

The Challenge for Equity Markets

This week, we are highlighting some recent insights from Gavekal founder Louis Gave. Below is a brief summary of his piece *"The Challenge for Equity Markets."*

-Unsettling news—from a potential UK departure out of the European Union, to on-going terrorist attacks in the US, and America's bizarre presidential race—is pressuring stocks.

-As has been the case in recent years, Japanese and European stock markets are lagging the S&P 500. Ominously, many of their big banks are in severe downtrends (financial stocks often lead stock markets).

-Oddly, the US dollar hasn't been benefiting from recent dislocations. Another strange development is that both the yen and the euro have been on the rise lately, particularly the former. (The dollar typically rallies during periods of global uncertainty.)

-Further, emerging markets are out-performing overseas developed markets for the year. This again is running contrary to the usual pattern.

-Asian equities look extremely attractive on a valuation basis compared to US stocks. However, past history would indicate that, should the US market struggle, Asia's greater cyclicity will be problematic.

-Global investors remain exceedingly concerned about China and, particularly, its debt level. Because this fear is so pervasive, it's unlikely to be the negative surprise that triggers a market panic.

-On the other hand, the worldwide investment community is generally quite optimistic about America, a big reason US stock valuations are so stretched. Consequently, should this cheery view of our market be challenged, the downside might be significant.

-US economic and earnings data have been notably deteriorating lately (the June jobs release was particularly a negative surprise), contrary to the view that America is a pillar of strength.

-It's possible that the US economy may be poised to reaccelerate but political uncertainty could work against that.

-Assuming conditions break favorably, there is likely considerably more upside in Asia. Potential tail winds include rapidly falling interest rates. These remain well above zero, unlike in developed countries; thus, they have considerable room for further declines, typically a very bullish development for stocks. Additionally, valuations are close to record-lows.

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