Knowing the price of everything and the value of nothing

With the leading stock indices ratcheting up further gains in the low double digits towards the end of 2017, we ask: are today's corporate valuations – and the projected cashflows on which they are based – really justified? In attempting to answer this question, we explore macroeconomic factors and their impact on anticipated growth in the relevant countries and sectors, as well as potentially disruptive forces that may compromise any standard scenario posited as likely.

From our perspective, the long-awaited growth – of 1 to 3% in the advanced economies and 5% or more in certain emerging economies – is not the primary cause for concern on the valuation front; we are more exercised about a range of *special factors*, all of which suggest that much is currently in a state of limbo. Governments in a striking number of countries seem to be skating on *unusually thin ice*: majorities are proving increasingly difficult to achieve while political extremism is eroding societal cohesion, and viable solutions have yet to be found for major agenda items – not least, Brexit. World leaders have still not really got to grips with the style of the new US president, even as there is much to suggest that he might be elected for a second term (directly confounding the expectations of European media outlets). When it comes to the Middle East, we see Western nations' opposition to Iran hardening as a result of a power shift within the Saudi royal family. While these phenomena do not necessarily pose immediate, explicit threats, they present investors with serious implicit risks – icebergs floating just beneath the surface. These imponderables are unlikely to have been properly priced into stock market valuations.

In the narrower, microeconomic context, we believe that *Industry 4.0* (Big Data, blockchain, Internet of Things, etc.) is likely to create greater uncertainty with respect to companies' cashflows in the "far future" than most market participants care to admit. The deconstruction of a swathe of processes, the subsequent overhauling of entire industrial systems – and indeed the radical refashioning of end-products such as cars and domestic appliances – make it very difficult to predict with any certainty who will come out on top. The risk that popular, amply capitalised, high-dividend companies will end up on the scrapheap cannot be dismissed out of hand. Here too, much seems to be hovering in limbo; reliable facts are hard to come by and very few economists or commentators have any sense of how things will look in four or five years' time.

On the *monetary policy* front, too, we seem to be adrift. There is plenty of talk about rolling back "ultra-liquidity", but so far precious little action has been taken, leaving the central banks with minimal room for manoeuvre for the foreseeable future. Given that "normalisation" has barely begun, the policy options available to central bankers seeking to tackle the special factors mentioned above are therefore limited. In addition to flagging up the economic distortions wrought by the (no longer terribly extraordinary) policy of free money, we draw readers' attention to fundamental actuarial problems besetting the valuation of future cashflows in the face of rock-bottom interest rates and an absence of risk premia on the financial markets. Now of all times, when society and the economy are undergoing such profound structural change (digital revolution, automation), the extreme positioning of these two parameters is causing the "far future" to weigh disproportionately heavily in the scales of corporate valuations. And, as we know, the far future is infinitely harder to predict than the "near future" – even when transformational change is not part of the equation. The upshot is an exuberance that – given the aforementioned limbo conditions and the potentially dramatic consequences of an ongoing technological revolution – is entirely misplaced.

We do not leave our analytical conclusions hanging in the air, however. Our essay closes with some concrete tips for entrepreneurs and asset portfolio owners. In our view, the days of blind, passive wealth management have been and gone, and there is no alternative to augmenting essential diversification with intelligent selection criteria; any other approach risks favouring capital-heavy dinosaurs that are systematically dying out. Now more than ever, when scanning the market for promising investment opportunities, we are looking for companies that have genuinely internalised the notion of creative destruction and innovation as the route to sustainable value creation. In short, we live by the mantra "Schumpeter inside!" – and we would urge our readers to do the same.

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