

WARWICK FINANCE SOCIETIES



Market Wrap-Up

Week ending January 27, 2013

Warwick Investment Club



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Warwick Investment Forum Coverage

Speaker Interviews (Part 1 of 2)

By Daryl Chia, Editor-in-Chief, 2nd Year BSc MORSE

Interview with John Authers, Senior Investment Columnist, 'The Financial Times'

by Bryan Huang and Daryl Chia

19 January 2013

John Authers is the Financial Times' Senior Investment Columnist, and is responsible for the weekly Long View and other columns on markets and investments. One of the world's most influential financial journalists, he appears frequently in U.S. and global media. After speaking at the Warwick Investment Forum, John has a most insightful discourse with the Warwick Finance Societies.

Thank you very much to coming to Warwick Investment Forum. Obviously you are a very prolific journalist. How did you manage to get to where you are today and how was the journey like?

I studied PPE at Oxford and was particularly interested in American politics. I spent a summer interning on Capitol Hill and went from there to working as a consultant for the Telegraph for a year, guiding them on how to cover the presidential election, which was then the election between George Bush Sr. and Michael Dukakis. I then managed on the back of that to get a place on the Financial Times graduate trainee scheme. In those days, they sent you to journalism school in Hastings, so I did do a brief bit of the local journalism beat and I started at the FT on New Year's Day 1990. I have been there for 23 years.

What about students these days – if they are interested in financial journalism, would you say the path will be similar, or would you think there are other means by which one can perhaps write for, say, the Lex Column on the FT?

Particularly in the Lex Column, we want a balance between young people who will say the emperor has no clothes and who will not be afraid to ask the naïve question, and the

'been there done that' types who know a lot more but also might not see the forest for the trees. I think in this day and age you want to see somebody who does have an understanding of how to deal with numbers, and who is able to express their own opinions – much like one learns in Economics or in an MBA. Then it is a question of having the ability to express an opinion differently, and there are many more ways to do that these days – you need to be out there on Twitter and blogs, and you need to be showing some kind of an entrepreneurial sense. As well as that, if you want to be a financial journalist, it could also be easier to start with some kind of a brief career in finance itself. We have one good financial journalist at the FT, for instance, who spent a year at Lehman Brothers and learned an awful lot.

So a combination of technical skills and industry experience is clearly key.

Moving on, our newsletter goes out to over 2,000 students at the Warwick Finance Societies. Would you be able to give a brief overview of what the two books you authored which have here are about?

The Fearful Rise of Markets, which came out in 2010, is basically my biggest and most ambitious attempt to write my take on the crisis, specifically answering the question of why are there so many more bubbles than there used to be and how we deal with that. In a nutshell, I felt that capitalism and markets are about a balance between greed and fear and for various reasons I believe that fear had been suppressed of late. There is one particular reason which I think is important that tends to not get as much play as it should do, and that is to do with the institutionalising of investment. It is not necessarily about banking – it is about the fact that investment decisions now tend to be made by people who are part of big institutions and who are following the agenda of the institution rather than simply trying to maximise returns.

The second book that came out only a few weeks ago and which is available in the U.K. only as an e-book is called Europe's Financial Crisis; it started as I was writing a second edition for The Fearful Rise of Markets and I decided to turn it into a book in its own right. It tells the story of the European financial crisis. I hold that it is basically driven by structural flaws in the shape of the Eurozone which were there from the beginning, combined with a flaw in the way that its banking system was run – it became far too 'over-banked' and the banks became too big to fail and too big to be rescued, and that

inevitably put pressure on the sovereigns. The catalyst for the crisis then came with the credit crisis in the States. The book is my attempt to give readers the best, briefest and most pithy account of why Europe is in crisis – as it still certainly is even though the crisis is in abeyance at the moment.

What kind of reader are you aiming this book at?

It would be people like Warwick students! It was an attempt at explaining from first principles but then going to a reasonably technical level reasonably swiftly on why Europe got into trouble in the first place.

Finally – and this is a big question – how do you think the crisis will pan out and what are your top trading recommendations for 2013?

While I would not rule out any scenario for the Eurozone crisis – and that is why it is important for one to hedge his bets – the single most likely scenario is that we muddle through and that you end up with a much more cohesive Eurozone, possibly with one treasury minister and Eurobonds, which will obviously make the decision for whether the U.K. wants to stay in much more interesting in terms of U.K. domestic politics. I think we will avoid disaster but will not avoid a long and drawn out recession – I find it very hard to see how that can be avoided in Europe.

Globally, I still see some chance that China and the U.S. somehow between them manage, from the money they printed, to kick off and find ignition, but I personally find it more plausible that we move yet again into something more akin to a disaster scenario – another really serious sell-off – and I think the most likely scenario is that the checks and balances of ‘deleveraging meets money printing’ and the ultimate result is years and years of rather stodgy markets that go sideways for a very long time. In terms of how I would invest on the basis of that – and I have said this in the FT – I would probably shade a bit towards stocks and away from bonds simply because the balance of risks have shifted a little in the last year and also since bonds are now wildly overpriced. Still, that does not mean they cannot stay overpriced for a long time and that is why I would only make a fairly gentle shift in the direction of equities.

Also, if you have any kind of long term perspective, first of all, value investing appears to be beginning to work better, and I would go with the value style of investing. If you

talk about the 10 to 20 year time horizon – which the average student has – there must be a lot of relative mis-pricings in this market. Value has failed for these five years because there is no catalyst for value to be realised when rates are held at unrealistic levels. Over a longer time period, the chances that value outperforms growth are overwhelmingly good, so if was in the lucky position of being a student who could put money aside into stocks at a regular basis for the long term, that is what I would do. Also, for the long term, Asia in general and China in particular are hard to bet against for the very long term. On the other hand, I am not confident in the vehicles that are out there that allow you to invest in Africa, so I would not say Africa, although I am tempted to.

Thank you very much, John Authers. We are just in time to catch the train home and thank you for coming to the Warwick Investment Forum.

Interview with Greg Davis,
Head of Behavioural and Quantitative Investment Philosophy, Barclays Wealth

by Daryl Chia

19 January 2013

Both a prolific academic and practitioner, Greg Davis holds a PhD in Decision Theory, built the first behavioural finance team in the world and co-authored the book 'Behavioural Investment Management'. After shedding light on behavioural biases and their interplay with rational investment decision making during his most intriguing speech ('Behaviouralising Finance: Attaining Anxiety Adjusted Returns' – video to be made available on wfsocieties.com soon), Mr Davis took time out to answer a few questions for the Warwick Finance Societies (WFS).

You have contributed a lot to the field of behavioural finance. Could you tell us what brought you to this field and the journey you took to where you are today?

I started out as an undergrad in Economics and Philosophy and I was always very interested in the philosophical underpinnings for economic theory and economics is all based on these axioms of rationality and what it means to be rational, and so later on in life when I was working as a management consultant I was turning these ideas over in my head and I really wanted to dig in a little bit deeper into the whole notion of human rationality and the philosophy of rationality, so I started at that time thinking I was going to do a PhD in pure philosophy, and it was when I started reading around the topic at that time that I stumbled across this field of behavioural finance and behavioural economics and it seemed to me such a perfect fit between theoretical and practical, between experimental and model based solutions between philosophy and reality, and so I completely swung my PhD thesis into behavioural finance, which was very fortuitous because at that time, there were not many people doing it, but little did I know, the field was just about to take off dramatically. So just after I started was when Daniel Kahneman won the Nobel Prize for economics and suddenly this field I know that I decided to study because I was very interested in it and passionate about it just took off in popularity and as it turned out I was quite well placed after my PhD to start turning that into a career which I never anticipated.

As you made your foray into this field, people worldwide were still clung onto modern portfolio theory and classical portfolio optimisation techniques with little consideration for the behavioural side of finance. As such, was it difficult changing people's mind-sets?

There were some people who were really for it and excited by it, but on the whole yes – there was a lot of work, a lot of persuading people and trying to do things that are practical and not just about telling stories that came across as too academic or too theoretical. We have had a team now at Barclays for over 6 years and a lot of that time has been implementing behavioural finance but a lot of that time is also persuading people that this is something worth taking seriously and is something worth putting budget behind. Still, there is a long way to go and we are only scratching the surface of what is possible in the practical application of behavioural theory.

Let's move on to your book – *Behavioural Investment Management* – which you published in early 2012. You write a lot of well received academic papers; what was your motivation behind writing the book?

The thing behind the book was in working on these ideas and the practical implementation of these theoretical ideas, you start to build up a framework for how you think about things and really work it out and I wanted a way of getting that out onto paper. It is not the sort of thing that is easy to do in short articles or thought pieces or journal articles because it is less about individual ideas and more about how they connect together. So the book was the right way to do that and it was really the chance to develop the theory in a broader way and to put it out there rather than to do what I do as a day job which is actually trying to solve practical problems and implementing these ideas or trying to convince people of very specific ideas and the book was a chance to stand back and do something that is a little bit more grand in scale which is still theoretical.

The book is aimed at both a professional audience and academic audience – it is quite technical and we have tried to be thorough and rigorous about it. It is about portfolio theory and not so much about how to control your emotions, but really how to take the quantitative aspects of classical finance and push them in a behavioural direction.

I saw that you founded this opera by the name of Open Outcry. Could you tell me more about it?

Yes, absolutely. Working with a composer friend of mine, what we did was to create a work of art that was expressing, in a very direct way, aspects of behavioural finance. An open outcry market is something that is a very visible and audible expression of people's emotions as they are pursuing their economic goals and their trading goals. So we took this idea and created an artificial market which had a quantitative model running it, and we had 12 traders. The catch was that the traders had to sing their trades. So the music we got out of that was something we could not really control that much – we set the market up and set it running without knowing what was going to happen, but what you get out of that is a sonic way of expressing the interaction, the network and the trading activity in a way that is at the same time quite artistic and cultural. We had the premier in London in the mansion house and we would love to do it again. It is not an easy thing to do as it places quite a lot of demands on the singers as they have to think like traders while singing, and it requires a big place, but we hope to put it on again, and hopefully sometime this year or next year we will have our U.S. or European premier.

The UK economy

Half Way to Triple Dip?

By Eleanor Gaffney, Analyst, 2nd year Economics

Fears are mounting that the UK could be heading towards an unprecedented triple dip recession. The UK economy shrank by 0.3% in the last 3 months of 2012. Before the official figures were released, George Osborne, addressing business leaders at the World Economic Forum in Davos, vowed to stick to the austerity drive despite what the data would say. He subsequently commented after the release of the figures that they 'are a reminder that Britain faces a very tough economic situation'.

A quick overview of 2012

2012 was a year of ups and downs. In the first three months the economy contracted with construction activity falling back sharply, there was another slide in the second quarter with the extra bank holiday for the jubilee affecting overall output. Between July and September, partly thanks to a boost from the Olympics, the economy bounced back, but in the final three months there was another fall in activity with the Office for National Statistics (ONS) citing a fall in mining and quarrying, after maintenance delays at the UK's largest North Sea oil field, as a key reason for this. The overall picture for the year was flat.

At Westminster the new figures have rekindled the debate about the extent to which George Osborne's deficit cutting plans have hurt the wider economy. Boris Johnson commented that the approach is right but made the somewhat vague point arguing that the 'overuse of austerity language' by the government and media needs to stop, and instead suggested that there needs to be more talk of investment and moving forward. Osborne was also forced to brush aside the comments from Olivier Blanchard, the International Monetary Fund's chief economist, after he suggested that Britain should reassess its fiscal position. The IMF has repeatedly urged Britain to reassess its policy framework if growth does not improve, but as near stagnation has continued for two years, it has never officially called for deficit reduction plans to change. It is noteworthy that the IMF defines austerity in a different way to the Treasury. While the coalition concentrates on the plans for public spending and taxation and insists these will not change, the IMF measures deficit reduction efforts by the estimated drop in cyclically

adjusted borrowing. In 2012, the fund praised Mr Osborne for moderating his deficit reduction plans, although this was simply a matter of a changed way of working out how much the cyclically adjusted level of borrowing was projected to fall.

Where does the economy go from here?

So where does the economy go from here in this first quarter of 2013. The business surveys are pointing to broadly flat output at best, consumer confidence is still very depressed, and with consumer's real pay still falling, the first quarter looks like it's going to be pretty tough too. Recent jobs forecasts have been positive however. Most forecasters expect growth for the full year, with Mr Philpott a leading labour economist forecasting an overall employment rise of 80,000.

In reality the UK is an economy that is not really going anywhere fast. It's not lurching backwards into a deep recession, yet nor is it really going forward either. The big debate leading up to the budget in March is how long is this flat period going to continue? No one is expecting or even suggesting that the budget will radically change the economy. The main concern seems to be to ensure that the budget does not worsen the economic situation. By the end of this year, providing there are no shocks to the economy and the euro zone starts to feel a bit more confident then forecasters predict we may be one percent larger, meaning national output will still be smaller than it was at the start of the recession.

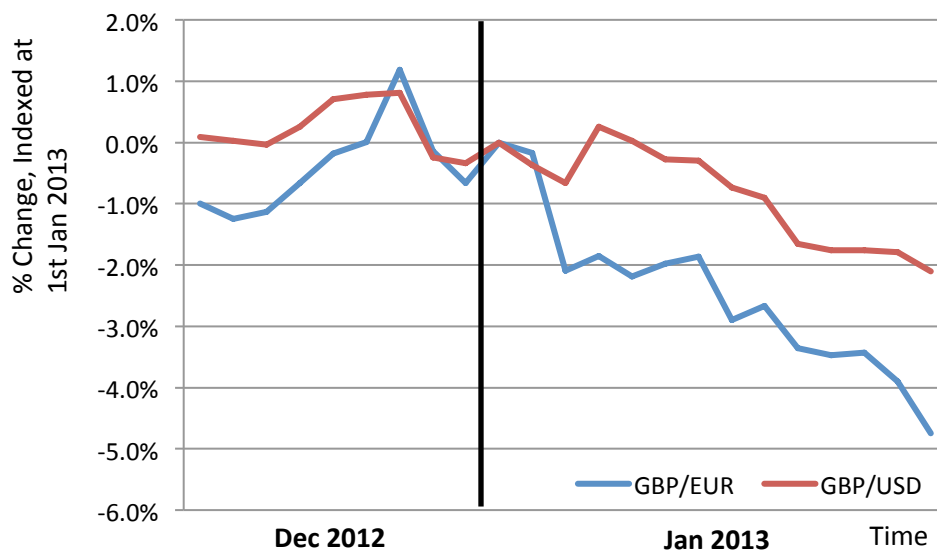
Foreign Exchange

Watch Out for the Falling Pound

By Richard Low, Analyst, MSc Finance & Economics

Since the start of the year, Sterling has been among the worst performing currencies, most notable is the Sterling's 5% decline against the Euro (see figure 1). Of the major currencies, only the Japanese Yen has fared worse; the Yen's has fallen 4.5% against the dollar and 6% against the Euro but that is because the Japanese government has taken deliberate steps to weaken the Yen, Downing Street has taken no such measures.

Figure 1 – Sterling's Underperformance in the last month



This article will explore the domestic and international factors that could account for the Sterling underperformance.

Recognise the Domestic Issues

There are increasing fears that the UK will experience a triple dip recession¹ (see figure 2). In 2012, the UK only expanded in the third quarter and this might be due to a one-time boost from the Olympics. With Chancellor Osborne set to pursue fiscal austerity, many private and public sector officials, including Olivier Blanchard, chief economist of

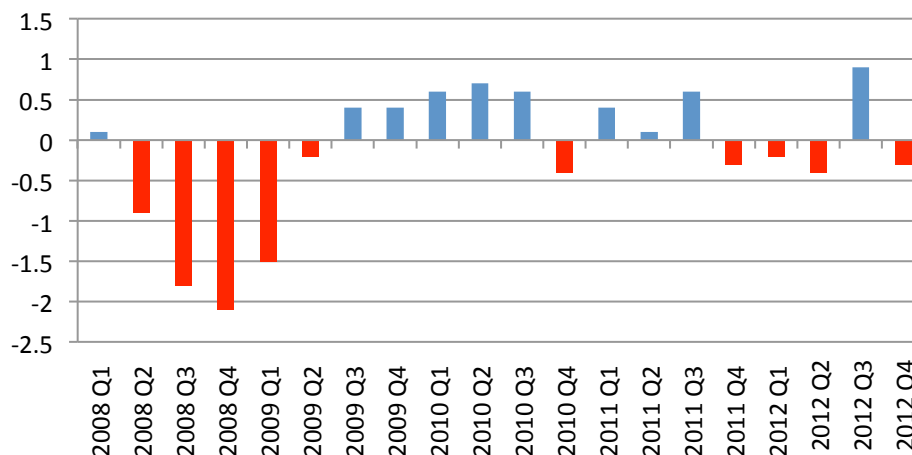
¹ A recession is defined as two consecutive quarters of negative growth

the International Monetary Fund and Jim O'Neill, the chairman of Goldman Sachs Asset Management, have urged the government to rethink its stance. Continued austerity will create a period of moribund economic growth, while doing little to manage the deficit. Ed Balls, the shadow chancellor, has even accused Osborne of “falling asleep at the wheel” and has demanded that chancellor change his tack to “kick start the economy”.

More telling is the way the markets have pushed up the yields on 10 year Gilts over 2% this month. Last year, when yields were at its record lows of just over 1.5%, parliamentary officials were using this as an indication that markets have in principle support austerity; now, they can no longer say so.

Assuming that the government does loosen up a little, the UK government is in a difficult position. Despite its plans for austerity, the budget deficit has crept up slowly, and in 2012, the government actually recorded a larger deficit than the previous year but more alarming is that government spending increased by 3% while taxes have remained flat, thus any form of stimulus is unlikely to be substantial.

Figure 2 – Britain’s Quarter GDP Growth



Rating agencies all know the quagmire that the UK is in and the three major agencies have put UK’s sovereign debt on negative watch. Given the current economic climate, it will be sooner rather than later that Britain will lose its much coveted triple A rating. This probably heralds a new paradigm in the way the world views UK debt and probably it is increasingly seen as being more similar to debt in continental Europe. All

these factors will continue to linger in the immediate future and the pound is likely to continue its downward trajectory.

Feel the international currents

Another factor could probably be due to rising investor confidence that the EU is unlikely to break up in the immediate future. Investment flows that were pulled out from the continent are now flowing back. During the worst of the sovereign debt crisis, US treasuries and Gilts outperformed their European counterparts and now that fears of a Euro breakup have somewhat abated, the flows are now in reverse. Britain is more likely to be hit harder than its Atlantic counterpart because investors have fewer reasons to hold Sterling or Gilts; the USD is still the world's global reserve currency and its treasury market is the largest and most liquid in the world. Thus, the current fall in the pound can be explained by a fall in demand coupled with a rising supply of pounds in international markets.

Conclusion

The recently concluded world Economic Forum has been the most optimistic since the Global Financial crisis, and while there remain great challenges ahead for policy makers of advanced economies, the worst might very well be over. A depreciation of the pound might actually help to increase export competitiveness and this form of monetary stimulus will not hurt the budget. However, in 2009, depreciation actually widened the trade deficit as the import bill soared faster than the increase in exports. Let's hope this time the J-curve actually holds for the UK and that it works quickly enough.

Britain and the European Union

Are You In or Out?

Analysis of Cameron's Speech

By William Caffrey, Analyst, MSc Finance with Behavioural Economics

Last week David Cameron gave a speech to European leaders, and the rest of the world, which explained his party's view on Britain's position within Europe. Cameron reiterated his wish to hold a Yes/No referendum on whether the UK should remain a part of the European Union if the Tories are re-elected in 2015. The speech has been criticised by France, Germany, the US and even by his coalition deputy, Nick Clegg. The only possible bright-side for Cameron is that he has pleased the Tory Eurosceptics and seemingly united his party, but at what cost?

Implications of a planned referendum

The reason why Cameron's plan has had so much criticism is that it generates a lot of uncertainty, which as we know, is terrible for investment. Britain attracts a lot of foreign direct investment for many reasons; its affluent population, its language, its great universities, its low corporate tax rate and of course its membership of the EU. The latter is what is at stake here. Foreign companies that set up in the UK avoid a tariff that other foreign companies must pay to trade with other European countries. This is the main reasoning behind a trading bloc and of a foreign company investing in a member country of such a bloc. The tariff is normally in the region of 4%-10%, which can amount to a significant cost for companies.

Should Britain elect to leave the EU, many foreign companies would not enjoy this avoidance of tariffs anymore, likely prompting them to reconsider their investment in the UK. The automotive industry, which has a large presence in the UK, has the potential to be hit hard by the UK leaving. Carmakers such as Honda, Nissan, Tata Motors and GM have factories in the UK and would likely relocate in such an event. Hence this proposed referendum has created a lot of uncertainty and will be "detrimental" to the UK economy, as Lloyd Blankfein, CEO of Goldman Sachs described the implications of the speech.

At present, Britain is on the brink of a triple dip recession, the first time it has been in such a situation. Uncertainty is not what the UK economy needs right now. It needs investment, both from domestic and foreign firms, particularly considering the Conservative push for austerity which rules out government investment.

Blackmail?

To many, including myself, Cameron's speech seems a little like blackmail. So two questions arise, the first is what does he want? Cameron has cited the need for reform in the EU, which is perfectly reasonable, as well as a better deal for Britain, which is less so. Britain has long had issues with many EU policies and treaties which it often opts out of, the Euro being a key example, so what else could he want? At present, it is not entirely clear, but France's benefits from the Common Agricultural Policy are likely a target.

The second question is what does the UK hold over the EU? Sure, the British economy is the 7th largest economy in the world, but Germany's is 4th, France's 8th, Italy's 9th and Spain's 13th. These four countries alone dwarf the UK, not to mention the many smaller economies, whose combined strength adds weight behind the EU.

Currently, it is estimated that 3 million jobs in the UK rely on trade with other countries in the European Union. In 2012, 38% of service exports and 50% of all UK exports went to the EU, which accounts for 15% of UK GDP. In contrast, only 2.5% of EU GDP relies on trade with Britain. The conclusion is that the UK has a lot more to lose than the EU does in the event of a showdown over demands.

Cameron himself has said that he wishes the UK to stay in the EU. He has therefore risked a lot if the main objective of his speech was to keep a few Tories happy.

Ratings Agencies

Prospect for a UK Rating Downgrade

By Marco Ross, Co-Editor 3rd year Accounting & Finance

Introduction

The United Kingdom currently enjoys triple-A ratings from all three major rating agencies – Standard & Poor's, Fitch, and Moody's – reflecting the considerable market confidence in the credibility and reliability of the government. Having maintained the enviable credit rating since 1978, doubts began surfacing in the wake of the recent crisis. In light of an aggravating Eurozone Crisis and a persistently sluggish UK economy, Moody's, Fitch and S&P placed the UK on negative watch in February, March and December of last year, respectively. While the turbulence of the Eurozone Crisis seems to have subsided in recent months, pressing issues such as Britain's standstill economy, and its precarious fiscal position and crippling fiscal consolidation, are worthy of consideration in evaluating the likelihood of a credit rating downgrade.

The UK economy

Having posted a relatively mild contraction in 2008 (-1.0%) followed by a sharper 4% drop in 2009, the UK economy has not been capable of forcefully recovering ever since. With quarterly growth rates ranging between -0.4% and 0.9% since 2010, the UK entered a double-dip recession in 2012 only to recover in the year's third quarter on the back of a much-needed boost from the Olympics. As fourth-quarter figures were released on Friday, the threat of triple-dip recession intensified with the economy having contracted 0.3% – versus expectations of -0.1%. As such, the economy may be described as stagnant at best, which pales in comparison with other developed economies such as the US or Australia; not only are the low growth rates in stark contrast with certain developed nations, but notably troubling has been the rather unique inability to conjure a strong recovery following the initial phase of the crisis.

Indubitably, troubles in the Eurozone – the UK's largest trading partner – have markedly damaged the UK economy. It should be noted here that while market optimism seems to have returned in the context of the Eurozone in recent months, the economic fundamentals of the currency bloc are stubbornly feeble with the ECB

predicting continued recession with a growth rate of -0.3% in 2013. Similarly important to Eurozone woes, and as will be discussed in the following section, fiscal consolidation undertaken by the current government is having a debilitating effect. With George Osborne steadfastly sticking to his austerity plan (to last at least until 2015) and lacking prospects for a credible recovery in the proximity of Britain, it is safe to wager that the UK's economic growth will remain subdued for the foreseeable future. A major driver behind the rating agencies' outlook revisions has been the UK's fragile economy; as such, despite positives such as a diversified service economy and a flexible labour market, this factor can be expected to exert further pressure on the country's perceived credit quality, with a triple-dip recession all but guaranteeing the loss of the coveted AAA status – as also indicated by Moody's.

Fiscal position and consolidation

Further intensifying pressure on Britain's rating is its sizeable budget deficit which, after having surpassed 11% in 2010, stood at 8% of GDP in 2011, thus trumping deficits in Germany and France and nearly matching the US's. Public debt more manageably stands at 85% of GDP which is in line with German and French figures. The high deficit figures have prompted the current coalition government to initiate a wide-reaching austerity programme in 2010 which aimed to eliminate the deficit. Not only has the massive austerity programme failed to deliver on the deficit front as the debt/GDP ratio has been rising and the deficit has only reluctantly declined, but economic progress has been significantly impeded as consumer and business sentiment decimated. Despite widespread calls for alterations to the plan, or even outright abandonment thereof, George Osborne has repeatedly demonstrated his determination to stick by the measures. Given the high budget deficits, an inclination toward fiscal consolidation is understandable; however, given the flipside of meagre to inexistent growth, the current government seems unable to strike an adequate balance between economic growth and fiscal austerity. This certainly represents a major threat to the country's rating as neither the fiscal or growth situation seems to be convincingly tackled.

Conclusion

With lacklustre growth and little political determination to limit the austerity drive in favour of growth, the UK seems destined to lose its triple-A status in the near-term.

Thus, at this point, with a dramatic turnaround seemingly unachievable, the matter of a credit rating downgrade appears to have become a question of when rather than if. Recent developments such as the announcement of an in-out EU referendum only further mire the UK in uncertainty and do not bode well for the prospect of AAA-rating sustenance.

US Equities

S&P 500: Rise or demise?

By John Peter Ong, 1st-year Economics

This week marked a symbolic victory for stock markets, with the S&P crossing its psychologically important 1500 barrier for the first time since the 2008 global financial meltdown. While renewed investor optimism has driven rising equity prices, some point to the two recent financial crises that occurred after the S&P passed this point in 2001 and 2008, claiming that we are inflating a bubble that will soon burst once again.



Source: Google finance

Trend Analysis

A cursory assessment of the performance of the S&P (blue line) over the past two decades seems to lend weight to the concern of an imminent slide in prices. However, rather than drawing fallacious conclusions from arbitrary data patterns, we should consider relevant economic factors in our analysis, in order to discern if there is indeed a sensible explanation for this trend.

Since the S&P tracks the overall performance of the US economy, US nominal GDP growth (green line) is a natural candidate for the appraisal of the S&P index, as it encapsulates both output expansion as well as inflation. With this in perspective, the chart quickly becomes less ominous – the difference between the two variables is clearly not as pronounced as it was during the previous two crises. Logically, economic growth

would lead to the value of US companies rising; hence it would be absurd to suggest that the 1500 barrier would forever be an inflated level for the index.

Yet, while GDP and S&P prices do exhibit gradual convergence, there still exists a glaring overvaluation, which points to the prospect of an impending market correction having a nontrivial probability. This gap is partially bridged by aggressive monetary easing by central banks worldwide, which has propped up security prices and boosted investor confidence. Should the Federal Reserve step off the gas on its terms – due to lowered unemployment as opposed to growing inflation – the price discrepancy would most likely be smaller, since real GDP growth and unemployment are negatively correlated.

Cross analyzing the US with the UK, we find a similar correlation between the FTSE 100 (red line) and UK nominal GDP growth (purple line). This has two implications. First, a meaningful relationship between nominal GDP growth and index gains exists. Second, the extent of divergence between the S&P and US GDP is most likely not a “natural” phenomenon of equity prices rising faster than output value, though that is not to say that both variables ought to increase identically as in the UK. Notably, given the UK’s significant exposure to the Eurozone epicenter, it would be reasonable to expect its equity prices to be relatively lower than the US, whose largest trading partners are Canada, China and Mexico.

Quick look ahead

Taking these factors into account, there is reason to believe that the S&P is currently overvalued. However, barring unexpected economic regression, it is conceivable that the current Bull Run will be sustained in the near future, given that nominal GDP growth and a dovish Fed mitigate the disparity. Having passed the 1500 mark, the S&P is likely to find direction over the coming week of US data announcements as markets watch for signs of economic recovery. We had best not pop the champagne too soon, lest the fizz go flat.

Note from the Team

We are always looking to improve; our team of analysts is dedicated not only to producing exceptional research but also to tailoring information to what best suits our readers.

We would appreciate any helpful feedback you may have as we strive to grow the quality and usefulness of our weekly market wrap-ups.

Please send this feedback to **D.Chia@WFSocieties.com** and the subject as “Fortnightly Wrap-up Feedback”.

Many thanks!

The Warwick Investment Club Research Team

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