

The FCO Cockpit – Global Bubble Status Report

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Chair of Entrepreneurial Risk

June 1st, 2015

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Main conclusion of this report:

More than ever, prices move together on a global scale across sectors and asset classes.

This inter-connectedness is what we have clearly been observing in this bubble status report since the beginning of the year:

- In the first quarter of 2015, we saw positive bubble signals⁺ in Equities, Bonds and Currencies, and negative bubble[°] signals in Commodities, mainly in Industrial Metals and Energy Products. *Warnings popped up on a scale that we had never observed before:* 85% of all Fixed Income Indices, 80% of European Equities Sectors, 50% of the Currency pairs and 45% of the Commodities analysed had bubble features;
- *In the last two months all these signals are fading simultaneously on the same global scale*, except for Chinese (and maybe more broadly Asian) Equities. In Europe and the US, there are hardly any more bubble warning signals in Equities and Bonds. The same is true for Currencies and Commodities.

⁺ A positive bubble warning signal is an indication of herding when people start buying because prices go up.

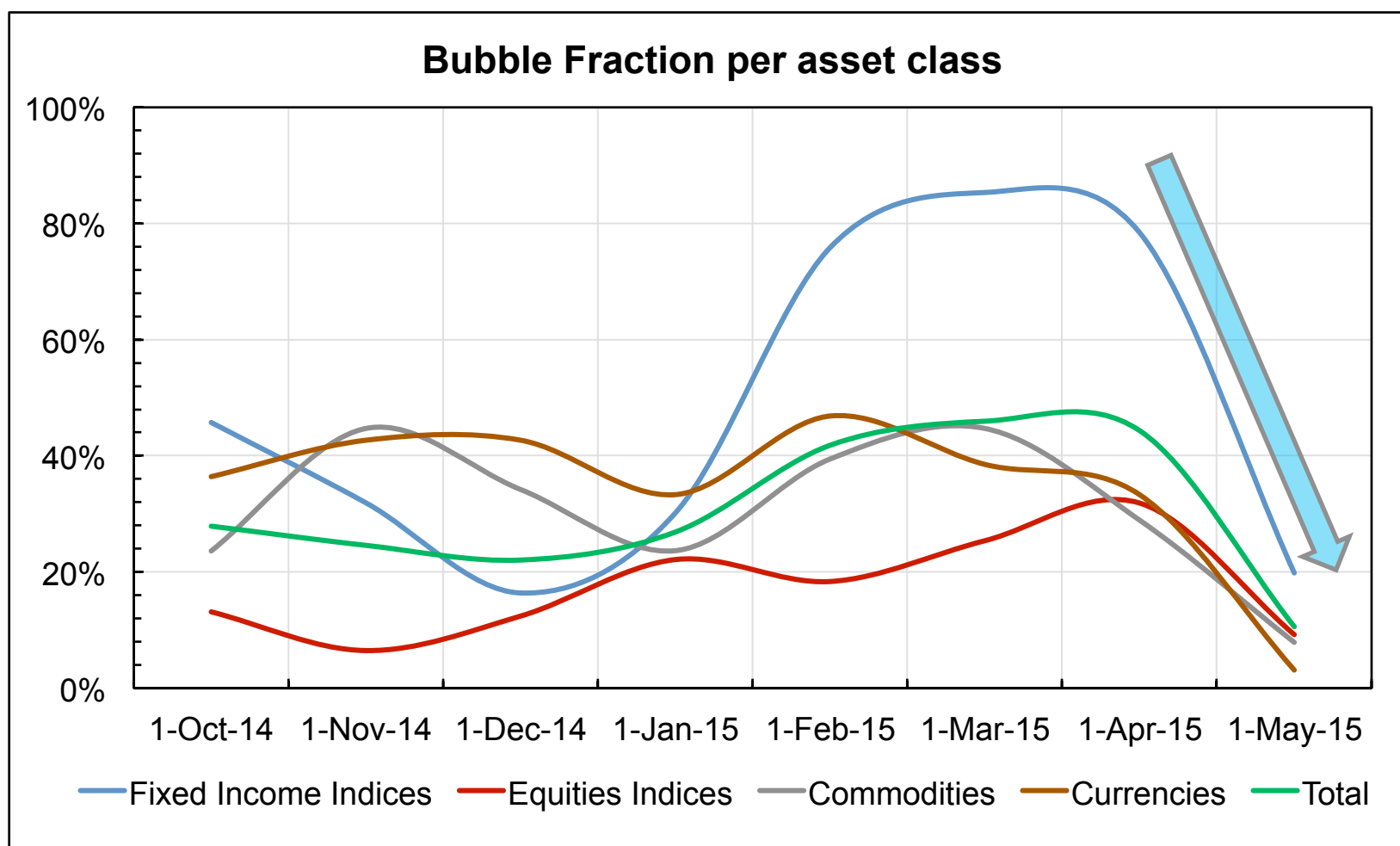
[°] A negative bubble warning signal is an indication of herding when people start selling because prices go down.

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434 systemic assets are monitored

	# Assets	# Bubbles June 1st 2015	% Bubbles June 1st 2015	% Bubbles May 1st 2015	% Bubbles April 1st 2015	% Bubbles March 1st 2015	% Bubbles February 1st 2015	% Bubbles January 1st 2015
Fixed Income Indices	116	23	20%	65%	78%	85%	76%	30%
Government	34	7	21%	68%	76%	88%	82%	67%
Corporate	82	16	20%	63%	79%	84%	73%	16%
Equities Indices	184	17	9%	30%	32%	25%	18%	22%
Country	77	13	17%	29%	32%	21%	21%	21%
US-Sector	63	3	5%	10%	14%	21%	27%	38%
EUR-Sector	32	0	0%	69%	78%	56%	3%	3%
Special	12	1	8%	42%	33%	0%	0%	0%
Commodities	38	3	8%	18%	29%	45%	39%	24%
Currencies	96	3	3%	13%	33%	39%	47%	33%
Total	434	46	11%	34%	44%	46%	42%	27%

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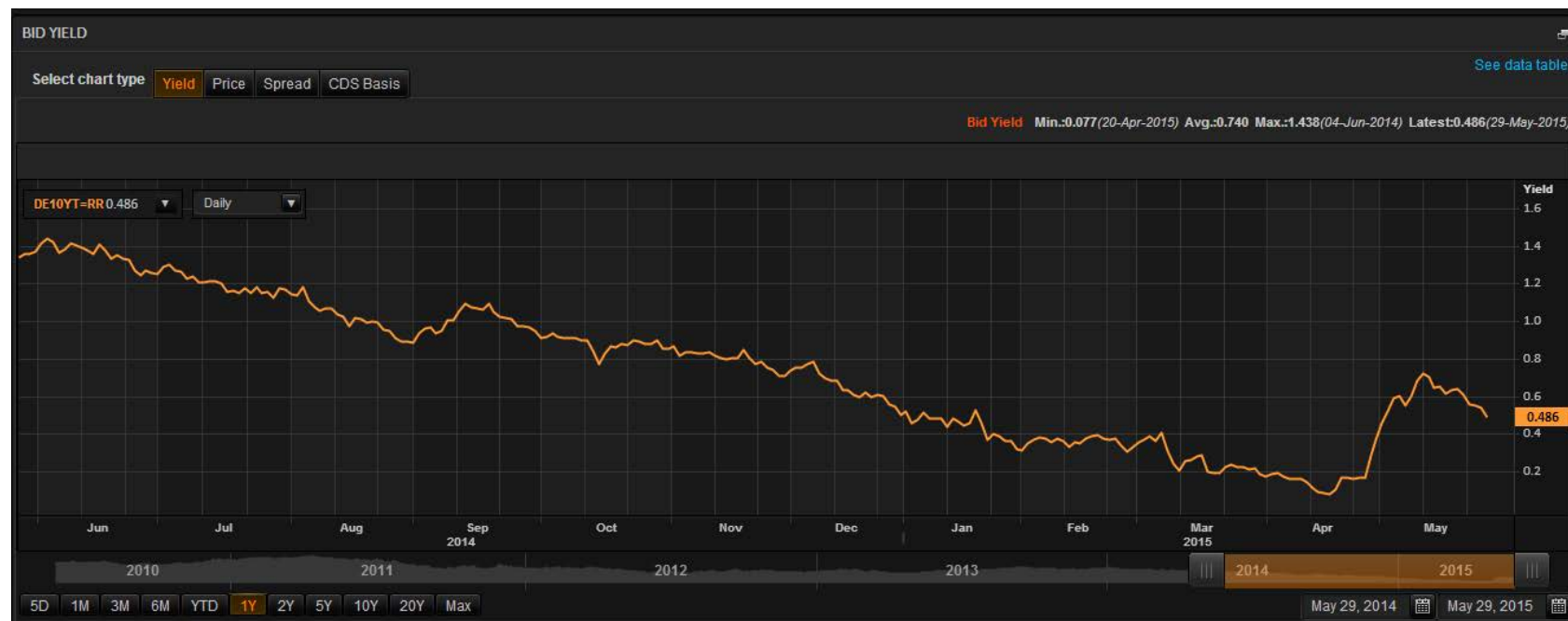


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Fixed Income

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Asset Class – Fixed Income

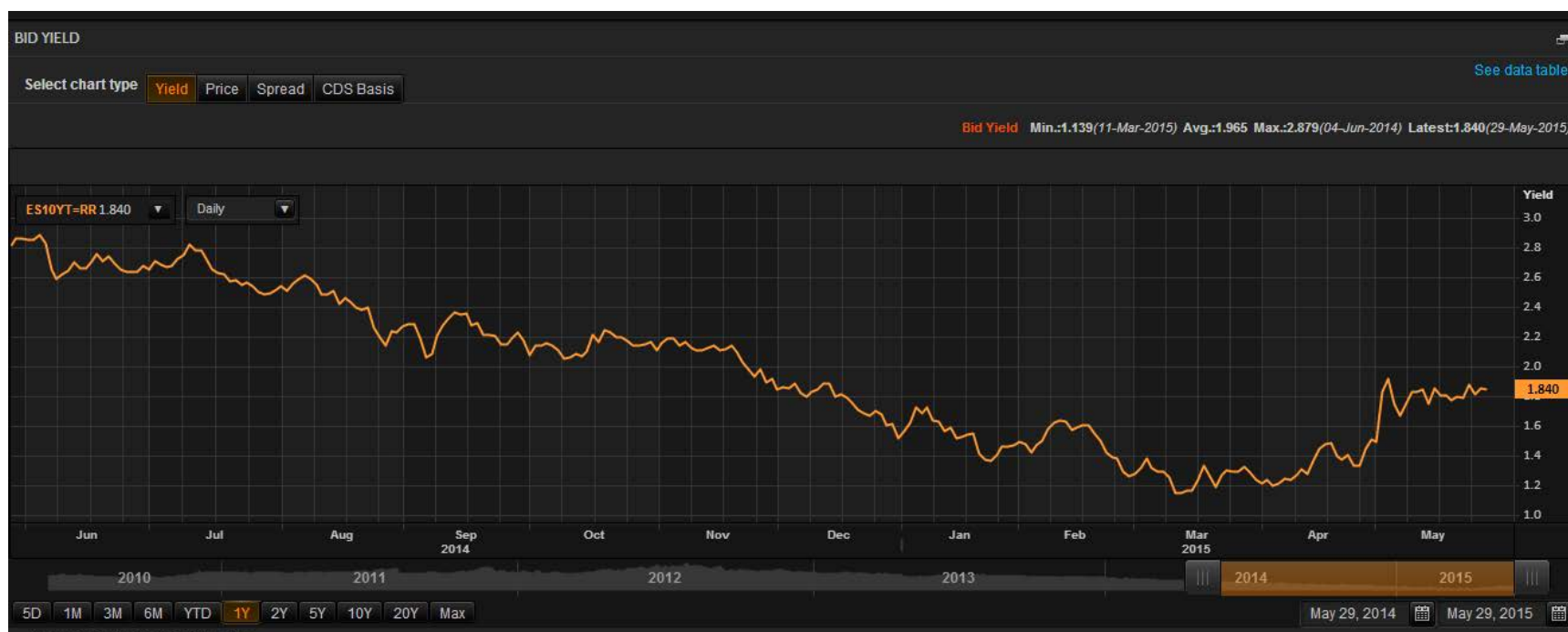


The graph shows the Yield on 10-year German Bonds.

We see that the secular trend of decreasing yields has changed in the last two months.

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Asset Class – Fixed Income

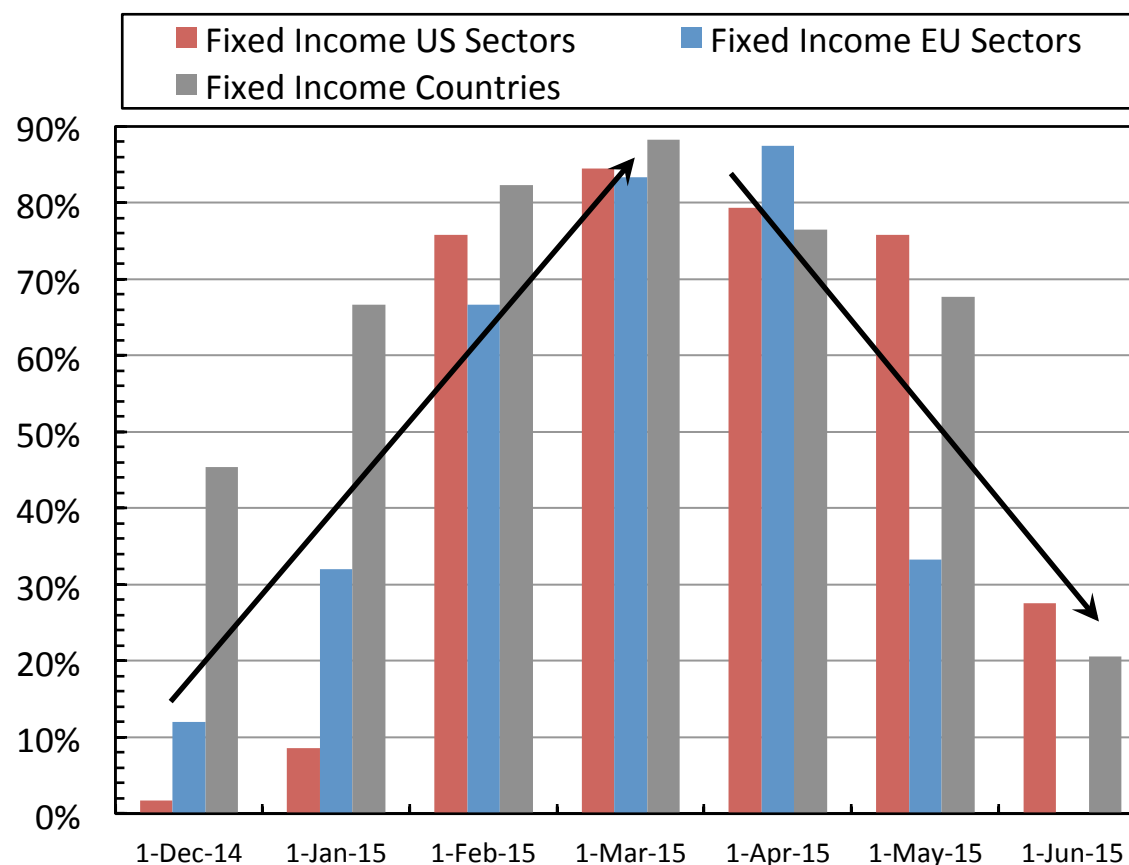


The graph shows the Yield on 10-year Spanish Bonds.

We see that the secular trend of decreasing yields has changed in the last two months.

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Asset Class – Fixed Income



General Observation:

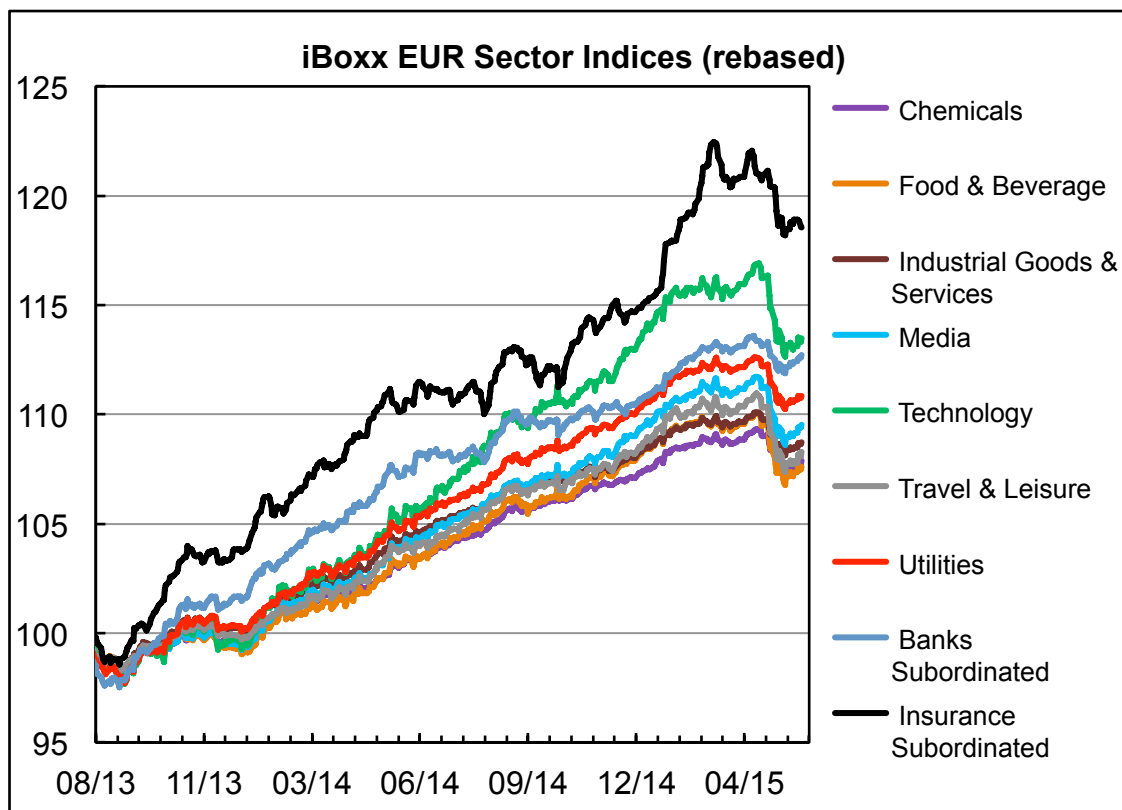
The first quarter of 2015, there was an unprecedented rise in bubble warning signals in Fixed Income indices. In the wake of the ECB QE announcement of January 22nd, more than 80% of the indices that we monitor gave clear warning signals.

With the recent correction, the drop in warning signals has been as sudden as its prior rise.

Movements are wild, suggesting herding and collective behavior.

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Asset Class – Fixed Income



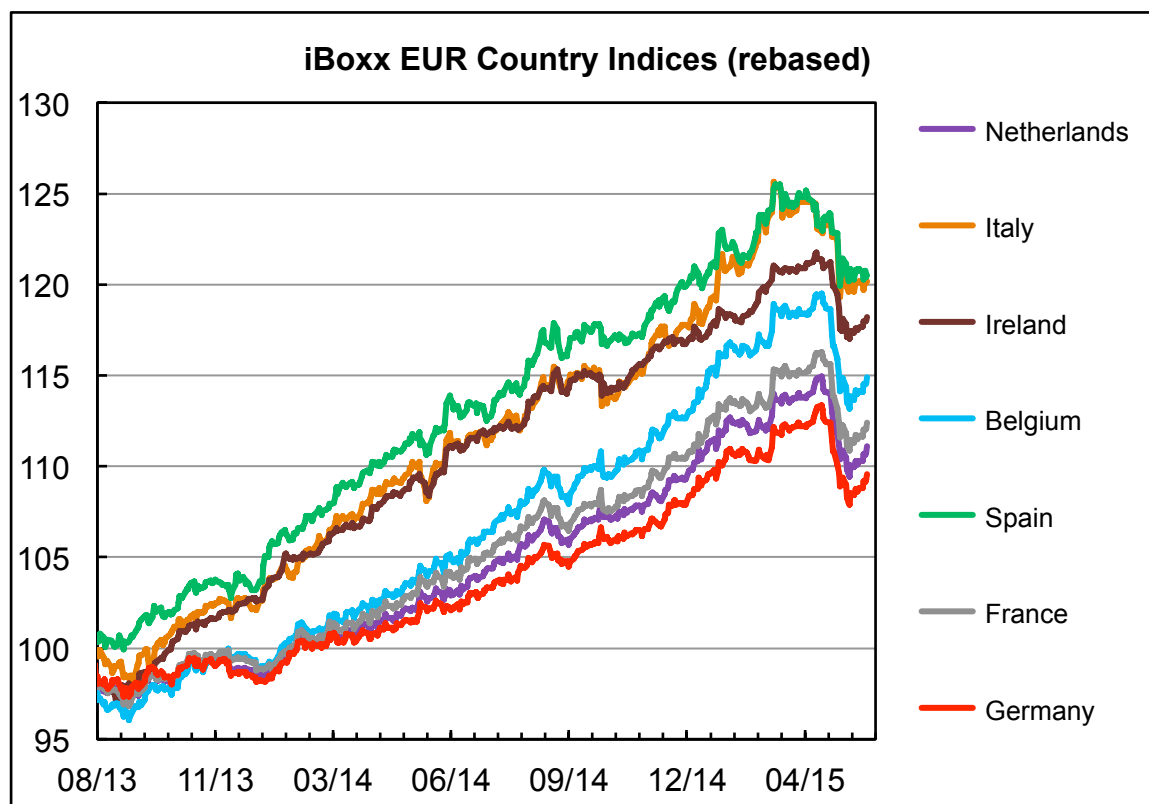
General Observation:

In March, we saw a peak in warning signals in European Fixed Income Sector Indices.

After that, a correction occurred across all sectors. This led to a general relaxation: there are no more warning signals in that asset class.

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Asset Class – Fixed Income



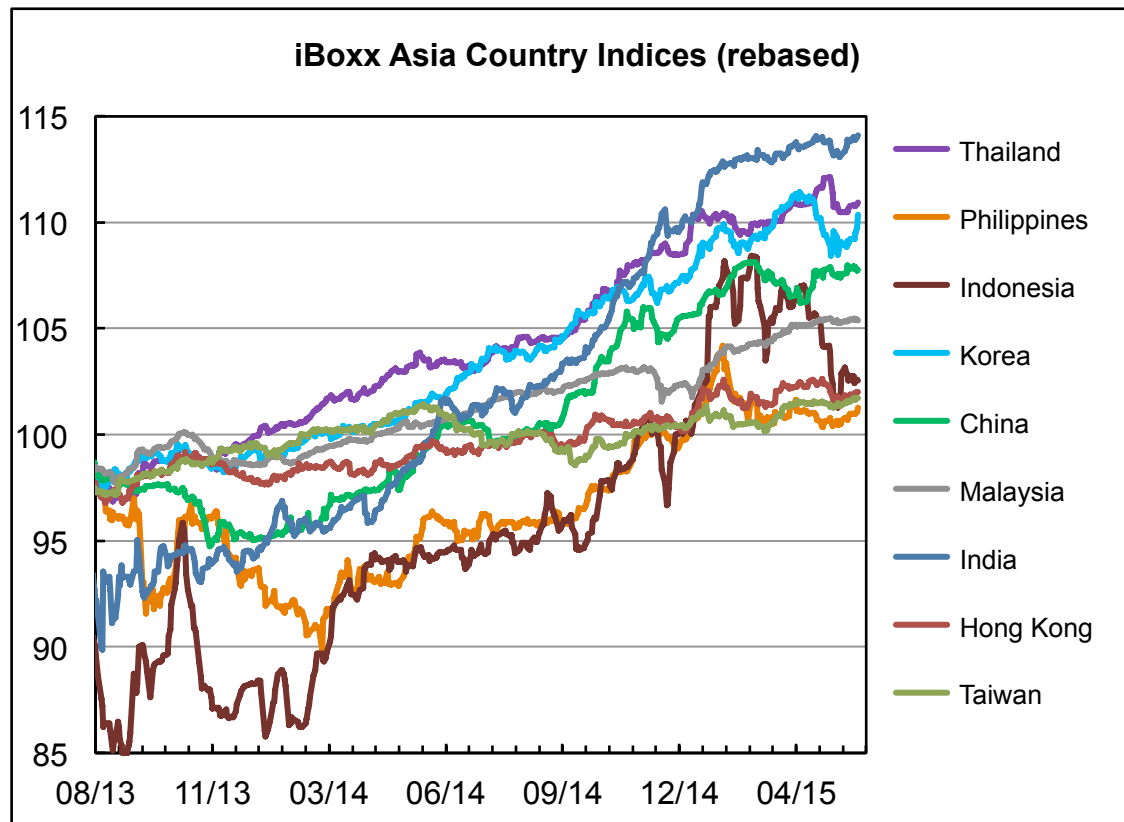
General Observation:

In March, we saw a peak in warning signals in European Fixed Income Country Indices.

After that, a general correction occurred. This led to a relaxation: there are no more warning signals in that asset class.

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Asset Class – Fixed Income



General Observation:

The same general correction cannot be seen in Asian Fixed Income Country Indices

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Asset Class – Fixed Income Indices

Fixed Income Country Indices	Yearly Return	DS LPPL Trust	DS LPPL Confidence
iBoxx EUR Slovakia Index	7.7%	28.8%	8.9%
iBoxx EUR Ireland Index	7.7%	12.0%	10.3%

Fixed Income Sector Indices	Yearly Return	DS LPPL Trust	DS LPPL Confidence
iBoxx USD Insurance Subordinated Index	5.9%	35.2%	8.2%
iBoxx USD Financials Subordinated Index	4.8%	10.3%	5.9%
iBoxx USD Real Estate Index	4.5%	10.3%	16.9%

General Observation:

Two months ago we saw warning signals across the board in all iBoxx Fixed Income Indices in the US and in Europe. Now all have disappeared but for a few indices.

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Equities

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Broad View:

This plot shows the performance of some major equity indices over the past two years (the time series are rebased to 100). We see that, since the beginning of this year, European Equities have outperformed US Equities and have caught up with Japanese Equities. US Equities have gone sideways in that period. The valuation gap between Hong Kong and Chinese stocks is closing. This is the consequence of the HK-Shanghai stock trading link becoming active.

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich

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Broad View:

This plot shows the performance of the same major equity indices year-to-date (the time series are rebased to 100).

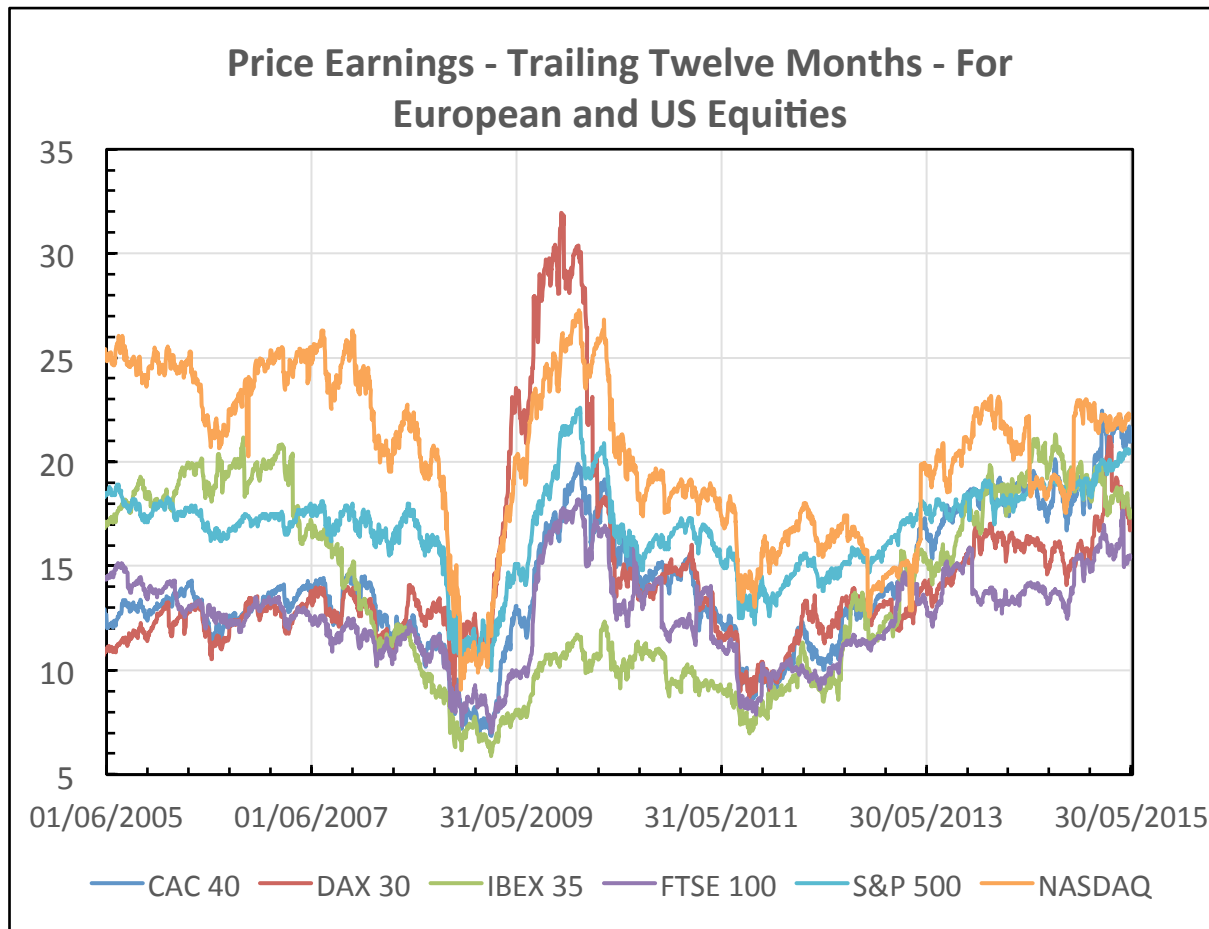
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When looking at Global Equities over the last three months we see:

- Mainland Chinese stocks outperforming, even after the most recent correction;
- Hong Kong stocks relaxing after the April rally;
- US stocks going sideways;
- European stocks relaxing after their rally in the first quarter;
- Brazilian stocks sliding back.

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Looking at historical Price Earnings ratios in the US and Europe, we can conclude that valuations are stretched.

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Asset Class – Equities Country Indices

Equities Country Indices	Yearly Return	DS LPPL Trust	DS LPPL Confidence	Country
<i>Positive Bubbles</i>				
SZSE 100 Index	125%	42%	40%	China
Shanghai SE Composite Index	126%	34%	25%	China
FTSE China 25 Index	35%	17%	16%	China
Budapest SE Index	17%	14%	16%	Hungary
TOPIX Stock Price Index	39%	11%	6%	Japan
Shanghai SE 50 Index	110%	11%	5%	China
Hang Seng Index	19%	9%	18%	Hong Kong

General Observation:

The observation is no surprise: Chinese stocks are in bubble territory. Clearly, the rise in the last year is not sustainable;

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Asset Class – Budapest SE Index



In the past three months, Hungarian stocks (in purple) rose more than 30% and have outperformed European stocks (in orange) by 25%. The Budapest SE Index now shows bubble warning signals.

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich

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Asset Class –Equities Sector Indices

Equities US Sector Indices	Yearly Return	DS LPPL Trust	DS LPPL Confidence
<i>Positive Bubbles</i>			
S&P 500 -Real Estate Mgmt&Devp	29%	9%	13%
S&P 500 Internet&Catalog Retail	22%	5%	15%

General Observation:

- We see exactly the same as with the Fixed Income Indices. Movements are wild. First there was a massive rise in warning signals across the board in European Equities. A correction followed. Now, all warning signals in European Equities have disappeared;
- Like in Fixed Income, the only warning signals that are left are in a few US Indices.

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Asset Class – European Equities Sector Indices

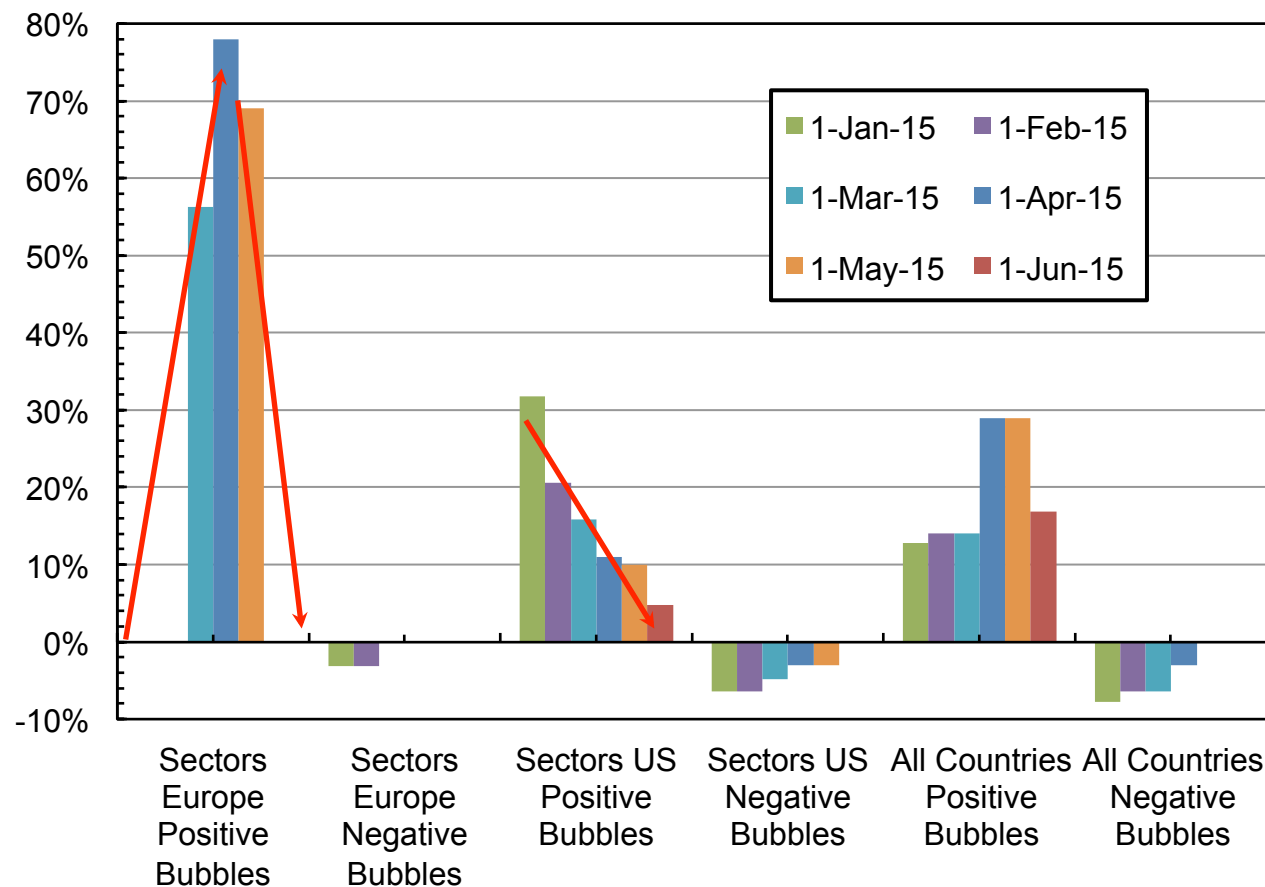


There have been interesting dynamics in European Stocks and Bonds. In the first quarter of 2015, there was a massive rise leading to unprecedented warning signals across all sectors. The recent correction led to some relaxation. As quickly as they appeared, all warnings have now died out.

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich

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Equities



In the first quarter of 2015, there was a massive rise in European Equities leading to unprecedented warning signals across all sectors.

The recent correction led to some relaxation. As quickly as they appeared, all warnings have now died out.

Also in US Equities, there are only a few indices that still show bubble warning signals.

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Asset Class – Equities Single Stocks

Next to the 185 global sector and country Equities Indices, we do a bubble analysis on single stocks taking all S&P 500 and Stoxx Europe 600 constituents with a market cap higher than \$ 50 bn, and all Hang Seng and Nikkei constituents with a market cap higher than \$ 15 bn.

In total, we analysed 221 stocks, 34 of these show bubble signals (0 negative and 34 positive bubbles). Last month 55 stocks gave clear signals.

So, in single stocks we see the same as in the indices, bubble warning signals are waning across the board.

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Single Stocks	Yearly Return	DS LPPL Trust	DS LPPL Confidence	Sector	Country
Positive Bubbles					
Walt Disney Co	31%	21%	15%	Consumer Discretionary	US
Starbucks Corp	41%	20%	17%	Consumer Discretionary	US
Accenture PLC	19%	12%	13%	Information Technology	US
ING Groep NV	47%	11%	14%	Financials	EU
Mitsubishi UFJ Financial Group Inc	60%	14%	27%	Financials	JP
Canon Inc	29%	16%	25%	Information Technology	JP
East Japan Railway Co	48%	26%	32%	Industrials	JP
Tokio Marine Holdings Inc	63%	28%	47%	Financials	JP
Sony Corp	136%	31%	11%	Consumer Discretionary	JP
Kao Corp	38%	26%	12%	Consumer Staples	JP
Fujifilm Holdings Corp	80%	13%	32%	Information Technology	JP
Industrial and Commercial Bank of China Ltd	34%	11%	38%	Financials	HK
China Construction Bank Corp	37%	13%	43%	Financials	HK
Bank of China Ltd	42%	17%	32%	Financials	HK
China Life Insurance Co Ltd	76%	14%	12%	Health Care	HK
AIA Group Ltd	33%	13%	16%	Financials	HK
Ping An Insurance Group Co of China Ltd	94%	21%	21%	Health Care	HK
MTR Corp Ltd	26%	31%	29%	Industrials	HK

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Currencies

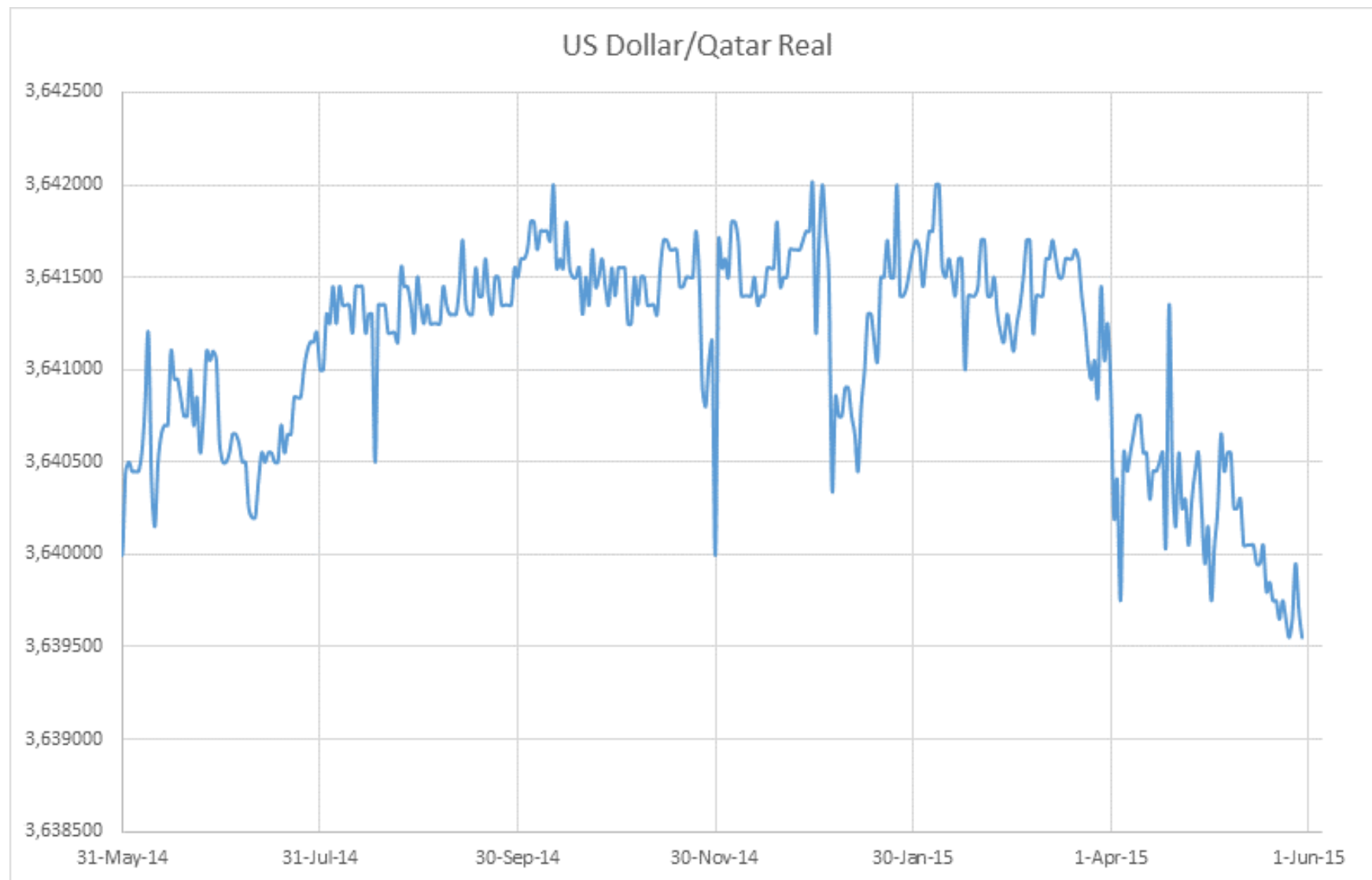
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FX	Yearly Return	DS LPPL Trust	DS LPPL Confidence
US Dollar/Argentine Peso	11%	46%	42%
US Dollar/Qatar Rial	0%	6%	25%
Swiss Franc/Turkish Lira	18%	6%	15%

Commodities	Yearly Return	DS LPPL Trust	DS LPPL Confidence
<i>Negative Bubbles</i>			
Tin ER Index	-34%	32%	28%
Robusta Coffee ER Index	-21%	13%	27%
Sugar ER Index	-44%	8%	5%

In the first quarter of 2015, we saw many very strong positive bubble signals in Equities, Fixed Income and Currencies, but also very strong negative bubble signals in Commodities, mainly in Energy and Industrial Metals.

It is striking that now that the bubble signals in Equities and Fixed Income are waning, the same happens simultaneously in Currencies and Commodities.



Notwithstanding the quasi-pegging of Qatar real wrt UD\$, this large negative bubble of the US\$ in Qatar real is significant in terms relative to its usual managed band. See news section 28 April 2015 (Movie of the euro/Swiss franc exchange rate) at www.er.ethz.ch/

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Asset Class – Currencies



DXY, the US Dollar Currency Index has followed the classical price trajectory of a bubble. Positive feedback due to herding leads to a faster-than-exponential price increase. The process is unsustainable and ends in a correction or a change in regime.

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich

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Asset Class – Commodities



Two months ago, the negative bubble signals on oil disappeared. At that time we suggested that prices had touched bottom.

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Conclusion

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Fixed Income:

The first quarter of 2015, there was an unprecedented rise in bubble warning signals in fixed income indices. In the wake of the ECB QE announcement of January 22nd, more than 80% of the indices that we monitor gave clear warning signals. With the recent correction, the drop in warning signals has been as sudden as its prior rise. Movements are wild, suggesting herding, collective behavior.

Equities:

Exactly the same was observed in Equities. Movements are wild. The rise and subsequent drop in bubble warning signals across countries and sectors has been sudden and simultaneous. This was seen in Sector Indices, Country Indices and in single stocks.

Contrarian to this global relaxation, however, Chinese stocks are red hot.

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Commodities & Currencies

Commodities and Currencies show a fascinating synchronicity with stocks and bonds. At the same time when bubble warning signals on stocks and bonds are fading out, we see the same thing happening with Commodities, where oil prices seem to be stabilizing and Currencies, where the Ruble and the US Dollar have rebounded.