Chief Economist's Comment

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New year, new chances

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After the painful losses in the stock markets in 2011, investors are longing for a year with less drama. Maintaining asset value is considered the primary objective. However, it is not highly rated sovereign bonds that offer the most favourable risk-reward profile, but stocks. Thus, 2012 will presumably turn into a year of the stock. A level of 7,000 for the DAX by the end of the year does not seem overly ambitious.

Significant stock losses in 2011

Following the painful losses in the stock markets in 2011, investors are longing for a year with less drama. Asset preservation is considered the primary objective.

A year ago the mood in the markets was still euphoric

By contrast, a year ago the mood in the markets was completely different. The forecasts for growth and profits were virtually off the charts, especially in Germany. For a long time, the debt crisis was considered a local problem of the smaller, peripheral euro countries. As a result, the vast majority of market participants assumed that stock prices would continue to rise. Quite a few were even predicting new highs for the DAX. We were pretty much alone with our forecast of the DAX at 6,200 at the end of 2011. This changed only when stock prices around the world plunged sharply during the summer months.

Subdued mood at present

Today, the mood of many market actors is still very subdued. Forecasters are currently trying to outdo each other with lowered growth expectations. Gloomy scenarios about the end of the euro are circulating. In spite of a focus by investors on real assets, the expectations for the DAX are rather restrained. Thus, the average of the forecasts of where the DAX will be by the end of 2012 is a modest 6,600 points; unlike last year, new highs are not on anyone's mind.

Chance for positive surprises

In the face of widespread scepticism, I believe, however, that the balance is in favour of chances for positive surprises in the coming year. To be sure, dealing with the sovereign debt crisis will also preoccupy the markets in the coming months. Thus, the voluntary write-off of some of Greece's debts by its private creditors has still not been finalized. And the strong refinancing needs on the part of other euro countries in the first quarter also remain an uncertainty factor. But all of these factors are already known and have been priced in. For example, the risk premiums on sovereign bonds from the euro periphery with a longer maturity continue to be at a significantly elevated level, after having eased temporarily.

Economic recovery in the course of 2012

However, if the euro countries continue their reform efforts, this will soon be reflected in the risk premiums. Stock markets will also benefit from risk aversion that will then wane. This trend is supported by an economic environment that will become more favourable again in the course of the year. While the economic data from the US have already been mostly better than expected for several months now, in Europe the negative surprises have so far still predominated. Most recently, however, the first signs of a bottoming out in the leading indicators are apparent also in Europe. For example, the German ifo Business Climate Index recorded the second slight rise in succession. And the Purchasing Managers' Index for the euro zone has also stabilised.

Favourable valuation of stocks

Experience teaches us that rising leading indicators and low interest rates constitute a positive constellation for stocks. To be sure, major surges in corporate profits are not to be expected in 2012. Moreover, the average profit estimates for 2012 are presumably still too high. For the DAX and the S&P 500, profit growth of 8 and 10 %, respectively, is being projected. However, analysts have been revising their forecasts downward for months. However, more important than the profit projections are the profit expectations inherent in the stock prices. Those expectations are noticeably higher and thus offer a buffer. On the basis of cyclically adjusted profits, German and European blue chip stocks, in particular, are similarly favourably valued as they were during the most pronounced lows of the last thirty years.

DAX expected to stand at 7,000 points

In addition, unlike US stocks, German and European stocks have already anticipated a significant economic weakening. Thus, the opportunities in 2012 lie in Germany and in Europe. Should there be setbacks on stock prices in the next few weeks, it would be worthwhile to use them to enter the European or German stock market. After all, in the face of rather negative real yields, capital preservation can barely still be accomplished precisely with highly rated sovereign bonds. Thus, 2012 will presumably be a year of the stock. A level of the DAX at 7,000 by the end of the year does not seem overly ambitious.

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