ERSTE Asset Management

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https://blog.en.erste-am.com/2015/07/01/upswing-equity-markets-expected-second-half-year/

Upswing in equity markets expected for second half of the year

Paul Severin

Developed equity markets are in the 6th year of a robust upward move. The MSCI Developed World Index rose by almost 18% per annum over the period (Mar 2009-June 2015) in Euro-terms. However, momentum has stalled in recent months. Stepan Mikolasek, new head of equity management of Erste Asset Management, names the main reasons: surprisingly weak US economic growth in the first quarter, concerns about China’s economy, the fear of a Fed rate hike and growing risk related to the Greek situation.

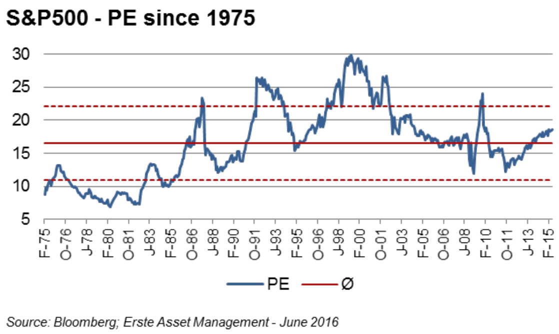
“Despite current headwinds for globalequities, a number of factors suggest that there is room for another upleg in the second half of the year”, says Mikolasek. Economists expect that US growth will re-accelerate in the course of the year, the Eurozone economy is growing faster than anticipated, and outside the US monetary policy of the main central banks (particularly European Central Bank, Bank of Japan) remains extremely accommodative.

Equity valuation not stretched

Equity valuation in developed markets, while not in cheap territory anymore is not particularly stretched. After the recent correction, US equities (S&P 500) are trading on 15.6 times estimated 2016 earnings, while the respective multiple for European stocks (Euro Stoxx 600) is 14.4. First quarter earnings confirmed that the earnings momentum in both markets remains supportive. Mikolasek: “Particularly in Europe, analysts forecast double-digit earnings growth both in 2015 and 2016.”

Stepan Mikolasek, Leiter Aktienfondsmanagement

Price-Earnings-Ratio of US-equities (measured with Standard & Poors 500 Index) 1975 – 2015



Risks are still considerable

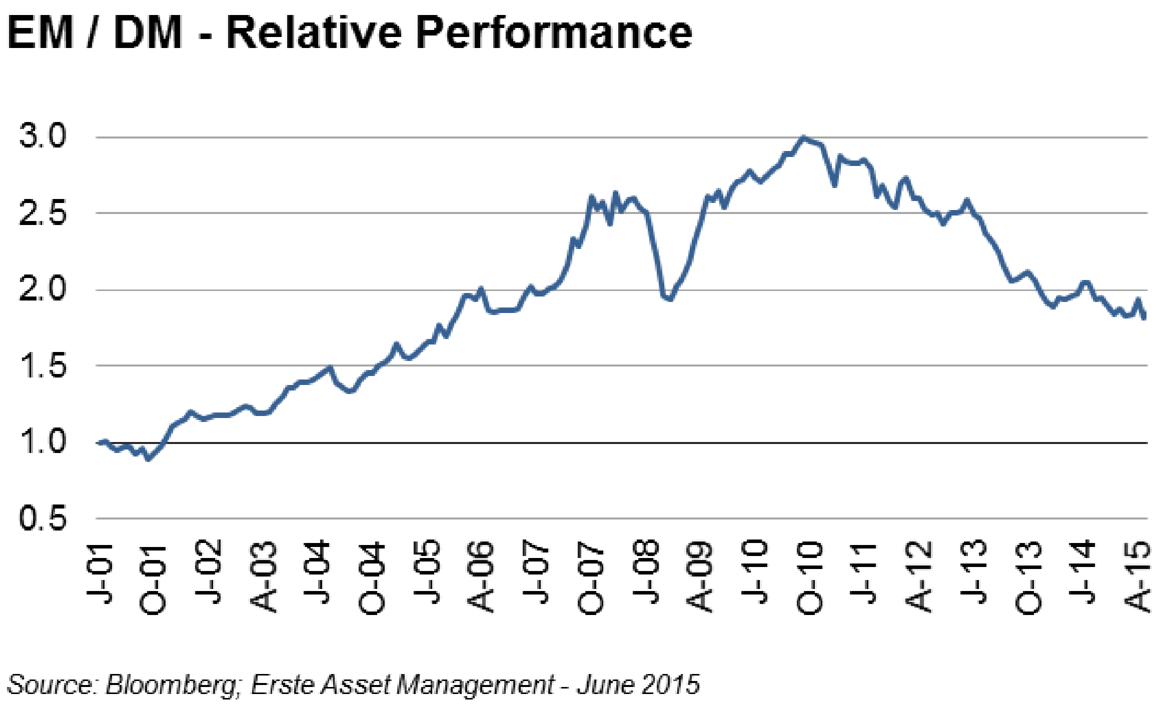
The rate lift-off by the Federal Reserve Bank remains a risk and could put pressure on risky assets, including stocks. That said, empirical evidence from previous rate cycles shows that – depending on economic circumstances, particularly the growth and inflation outlook – the negative impact from rising rates could be short-lived.

In the current situation, the surprise factor should be close to nil, given that the upcoming Fed move has been widely discussed for more than year and the path toward higher rates will be less steep than in previous cycles.

Emerging markets equities lag behind

Emerging market (EM) indices have been lagging their developed market (DM) peers since 2010. This is due to a number of developments. Peter Szopo, chief equity analyst of Erste Asset Management: “Probably the key reason is the shrinking gap between economic growth in EM and in DM, which after reaching 5-6 percentage points in the mid-2000s is now down 2-2.5%”.

Relative Performance of Emerging Markets (MSCI World Emerging markets) equities vs. Developed Markets equities (MSCI World Developed markets) (2001-2015)



Moreover, the end of the commodity super-cycle, which benefited important emerging economies, slowing economic reforms and political uncertainty have held back EM stock markets. Peter Szopo has no illusions about this: “None of these factors will significantly improve in the near-term.”

In addition, the rising risk-aversion of investors in the course of the unfolding Greek crisis will provide additional headwind. Valuation of EM equities, on average, is benign with the MSCI trading on 12.4x trailing earnings, and earnings will likely recover in 2015 and 2016. Szopo: “However, on its own, valuation will likely not be sufficient to trigger a rerating of EM equity

Peter Szopo: Chief equity strategist Erste Asset Management

markets."

Regional focus on European Stocks
Preferred equity sectors: Health care, Technology and Consumer discretionary

Erste Asset Management prefers European stocks in the global equity fund ESPA STOCK GLOBAL. On a sector level Health care equities, Technology and Consumer discretionary stocks are the favoured choice.

Paul Severin

Paul Severin has worked at Erste Asset Management since April 2008. Until 2012 he was responsible for the company's product management; he has directed communications and PR activities since April 2012. From 1992 to 2008, he was director of equity fund management and deputy director for institutional funds at Pioneer Investments Austria in Vienna.

His career in the securities business began in 1992 at Constantia Privatbank as a portfolio manager and analyst. He worked as primary analyst at Creditanstalt Investmentbank in Vienna from 1994 to 1999.

He studied international business at Innsbruck University and Marquette University in Milwaukee, WI, USA. Before his university studies, he worked at Dornbirner Sparkasse in letters of credit and export financing.

Paul Severin is a member of the board at ÖVFA (Austrian Association for Financial Analysis and Asset Management) and a CEFA charter holder.