

<http://blog.en.erste-am.com/2017/01/05/the-year-2016-was-full-of-broken-trends-on-the-stock-exchanges/>

The year 2016 was full of broken trends on the stock exchanges

Harald Egger



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Another year has passed, and it is time to look back. The year on the stock exchanges started out worse than in a long time. After only a few trading days, losses averaged 10%. The fear of economic turbulences originating in China dominated the markets. Meanwhile the currency of choice during a crisis, gold, was picking up speed, gaining 20% within a short period of time.

The equity markets hit their lows around mid-February. Global equities (as measured by the MSCI World index) had shed 17% by then. Surprisingly it was the central banks (above all Mario Draghi) that managed to calm the investors and herald a trend reversal on the equity markets. However, the change in sentiment did not mark a return to a normal state of affairs on the equity market: trends that had existed for years were broken, and the preference of investors turned significantly. At the beginning of the year, investors preferred companies with strong dividends; low interest rates and bond yields had driven conservative investors to the equity market. They preferred “boring” sectors such as utilities and telecoms, i.e. not sectors excelling in earnings growth, but in attractive dividends. Momentum and high growth failed to meet the initial euphoria.

Trend reversal in commodities as crucial factor for stock exchanges

The trend reversal of the oil price was a crucial factor for the stock exchanges. Commodities (sector: materials), which had been caught in a sustainable downward trend since mid-2014, finally bottomed out and embarked on an upward trend from mid-March onwards. As a result, two sectors, i.e. energy and materials, took centre stage and eventually left all other sectors far behind them in terms of 2016 performance. At +25.8% the energy sector closed the year in first place, followed by materials (+22.5%). Only the IT sector managed to somewhat keep up at +10.3%. Conservative sectors such as healthcare or consumer staples ended up far down the list.

PERF LOC. CURRENCY	2016	2015	2014	2013	2012
ENERGY	25,82%	-21,97%	-10,54%	16,25%	-1,75%
MATERIALS	22,50%	-12,79%	-0,70%	4,24%	8,13%
INDUSTRIALS	11,99%	-0,97%	4,35%	32,96%	14,48%
FINANCIALS	10,93%	-1,45%	6,52%	27,79%	25,08%
IT	10,28%	4,43%	16,87%	28,85%	12,81%
UTILITIES	4,89%	-6,15%	17,44%	9,42%	-2,01%
TELECOM	4,63%	3,75%	1,51%	28,35%	1,16%
CONSUMER STAPLES	2,27%	7,29%	9,98%	19,28%	10,05%
CONSUMER DISCR.	1,46%	3,98%	2,45%	37,27%	22,32%
HEALTH CARE	-5,18%	9,16%	23,45%	37,48%	18,02%

Chart 1

Historical performance data are not indicative of the future performance. The chart is based on referential indices.

Presentation before fees and taxes. Source: Bloomberg (31 December 2016)

Emerging markets stock exchanges benefit from the improvement on the commodity markets

The trend reversal on the commodity markets sparked the interest in selected emerging markets. Brazil – dominated by commodities – recorded an increase of 74% (in EUR) in 2016. Russia – the proverbial oil market – failed to match that performance at a still remarkable +50%. Overall the performance of certain emerging markets was enough to push the overall emerging markets performance ahead of the performance of the developed economies. This was unlike anything we had seen in the previous six years. The trend reversal on the commodity markets was followed suit by a general trend reversal in investor behaviour. Value shares, out of fashion for a long time, launched a remarkable comeback in 2016 at the expense of momentum and growth shares, which for a long time had been the investors' first choice. Growth shares had outperformed value shares for the extraordinarily long period of ten years. This resulted in an according positioning of most of the investors, who were often having massive problems matching the market performance. This is not unusual at times when long-term trends are going through a reversal.

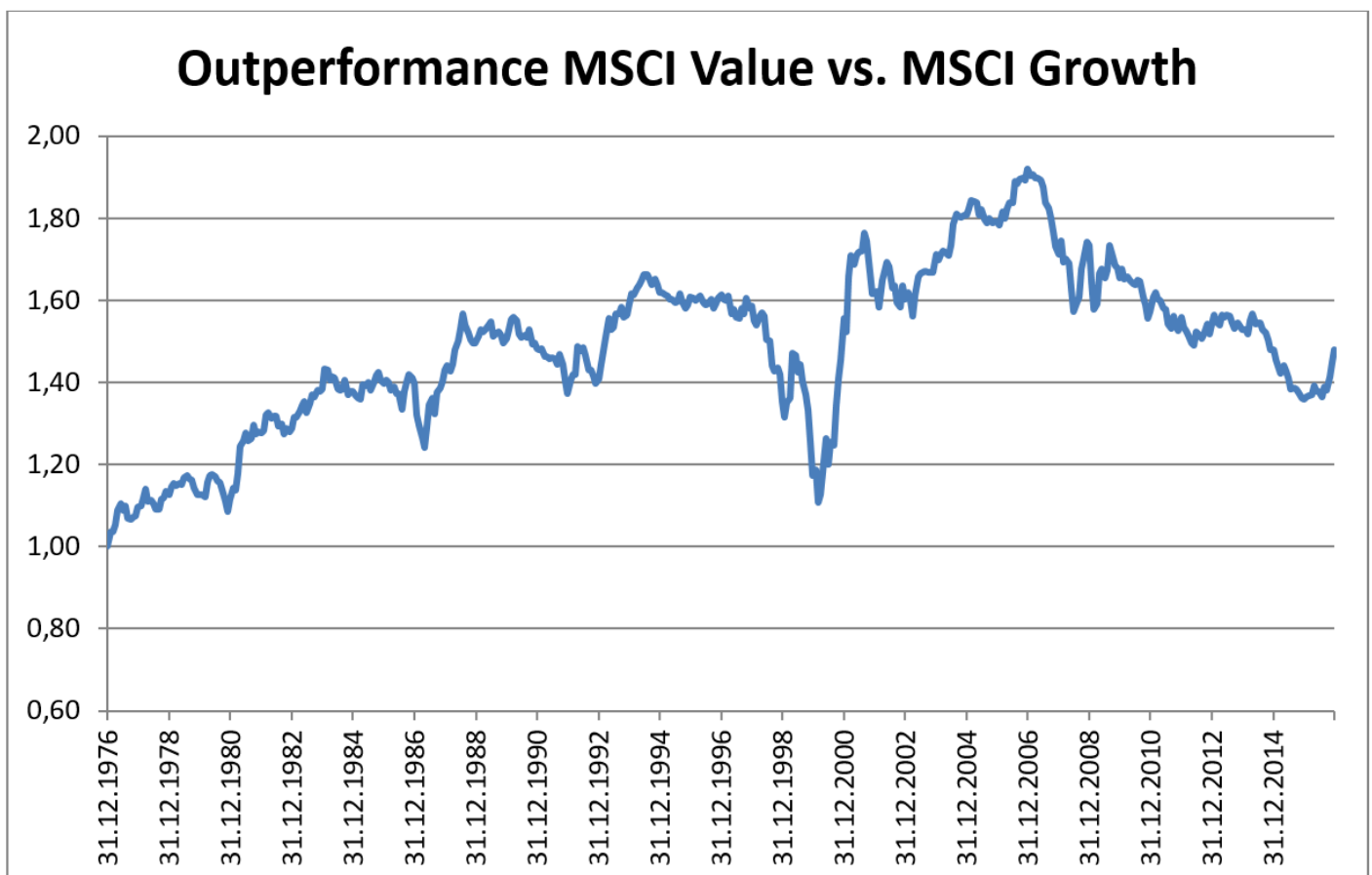


Chart 2, source: Thomson Financial Datastream

Historical performance data are not indicative of the future performance. The chart is based on referential indices.

Bank shares recorded a drastic increase

In summer 2016 the reflation trend continued, and bank shares embarked on a phase of strong outperformance. After all, a steeper yield curve benefits banks as well. This caused the outperformance of the value segment to speed up yet again, as chart 2 illustrates.

The surprising Brexit decision by the British citizens was causing short-lived jitters on the equity side. The British pound was more badly affected. But the weakness of the British pound supported the export-oriented UK companies, as a result of which the British market came in no. 1 among the developed European stock exchanges.

Trump's election victory makes deflation fear fade into the background

The fear of deflation, which had extended into the beginning of 2016, is gradually waning. While Trump's election victory in November did not set off this development, it did fuel it. As surprising as Trump's victory may be, much of what he has announced or plans to do is inflationary. Apparently, this calms the majority of investors.

Many people expected greater frictions on the markets as a result of a positive Brexit vote and a victory by Donald Trump. In 2016 many investors had to learn again that political markets have short legs. – An old stock exchange rule that was confirmed yet again.

The deflation fear has been fading into the background among investors, and optimism is on the rise. A development few would have expected. However, that optimism has to be supported by action, which means that 2017 will definitely not be less any exciting than 2016.

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Harald Egger

Harald Egger is Chief Analyst and has worked at Erste Asset Management since 2001. Previously he worked for four years as a fund manager and analyst for AXA Investment Management in London. He headed the equity segment within Erste Asset Management and was CIO until April 2013. He has been employed in the finance industry since 1992.