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Are global equity markets too expensive?

Paul Severin

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Interview with Peter Szopo, equity strategist Erste Asset Management (EAM) and Andreas Rieger, fund manager of ESPA STOCK GLOBAL

ESPA STOCK GLOBAL is an actively managed equity fund that invests in selected single stocks from around the world. In the last year the fund gained 14.31%, over the last five years the annualized performance was 10.45% p.a. *). For equity investors, the new year started very turbulent. I have asked Peter Szopo, our equity strategist and Andreas Rieger, fund manager of the ESPA STOCK GLOBAL about the latest developments (esp. China, interest rate cycle, valuation etc.) and how they navigate the global equity portfolio in this environment.

Infobox: The ESPA STOCK GLOBAL fund is an actively managed equity fund that invests in single stocks from around the world. Besides the developed markets the investment universe also includes emerging markets. The investment process is based on a fundamental company analysis. The selection of stocks focuses on high quality growth companies that are attractively valued. The stocks are equally weighted and the fund ESPA STOCK GLOBAL is managed independently from a benchmark.

***) The performance is calculated in accordance with the OeKB method. It already includes the management fee. However, the illustration is net of the one-off load of up to 5,00 %, which falls due at the time of purchase, and of other fees that reduce the return as well as of the individual account and deposit fees. Past performance is not a reliable indicator of the future performance of a fund.**

Peter, the start into the new year has been more than bumpy on the equity markets. Do investors have to brace themselves for a difficult year?

Foto: Peter Szopo, Chief Equity Strategist, EAM

Yes. Although I am fairly confident that we will see a recovery after the turbulent start, volatility will remain high. For one thing, the interest rate turnaround in the USA is causing uncertainty. The question is what path to expect in the wake of the interest rate hike in December, and how the American economy and emerging markets will react to the new situation. Add to that the turbulences in China and the volatility on the commodity markets…

Many eyes are looking at China. What do you expect will happen?

The transformation of the Chinese growth model from an investment-based to a consumption-based model makes sense and has been expected by economists and investors. But a transformation process like this one comes with frictions, even more so since in this case we are talking about the world's biggest economy, going by certain criteria. In addition, China is bit of a black box, because it is hard to fully trust the economic data, and economic policies are often erratic. The crucial question will be whether Chinese authorities push for a pronounced devaluation, as many currently fear. This would directly have a negative impact on emerging markets.

What sort of impact do commodity markets have on global equities?

Falling commodity prices are seen as sign of a weakening global economy, which, of course, equity investors do not appreciate. Also, the decline in commodity prices supports deflationary tendencies that we have witnessed on a global scale, which makes monetary policy even more difficult, given that interest rates are already hovering around the zero lower bound.

In the USA further moderate interest rate increases are expected. What sort of impact will that have on equities?

Past experience of initial interest rate hikes after extended periods of stable rates has shown that volatility will be elevated for a few weeks or months. But at least in the two most recent cases, i.e. in 1999 and 2004, keyUS and European equity indices had passed the level prior to the rate lift-off after twelve months.

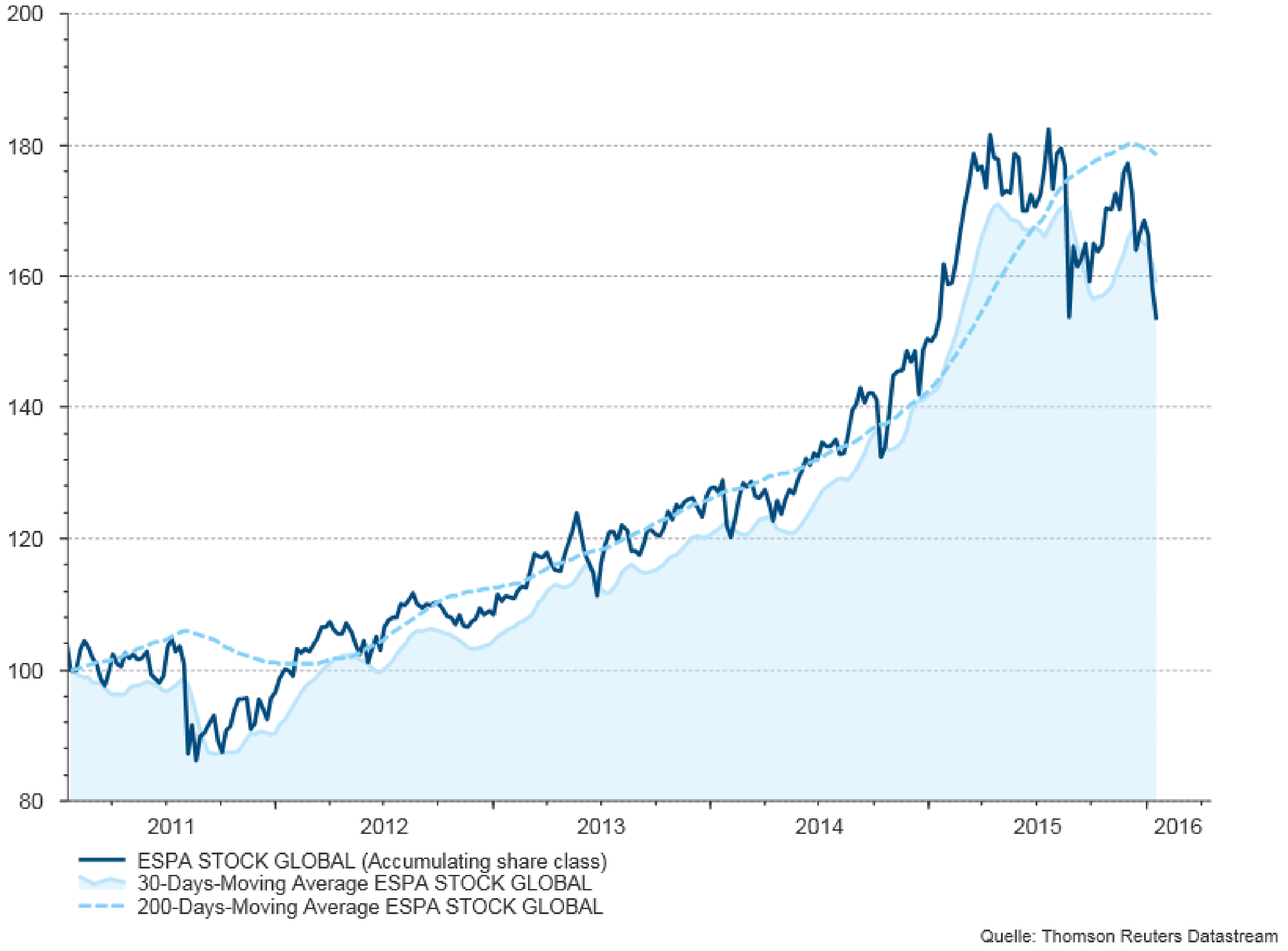
How do you rate the earnings situation in the corporate sector?

I can see only little potential for positive surprises in the USA, given that profit margins are at the upper limit of their long-term range. In addition, the strong US dollar is burdening the companies. In Europe and Japan there is more reason to be optimistic, both on cycliccal grounds and due to the currency situation.

Are the stock exchanges too expensive?

They are not too expensive, but at the same time, they are not exactly excessively cheap either. There is little to suggest that we will see a re-rating across the board this year, i.e. an increase in the price-earning ratio of the overall equity market, like we saw in the past five years in the USA and in Europe. A reasonably positive development in the stock markets would require stable earnings in the USA and improving earnings momentum in Europe and Japan.

Performance ESPA STOCK GLOBAL (31.12.2010 – 18.1.2016)
Chart ESPA STOCK GLOBAL compared with 30 days and 200 days moving average



Source: Datastream as of 19.1.2016; The performance is calculated in accordance with the OeKB method. It already includes the management fee. However, the illustration is net of the one-off load of up to 5,00 %, which falls due at the time of purchase, and of other fees that reduce the return as well as of the individual account and deposit fees. Past performance is not a reliable indicator of the future performance of a fund.

Andreas Rieger, Fund manager ESPA STOCK GLOBAL

Let us talk about the global equity portfolio. Andreas, last year you managed to outperform the global index significantly. What were the main contributing factors?

The focus of the investment is on quality shares and companies with strong growth rates. This positioning paid off last year. In terms of sectors, we achieved particularly strong contributions to the outperformance of the fund from consumer goods and technology. In addition, underweighting the energy sector was a good decision, in view of the declining oil price.

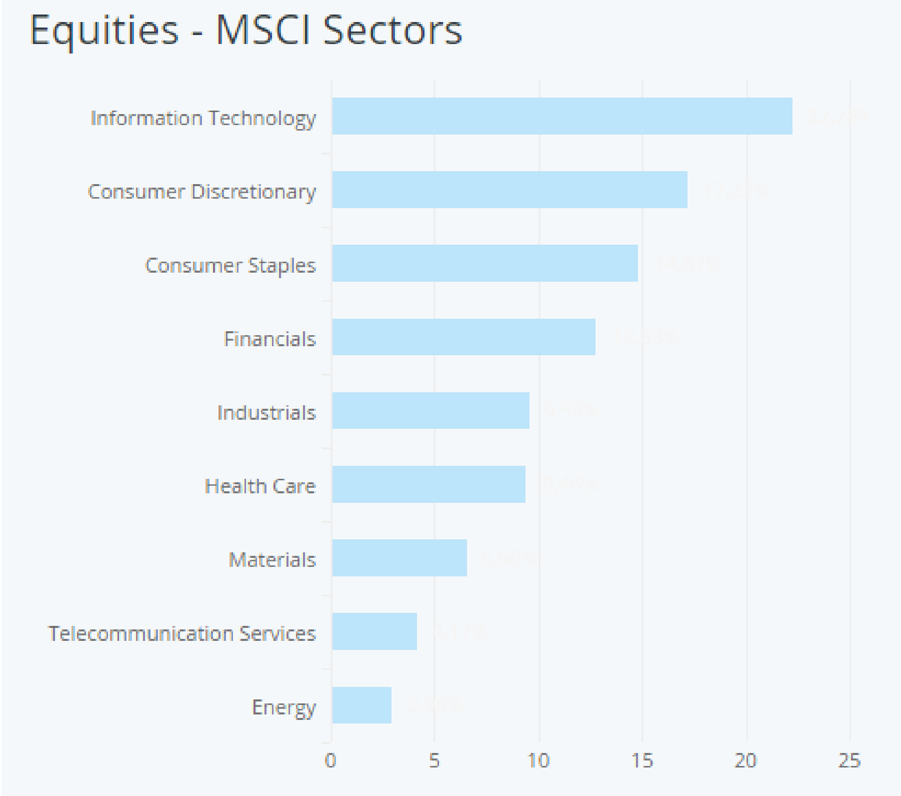
What regions and sectors do you prefer?

As far as sectors are concerned, we can see opportunities in staples, i.e. non-cyclical consumer goods, and in the technology sector while regionally we maintain our focus on North America and Western Europe. Emerging markets will continue to play a secondary role this year.

ESPA Stock Global – Portfolio split by

What role does cash play in your strategy?

We think we have a fairly volatile year ahead of us and will therefore generally hold a bit more cash in the fund than in 2015. There may be more swings in terms of inflows and outflows into the fund.



Source: ERSTE-SPARINVEST; data as of 31.12.2015

What advice can you give private investors in this sort of environment?

Keep calm and seize opportunities.

More information about the fund:
http://www.erste-am.at/en/private_investors/fund/search/1-17001/overview

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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

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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.