



# Irrational Exuberance?

December 2020

- Equities are underweighted in favor of liquidity
- Risk premium and risk index provide a negative contribution to the assessment of equities
- Carefree but not yet euphoric investors
- Good performance of all risk assets

## Record-breaking initial public offerings

The sibylline statement "Irrational exuberance" was made in December 1996 by the famous U.S. Federal Reserve Chairman Alan Greenspan. His intention was to draw attention to the psychological basis for a speculative bubble. As we know today, he was right about his warning, but his timing was miserable. The bubble did not burst until March 2000, which is why we have added a question mark to the title of our publication. We are not crash prophets. However, we are confident of our ability to "take the temperature" of financial markets, which has continued to increase since our last publication:

The continued rise in global stock markets has led to a further decline in the equity risk premium, which has slipped into unattractive territory.

Of particular concern, however, is the current performance of the IPO market, which has already set a new record in terms of volume this year. The most recent initial public offerings have left capital-hungry CEOs speechless, with opening prices almost doubling from the original issue price. Just a few months ago, for example, Airbnb was scheduled to realize a USD 35 billion IPO. On the first day of trading, the company had a market capitalization of USD 100 billion, fifty percent above the issue price.

The fact that 80% of the newly listed companies placed on the stock exchange this year do not make any profits does not seem to bother the new stock exchange heroes, who are operating from their home offices and are solely focused on a prosperous future.

In the environment described above, it is not surprising that our anti-cyclical risk index slipped from neutral to negative. The mood is however only carefree and not yet euphoric.

Assessment Bonds: -											
		Yields				Spreads					
		low	-	0	+	++	low	-	0	+	++
New	X					New	X				
Old	X					Old	X				

Assessment Equities: -											
		Shiller PE				Risk Premium					
		expensive	-	0	+	++	low	-	0	+	++
New	X					New	X				
Old	X					Old	X				

		Leading Indicators				Risk-Index					
		Contraction	-	0	+	++	Euphoria	-	0	+	++
New						New	X				
Old						Old	X				

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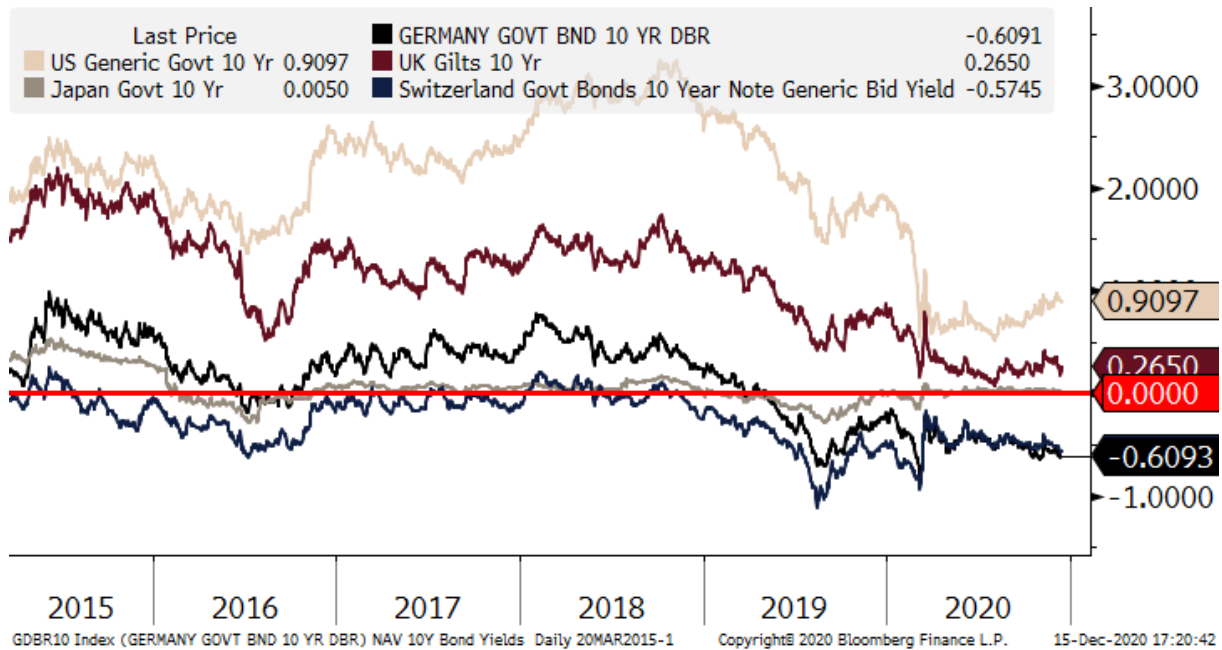
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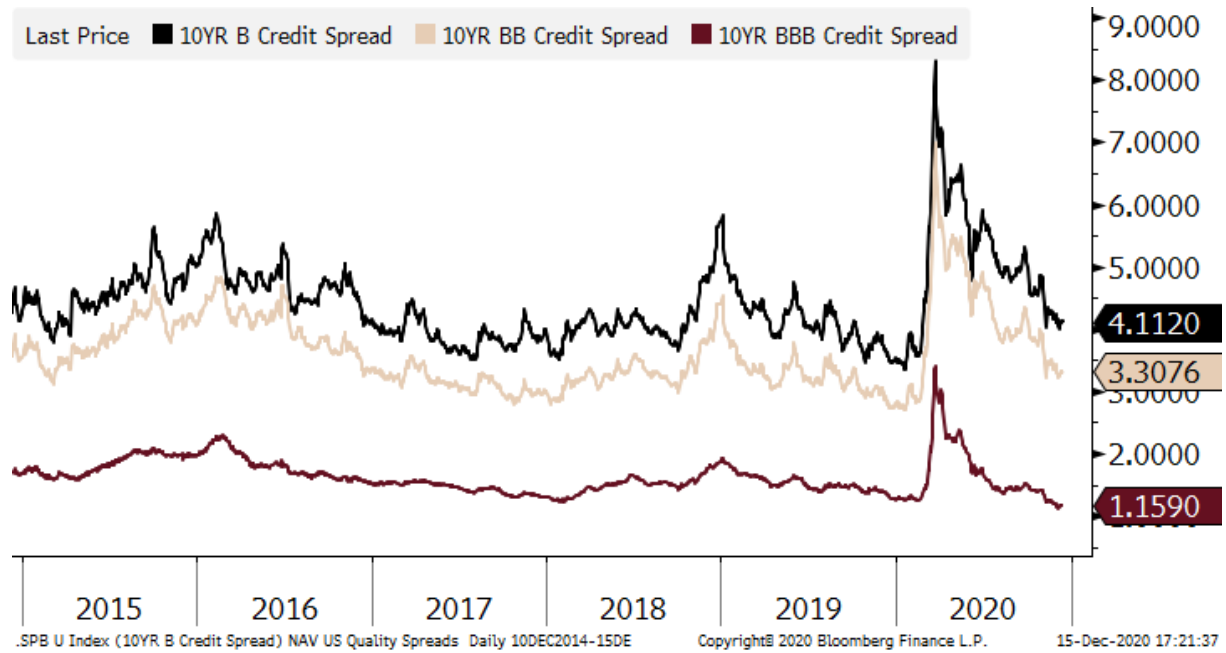
The sum of all indicators leads to a negative assessment of equities, whose weighting we have lowered in favor of liquidity. In case of a further deterioration of the risk index (emergence of euphoria), we will not hesitate to further reduce the equity weighting. Fixed income remains underweighted and alternative investments neutrally weighted.

**Interest rate level** (indicator --) / **Spreads** (indicator -)  
 Assessment unchanged / Assessment unchanged

Interest rates on government bonds are still at an extremely unattractive level.



Risk premiums on high-yield corporate bonds have declined further and look unattractive.



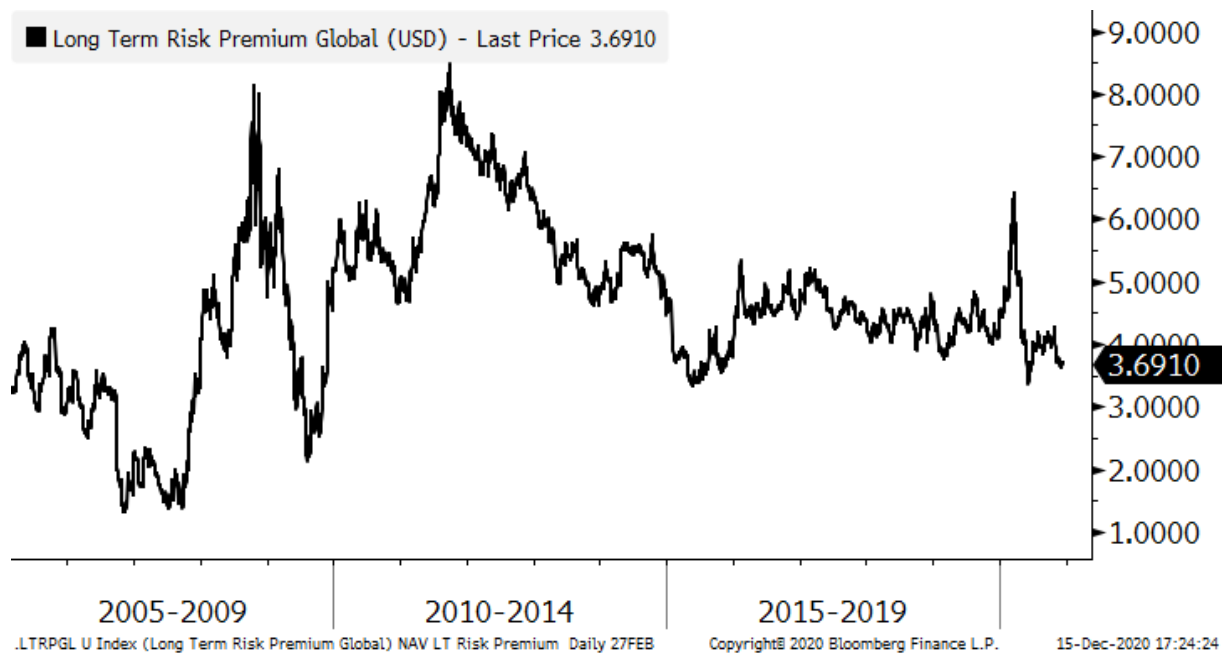
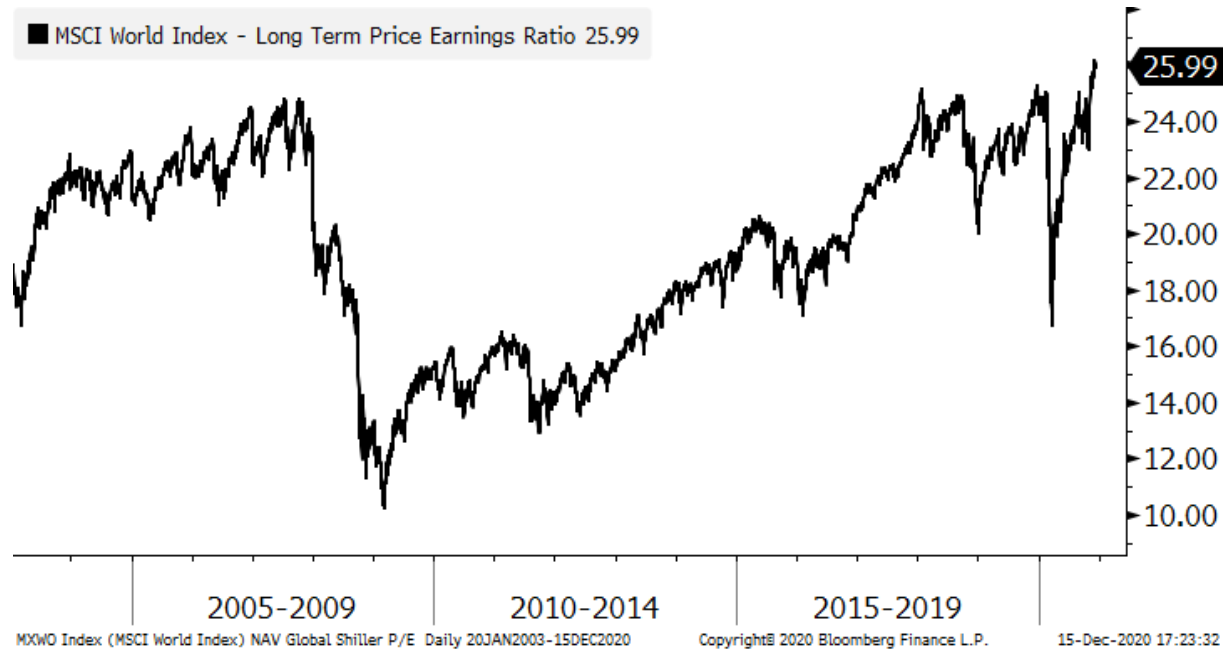
Emerging market corporate bond risk spreads are still relatively attractive, but have also dropped notably.



**Shiller P/E ratio (indicator --) / Risk premium (indicator -)**

Assessment unchanged / Assessment downgraded to – from 0

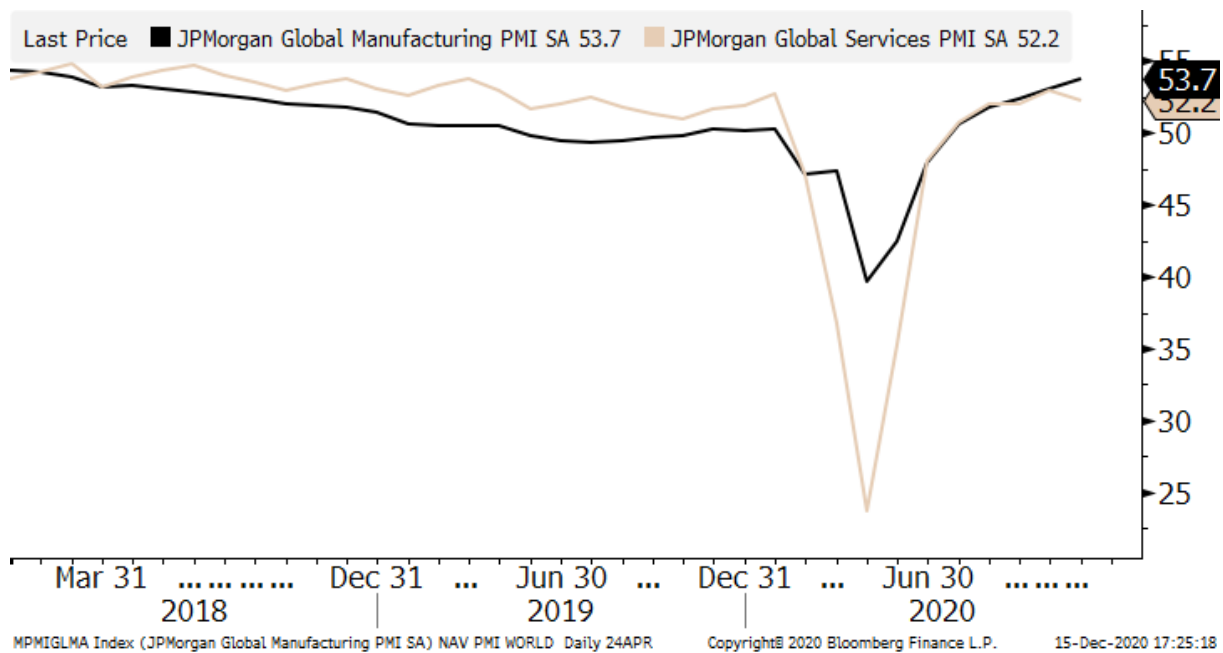
The absolute valuation of stock markets has become even more expensive, while risk premiums (both due to the rise in the stock markets) have also fallen further. Hence, equities are now also unattractive in relative terms.



## Macro leading indicators (indicator +)

Assessment unchanged

Global manufacturing PMI data for November rose again from the previous month, from 53 to 53.7, while global services PMI data fell from 52.9 to 52.2 over the same period. The drastic measures to contain the pandemic are likely to lead to a more significant decline in economic activity in the services sector next month. Due to the steeper yield curve but also the expectation of an economic normalization next year, we remain positive on this component.



**Risk index** (indicator -)

Assessment downgraded to – from 0

Investors are now acting carelessly on the financial markets. The volumes as well as the price development of IPOs speak a clear language in this respect. Other indicators such as a record low put/call ratio as well as extreme USD/EUR short positions are further signs of an overly positive and also one-sided positioning of investors. However, since this behavior has not yet spread to all market segments, it is too early to speak of euphoria. We remain particularly vigilant with regards to the further development of the risk index.

*Zurich, December 2020*

*Dear customers and readers*

*We wish you a Merry Christmas and a Happy and Healthy New Year 2021.*

*We look forward to navigate you through the financial markets as we would like to thank you for your highly appreciated readership.*

*Yours sincerely*

*Sound Capital Ltd.*

## Appendix:

The Navigator is the central tool for our investment allocation. We use it to systematically and consistently assess the aspects that are relevant to the development of the financial markets. As a result, our clients can rely on a rational and anti-cyclical implementation of our investment decisions.

- **Focusing on the essentials:** Interest rate level, risk premium, valuation, economic development, investor sentiment and positioning. These are the decisive factors for success on the financial markets, especially in turbulent times when the temptation to react irrationally to the headlines is particularly strong.
- **Comparability over time and place:** The factors mentioned above are equally relevant for all markets and at all times. This is the result of a strict «backtesting» process that continues into the future.
- **Cumulating our investment experience:** Our strength lies in the many years of experience of our partners and principals. It is precisely this experience that we summarize and make applicable with our Navigator.
- **Transparency:** Thanks to our monthly publication, our clients always know where we stand in the investment cycle and where the financial markets are headed.

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Datenquelle: Bloomberg