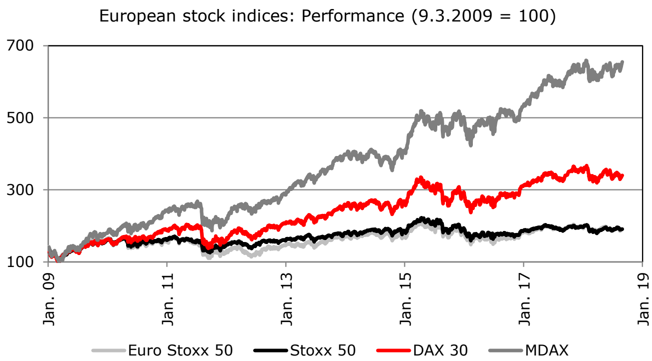
August 31, 2018

Stock markets: No end in sight of record-breaking climb in the US

The United States is still the country that breaks records. Last Wednesday, the S&P 500 marked the longest advance in its history. Since its low of March 9, 2009, the index has climbed without a 20% correction for more than 3,450 days. That surpasses the previous record set between 1990 and 2000. In the period from 2009 to 2018 the S&P 500 gained more than 320% in value, and the Dow Jones 30 almost 300% (each in USD). The stocks of smaller US companies that form the Russell 2000 have done even better, increasing in value by more than 400%. However, the top performer in the United States is clearly the tech-oriented NASDAQ, which has gained over 500% since March 2009 and has thus far outshone most other well-known stock indexes.



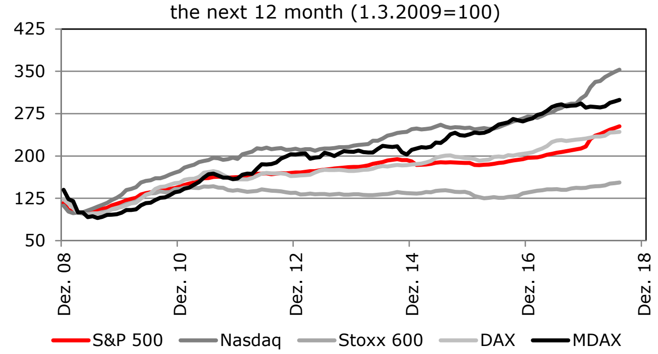
In international comparison, the US bull market has moved the fastest by far. The European Stoxx 50 and Euro Stoxx 50 indexes have only managed to gain a comparatively modest 90% in the past nine and a half years. However, German stocks in the DAX 30 have done better with an increase of 240%. Those in Germany who ventured into the second tier of listed companies and invested in the MDAX at that time saw a plus of just over 550% and thus almost surpassed US tech stocks.



Even though the S&P's entire value increase in this cycle (so far) has lagged behind the trend of the 1990s, probably very few would have expected such a long upswing in March 2009. At that time, the world economy and financial system were in an extremely precarious situation due to the bursting of the US real estate bubble and collapse of Lehman Brothers in September 2008. Thanks to the Federal Reserve's dauntless intervention and unconventional monetary policy, the economy managed to regain its footing and the stock markets recovered. However, the path to new record levels was by no means a straight line. For example, the rapid increase of government debt after the crisis almost brought the bull market to an end in August 2011, when Standard & Poor's downgraded the credit rating of the United States. The S&P 500 initially dropped steeply, but managed to recover subsequently. Another threat to the stock market upswing arose between summer 2015 and the beginning of 2016, after China devalued its currency and the oil price and other commodity prices came under pressure. But that weak spell also turned out to be only a brief episode.

To what may we attribute the good performance of the US stock markets, in particular, and what conclusions may we draw from that for the months ahead? Corporate earnings are the most important factor for price performance. Thanks to the stronger economic recovery in the United States compared with Europe, the earnings of US companies have developed substantially better since 2009. The earnings of companies in the pan-European Stoxx 600 index, for example, are only negligibly higher today than in 2009. On the other hand, the situation looks better in the case of companies in the DAX and especially the MDAX indexes. This reflects the stronger economic upswing in Germany compared with other European countries and the higher profitability of small and medium-sized companies. For a long time, the MDAX companies were even able to keep pace in earnings development with US tech stocks, and that did not change until this year due to the better economic situation in the United States and positive effects of the tax reform.

Stock markets: earnings and earnings expectations for the next 12 month (1.3.2009=100)



Of the 19 different sectors in the Stoxx 600, only the automobile sector has been able to raise its earnings level significantly. Starting from a low level, the personal and household goods, technology, and travel and leisure sectors have at least managed to double their earnings. However, almost ten years after the big crisis, earnings in the utilities, telecommunications, banking, and oil and gas sectors are still below their spring 2009 levels. On the other hand, all eleven sectors of the S&P 500 exhibit a higher earnings level. Earnings have more than tripled in the consumer discretionaries sector (thanks largely to Amazon and Netflix) and almost tripled in the technology sector. In contrast to Europe, earnings are significantly higher today than before the crisis mainly for US financial companies, but also telecommunications companies, utilities, and energy companies are earning more now than in March 2009.

Fundamental conditions suggest that US stock markets will continue to show better performance than many others in the near future. Europe, Japan, and emerging countries are suffering significantly more than the United States from uncertainties due to the trade disputes fomented by President Trump. Consumers and businesses in the United States are benefiting from the effects of the tax reform, higher government spending (e.g., for defense), and deregulation. Consequently, economic growth there should continue to be above 3% and hence significantly higher than in most other countries in the coming quarters. The economic strength of the United States will lead to a more than proportionate increase of earnings again in the quarters ahead. After rates of increase of 25% in the first half of 2018, earnings growth should only slow slightly to near 20% in the second half, with lower taxes accounting for about half of that. Another earnings increase of about 10% is expected for next year, and earnings expectations have recently been revised upward.

On the other hand, in contrast to the United States, earnings expectations for European countries this year have been lowered somewhat, and year-on-year growth rates are likely to be about 5%. Despite the fact that US stocks are valued higher than European stocks, we nevertheless recommend focusing on the United States. The higher valuation of US stocks is not likely to become a problem until US companies are no longer able to increase earnings in line with expectations. However, as long as the economy cooperates, that risk should be low.

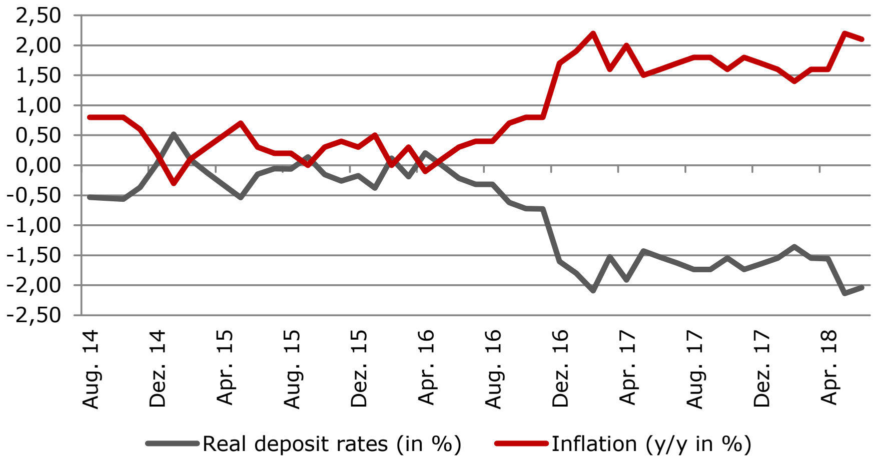
Weekly outlook for September 3-7, 2018

	Mar.	Apr.	May	June	July	Aug.	Release
DE: PMI, manufacturing, final	58.2	58.1	56.9	55.9	57.3	56.1	Sept. 3
DE: PMI, services, final	53.9	53.0	52.1	54.5	54.4	55.2	Sept. 5
DE: New orders, m/m	-0.6%	-1.6%	2.6%	-4.0%	1.5%		Sept. 6
DE: New orders, y/y	3.0%	0.9%	4.7%	-0.8%	1.5%		Sept. 6
DE: Industrial production, m/m	1.4%	-1.3%	2.4%	-0.9%	0.7%		Sept. 7
DE: Industrial production, y/y	3.6%	1.4%	2.9%	2.5%	3.3%		Sept. 7
DE: Exports, m/m	1.4%	-0.1%	1.6%	0.1%	0.2%		Sept. 7
DE: Exports, y/y	4.1%	3.1%	3.6%	5.7%	5.7%		Sept. 7
DE: Imports, m/m	-0.4%	2.5%	0.7%	1.3%	0.1%		Sept. 7
DE: Imports, y/y	2.4%	4.3%	4.3%	8.9%	7.0%		Sept. 7
EUR19: PMI, manufacturing, final	56.6	56.2	55.5	54.9	55.1	54.6	Sept. 3
EUR19: Producer prices, m/m	0.0%	0.0%	0.8%	0.4%	0.2%		Sept. 4
EUR19: Producer prices, y/y	2.0%	1.9%	3.0%	3.6%	3.8%		Sept. 4
EUR19: PMI, services, final	54.9	54.7	53.8	55.2	54.4	54.4	Sept. 5
EUR19: Retail sales, m/m	0.6%	-0.2%	0.3%	0.3%	0.2%		Sept. 3

MMWB estimates in red

Chart of the Week: Negative portfolio return due to savings deposits

Real deposit rates for households in Germany



The monetary wealth of German households is growing. It increased from EUR 5.665 trillion at the beginning of 2017 to EUR 5.875 trillion in the first quarter of 2018. That represents a nominal plus of 3.7%, or a significantly weaker 2.2% in real terms. This still appears relatively encouraging at first sight, but it is not because of Germans' investing skills. Their propensity to save is the real reason. This "saving nation" has only been able to increase wealth by means of active asset accumulation. The total return on monetary assets – consisting of securities, claims on insurance companies, and savings deposits – was actually even negative. While the value contribution from claims on insurance companies was still positive, only negative returns could be achieved with securities and bank deposits in the first quarter of 2018. The negative real interest on savings deposits especially has diminished the monetary wealth of German households. There are two reasons for this. One is that bank deposits are the largest portfolio component at just under 40%. The other is that nominal interest rates remain historically low while inflation rates have started to rise again. The result is a negative real interest rate of more than 2%. But even this guaranteed loss of wealth does not seem to keep the Germans away from their beloved savings accounts.

Market data overview

Stock marktes	As of 31.08.2018 12:49	Change versus 24.08.2018 -1 week	30.07.2018 -1 month	30.05.2018 -3 months	30.08.2017 -1 year	29.12.2017 YTD
Dow Jones	25987	0,8%	2,7%	5,3%	18,7%	5,1%
S&P 500	2901	0,9%	3,5%	6,5%	18,0%	8,5%
Nasdaq	8088	1,8%	6,0%	8,4%	27,0%	17,2%
DAX	12391	0,0%	-3,2%	-3,1%	3,2%	-4,1%
MDAX	26930	0,4%	0,2%	2,2%	9,8%	2,8%
TecDAX	3005	0,8%	3,2%	7,4%	33,0%	18,8%
EuroStoxx 50	3398	-0,9%	-3,3%	-1,3%	-0,2%	-3,0%
Stoxx 50	3049	-0,7%	-3,3%	-0,9%	1,1%	-4,1%
SMI (Swiss Market Index)	8984	-0,8%	-2,0%	4,7%	1,5%	-4,2%
Nikkei 225	22865	1,2%	1,4%	3,8%	17,2%	0,4%
Brasilien BOVESPA	76404	0,2%	-4,8%	-0,5%	7,8%	0,0%
Russland RTS	1080	1,4%	-7,1%	-7,1%	-0,4%	-6,5%
Indien BSE 30	38645	1,0%	3,1%	10,7%	22,1%	13,5%
China Shanghai Composite	2725	-0,2%	-5,0%	-10,4%	-19,0%	-17,6%
MSCI Welt (in €)	2182	0,3%	1,8%	3,7%	14,5%	6,7%
MSCI Emerging Markets (in €)	1058	0,1%	-2,7%	-5,1%	-0,6%	-6,0%
Bond markets						
Bund-Future	163,14	5	171	112	-200	146
Bobl-Future	132,19	-2	57	-38	-97	58
Schatz-Future	111,98	0	6	-21	-28	1
3 Monats Euribor	-0,32	0	0	0	1	1
3M Euribor Future, Dec 2017	-0,29	0	1	-5	-8	0
3 Monats $ Libor	2,31	0	-3	1	100	62
Fed Funds Future, Dec 2017	2,23	1	0	14	85	0
10 year US Treasuries	2,85	1	-13	0	71	44
10 year Bunds	0,35	0	-5	0	6	-8
10 year JGB	0,11	1	1	8	10	6
10 year Swiss Government	-0,10	1	-10	-2	4	3
US Treas 10Y Performance	565,73	-0,2%	1,2%	0,1%	-4,2%	-2,7%
Bund 10Y Performance	620,46	0,0%	1,1%	0,7%	1,7%	2,2%
REX Performance Index	484,16	-0,2%	0,1%	-0,3%	-0,1%	0,7%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,74	3	-5	-4	6	6
IBOXX BBB, €	1,64	3	5	4	38	41
ML US High Yield	6,49	0	-5	-7	41	34
JPM EMBI+, Index	777	-0,9%	-2,9%	-2,5%	-7,2%	-7,0%
Convertible Bonds, Exane 25	7476	0,0%	0,9%	1,4%	4,9%	1,1%
Commodities						
CRB Spot Index	410,96	-0,4%	-5,0%	-7,9%	-5,6%	-5,0%
MG Base Metal Index	314,02	1,0%	-0,8%	-10,9%	-7,2%	-12,5%
Crude oil Brent	77,29	1,4%	3,0%	0,3%	49,2%	16,0%
Gold	1205,61	-0,2%	-1,5%	-7,4%	-7,9%	-7,5%
Silver	14,56	-2,2%	-6,2%	-11,9%	-16,5%	-14,4%
Aluminium	2111,50	1,9%	1,8%	-6,7%	2,1%	-6,4%
Copper	6062,50	-0,5%	-2,6%	-11,2%	-10,1%	-15,9%
Iron ore	67,21	-0,4%	4,7%	1,8%	-10,5%	-5,7%
Freight rates Baltic Dry Index	1614	-4,9%	-5,2%	54,9%	36,7%	18,2%
Currencies						
EUR/ USD	1,1655	0,6%	-0,2%	0,2%	-2,2%	-2,8%
EUR/ GBP	0,8965	-0,9%	0,6%	2,5%	-2,8%	1,0%
EUR/ JPY	129,11	0,1%	-0,5%	1,9%	-1,6%	-4,4%
EUR/ CHF	1,1267	-1,1%	-2,9%	-2,1%	-1,4%	-3,7%
USD/ CNY	6,8335	0,3%	0,2%	6,4%	3,6%	5,0%
USD/ JPY	110,99	-0,2%	-0,1%	1,9%	0,7%	-1,5%
USD/ GBP	0,77	-1,1%	1,1%	2,1%	-0,6%	4,1%

Carsten Klude
+49 40 3282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com

Bente Lorenzen
+49 40 3282-2409
blorenzen@mmwarburg.com

Julius Böttger
+49 40 3282-2229
jboettger@mmwarburg.com