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Current Situation

The month of May was a good month for bond as well as for stock holders. Nearly all long term government bond and the leading stock markets including US technology stocks after their recent sellout have created positive investment returns. It was an unexpected event because it happened not only in the curious month of May but also that the two asset classes have performed unanimously together in this late stage of the bull markets. Explanations have been manifold. At the end it seems to be the all over fundamental confusion about the state of the economies and the future direction of price increases (fear of global deflation?) together with the still massive free liquidity that have equally driven both markets.
The recent performance of the financial markets is even more surprising as the US economy came in with a negative first quarter and is possibly not as robust as commonly assumed. According to the latest comments of the IMF the European economies still have to be considered as being vulnerable. In addition the worrisome results of the recent European election and the push to nationalism and to the renunciation from the idea of a unified Europe have been a painful wakeup call for the established parties. It did not only happen in France after a two years' chaotic presidency under Mr. Hollande but also in Spain, Great Britain and in Germany, too. More and more citizens are deeply concerned about the ethic state of their parties in power and their opportunistically acting politicians in resolving the burning social and economic problems. Unemployment, pauperization, anemic economic growth over the course of the last decade and the fear of the disability of the leading political class of resolving these problems have been the main drivers to the right. On top, the ECB until now has chosen a path that has been counterproductive with respect to the state of the EU banking system.

Economic Outlook

The good news: something will have to happen in the EU after the elections and the mandate is clear. Country by country, starting with France and Italy, politics will have to make a complete turnaround away from socialistic governance towards social market economy. That means socio-economic reforms at all angles including labor, trade, tax and privatization. Investments in infrastructure are unconditional as well as the dramatic reduction in labor cost and the tax load of corporations. All these countries need some sort of a long term scheduled economic agenda probably in the style of the late German agenda 2010. This will be the only way-out from economic anemia and unemployment towards economic growth and longer term prosperity for its people. The ECB is about to take its share and the leaks of information indicate that at its next meeting early June several long term steps will be taken in order to liquefy the whole system.

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After the weaker than expected data from the USA and China the economic trough may already be behind us and that economic growth will again reaccelerate from now on, however probably not at a pace as predicted earlier in the year. Central banks and the fed, too, will stay further accommodative as the risk of deflation is by far greater today than the start of a new inflationary cycle.

Financial Markets

Against this encouraging fundamental background the financial markets should further progress over the early summer months. Government bond markets with the exception of the US should still do ok although at a lesser pace from now on. The EU periphery could still further profit from the new ECB policy. Windows of opportunity have also opened at a variety of EM bond markets.
The Western stock markets, relative underperformers over bonds so far this year, should have completed their corrections in the month of May and should accelerate their upward moves from here on. There are several reasons for this assumption. Firstly, for the first time in two years earnings' revisions in the US have turned positive and global earnings' revisions have also improved. Buying EU stocks could even be more rewarding, if several EU countries together with the help from Brussels would introduce reforms and any economic stimulus packages.
Secondly, the recent fear of a stock market collapse or even a new bear market in stocks should meanwhile been widely dispersed. Early this year certain overpriced groups and stocks such as many smaller capitalized companies, biotech and internet companies have corrected by about 20% from their peaks and are about to form a new base.
On the other side statistics prove that new equity bear markets have never started because of overvaluation but only of emerging recessions. This is not the case today; in contrary US transportation stocks have not only made new highs because of rising profits but also have outperformed the lagging Dow Jones Index by a wide margin. This industry is transporting the goods that the American economy produces. Higher or accelerating earnings stem from higher traffic volume, because there have been more goods produced that have to be shipped. According to the Dow Theory the transportation index leads the Dow and this gap should be closed by the DJ Index and by the broader S&P 500 Index in the intermediate future. It, therefore, should make sense to stay invested in equities or depending on individual risk strategies to increase the equity exposure over the summer.

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