When will there be a correction?

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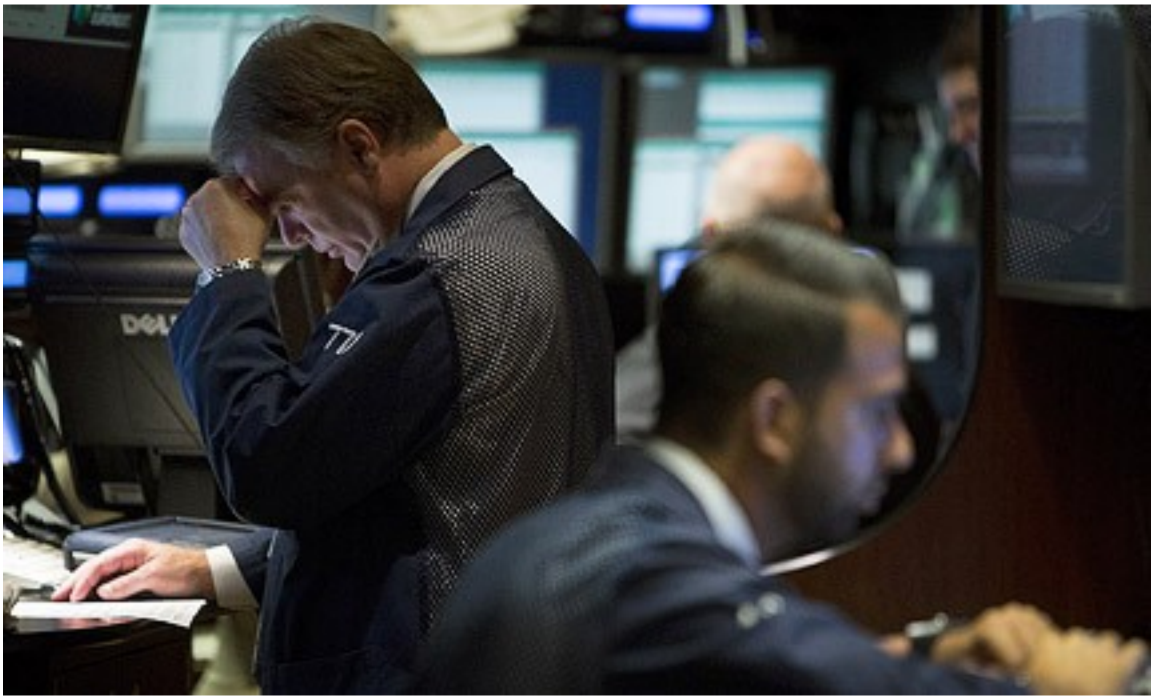
US investors in particular have experienced significant growth over the past five years. Photo: Bloomberg

That is the big question investors are asking themselves these days.

This is particularly true of US investors, who have seen their money triple from the bottom of the market a little over five years ago. The journey has not been entirely without risk, however.

Both in 2010 and 2011 there were significant corrections of 15 percent or so. These came in the form of flash crashes, downgrading of debt, the Eurocrisis and Emerging Market scepticism.

Over the past three years, the share price curve has been almost linear, however. Falls in some sectors have been compensated by rises in others. With low growth and moderate earnings developments, the result has been a significant revaluation of the stock market. Still, the revaluation has not resulted in anything worse than that the level for non-cyclical key figures are somewhere around the level from the period 2004-2007. With the level for risk free interest rates halved, it doesn't seem as though there is much danger afoot.

What is striking is how uniform developments have been globally so far this year. As of Monday morning the performance of global emerging markets and the world index was almost identical, with the markets up 6.8% and 6.9% respectively as measured in euro.

Nevertheless, from a ten-year perspective, we observe certain anomalies.

Emerging markets have, naturally enough, fluctuated the most. First, they were substantially repriced, right up to the autumn of 2007, at which point they plummeted, before again being repriced right up until the winter of 2010, and finally moving sideways for four years. As companies grow and develop, the effect has been that they have become cheaper and cheaper.

Having been ravaged by the Eurocrisis, Europe is also cheaper than it was ten years ago, owing to the fact that companies' earnings continue to limp along. In addition, last year's winning market, Japan, is this year's weakest major market. Company earnings appear to be increasing substantially. At the same time Japanese companies are astoundingly cheap, both from a historical and geographical perspective. Faith that the country's economy is finally on the mend has clearly not been discounted in the market yet.

At the start of the year there were, as usual, numerous predictions about one thing and another. Most of them, including the consensus – or as we like to say, the sum of people's accumulated prejudices – were wrong.

Interest rates did not rise; they fell. There was not more unrest in global emerging market currencies. China did not fall off a cliff and suffer an ensuing banking crisis. The collapse of the European peace paradigm shift from 1991 up to Russia's annexation of Crimea had an impact for a little over a month and did not exceed 10 percent. Except in Russia, of course. Peace, calm and increased oil production from Iraq did not become a reality either. And Norwegian house prices did not plummet either. It just felt as though they did in January.

So back to the case in hand: when will the correction come?
When the interest rate rises, say some. When volatility increases, say others. The latter is a wonderfully self-fulfilling prophecy. But both are in a sense right.

Expectations about rising interest rates will come when the signals of rising growth become consensus. This may trigger a shift from equities to bonds, and possibly also expectations of higher inflation. But not necessarily. Better earnings developments in market-sensitive sectors may compensate for this as was the case in the years 2004-2007. The trend is the opposite for the time being. The European Central Bank should now work to counter deflation – as did Japan and the US before them. With careful stimuli from China, we are now in the situation that all four corners of the earth are pulling in the same direction.

What are the danger signals?
The structural shift in volatility was a very clear signal in 2007 and 1997. Silly sales of new shares from companies as we saw in 1999/2000 and in 2007 are another example of an indication that we are headed into darker times.

However, it is important to remember that the trenches from a previous war cannot necessarily be used in the next one.