

## Moderating equity bullishness gives precious metals a shot in the arm

### Summary

- Slowing ETF inflows into equities and reversing ETF outflows from safe havens indicate sentiment towards equities is subdued, but not souring. In this environment, growth and high beta segments of the equity market remain vulnerable
- Central banks' cautious rhetoric and patchy growth expectations drive the defensive positioning by index investors. Inflation-linked bonds, gold and silver regain appeal
- Investors who share this sentiment may consider the following Boost ETPs ([www.boostetp.com/products](http://www.boostetp.com/products)):

#### Long commodities:

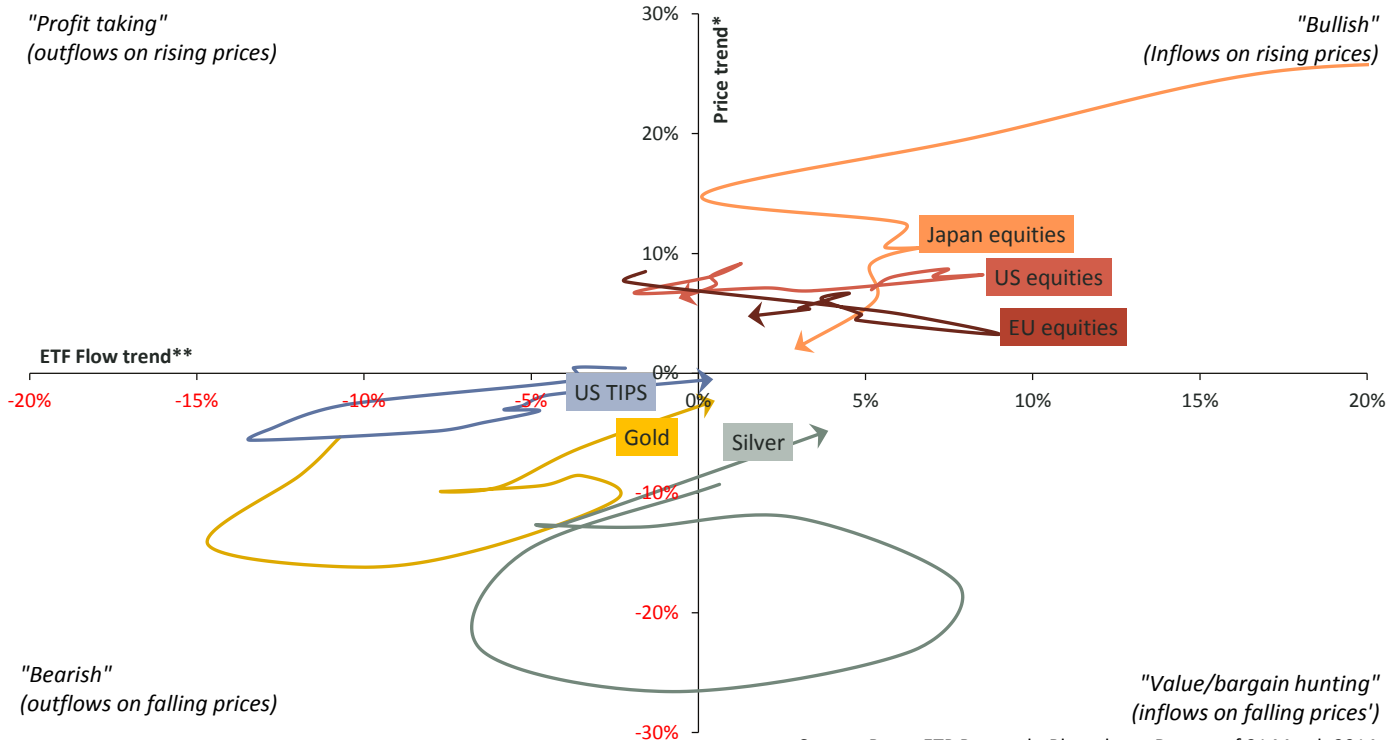
1. Boost Gold 3x Leverage Daily ETP (3GOL)
2. Boost Gold 2x Leverage Daily ETP (2GOL)
3. Boost Silver 3x Leverage Daily ETP (3SIL)
4. Boost Silver 2x Leverage Daily ETP (2SIL)

#### Short equities:

1. Boost NASDAQ 100 3x Short Daily ETP (QQQS)
2. Boost TOPIX 1x Short Daily ETP (1JAS)

### Index investors position defensively: equity inflows moderate as safe haven outflows reverse

Price vs ETF flow trend - 12M to end of Mar 2014



Source: Boost ETP Research, Bloomberg. Data as of 31 March 2014

\* based on benchmark's price deviations from moving averages

\*\* # of net subscriptions over 3 months rel to starting # shares outstanding

The Fed's subdued and uncertain stance over the outlook for the US labour market keeps its rhetoric dovish, while weakening Eurozone inflation pressures the ECB to consider unconventional stimulus. The effect is bullish for safe havens and is expected to revive inflows into inflation linked securities and gold. As a levered bet on gold, sentiment may become more bullish for silver. Underpinned by slowing global growth, the high beta segment of the equity market is most at risk

of coming under pressure. Investors who share this sentiment may consider the following positions:

#### Long precious metals:

1. Boost Gold 3x Leverage Daily ETP (3GOL)
2. Boost Gold 2x Leverage Daily ETP (2GOL)
3. Boost Silver 3x Leverage Daily ETP (3SIL)
4. Boost Silver 2x Leverage Daily ETP (2SIL)

## Short equities

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2. Boost TOPIX 1x Short Daily ETP (1JAS)

## Index investors' defensive repositioning subdues but not sours sentiment in equities

Since the start of this year, enthusiasm for risk assets has dissipated, but lately, has become more entrenched as index investors' appeal to safe havens are rekindled by cautious central bank rhetoric and patchy evidence of growth. Until the strengthening of the labour market in the US is on a sustainable footing, the Fed will seek to suppress long dated bond yields for as long as possible. While already committing itself to unwind \$10 billion of QE every month, the only other option left was for it to communicate its intention to prolong its near zero interest rate policy more vigorously last week. Meanwhile, the ECB is carefully readying markets for possible unconventional monetary stimulus; likely to come in the form of an asset backed securities purchase program as a targeted response to revive activity in Eurozone's SME sector which is largely shut off from obtaining affordable credit. The rhetoric by the Fed and the ECB is expected to spark more interest in safe haven assets.

According to our research, ETF investor sentiment has grown more cautious. Slower equity inflows into developed market equities are coinciding with a recent reversal of ETF outflows from core safe haven assets classes, including inflation protected securities and gold (see chart)<sup>1</sup>. While ETF allocations into both asset classes remain relatively small when compared to the large outflows seen throughout most of 2013, the mere halt in outflows there suggests equity ETFs too, will struggle to find the exceptional level of support as they have enjoyed last year.

## NASDAQ undermined by de-rating of technology

The dissipating price momentum of major equity markets coming amidst waning risk appetite of index investors is most evident in the US. Following the exceptional gains seen last year, profit taking is becoming more evident, with this year seeing evidence of share redemptions matching, if not outnumbering

creations in US equity ETFs. Fearful of too much growth being priced into the equity market has weighted heavily on the high beta segment of the equity market, as was evident in NASDAQ's sharp sell off last week.

The derating of tech shares may not spill over into a full fledged retreat from equities however. Thanks to profits and large cash balances, tech stocks' valuations (NASDAQ 100's hovers around the mid teens on forward earnings) are nowhere near the fictitious valuations of 1999 and 2000. That, together with the fact that now, unlike then, bonds offer dismal yields, should offer support for equities, in particular within the value and high dividend segments. From that point of view, the correction in US equities has come sooner rather than later, which is preferable in that consolidation in share valuations is now more aligned with fundamentals and may offer renewed support for equities further out.

## TOPIX undermined only by PBoC and ECB under pressure to ease

While enthusiasm towards Japanese equities by index investors has also waned significantly, it too has not soured. As is shown in the chart, Inflows into Japanese equities have merely slowed down from 'extreme' levels soon after Shinzo Abe was elected as PM in December 2012. The extent of over enthusiasm is evident in the exceptionally strong inflows in Japanese equity ETFs seen in the early stages of Abenomics. For instance, when judged from the trend of rolling 3 month inflows alone (without taking into account capital appreciation) the net creation of shares over a rolling 3 month period up until the start of the Fed taper talk in June last year has grown the size of Japanese equity ETFs by approximately 20%. The support of index investors has helped propel Japanese equity benchmarks to rise by over 50% in 2013.

Following last year's strong rise, this year Japanese equities have corrected sharply lower. However, given the high stakes involved in implementing Abenomics' three arrow policy, a scenario of Japan backtracking from either QE or fiscal reform is remote. At stake is the credibility of the BoJ, which explicitly framed its monetary policy goals around key quantifiable targets (doubling the rate of inflation to 2% over a two year period, through doubling the monetary base). Until those target are hit and inflation is firmly entrenched, the pressure for the yen to devalue remains. With respect to fiscal reform, the recent consumption tax

<sup>1</sup> Net inflows on the x-axis are calculated as net creations of shares over 3 months relative to the starting number of outstanding shares, based on a pool of major ETF providers. The price trend on the y-axis are internally calculated and refer to the benchmark of the asset class ETFs track.

hike to 8% (from 5%) accompanies enough offsetting measures in tax breaks and deductions on income to be conservative enough to prevent any major consumer spending pull back from reoccurring (such as was the case in 1997 when the sales tax hike was last introduced and the economy fell into recession). Hence, the waning enthusiasm in Japanese equities is more due to driving forces beyond Japan's control, such as a more FX interventionist China and a more cautious sounding US Fed, each of which has worked to appreciate the yen to undermine Japanese equities, than due to investors' doubts about Japan's domestic policy itself. Longer term, the implementation of Abenomics is expected to reinvigorate investor interest in Japanese equities.

### **Deep value still attract investors into Italian equities**

Index investors' bullish sentiment towards European equities has also waned. However, given the marked differences in performance within the Europe's regional equity markets, most notably between the DAX (which is down by 2.5%) and FTSE MIB (which is up by 12%), it too suggests that the erosion of support is not across the board but more focused on higher beta plays. Germany stands out as having succumbed under pressure, given its exposure to China and its reliance on cyclical sectors. In contrast, starting off from relatively depressed valuations following years of underperformance relative to the US and European peers, Italy's equity market revival is a direct result of the healing bond market in Europe. The falling European bond yields are bolstering the balance sheets of Italy's financial sector stocks that together make up almost a third of the FTSE MIB. Along with bold steps taken by Italy's largest banks to clean up balance sheets and improve transparency ahead of much needed equity capital raisings, the upbeat sentiment in Italian equities is justified on its improving fundamentals.

Since the correction in equities has come sooner than we expected, valuations within segments of the equity market have likely already realigned with fundamentals. This promises potential for equities to regain traction later this year, albeit with less of the vigor of 2013. For now, save havens look set to benefit in this environment.

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