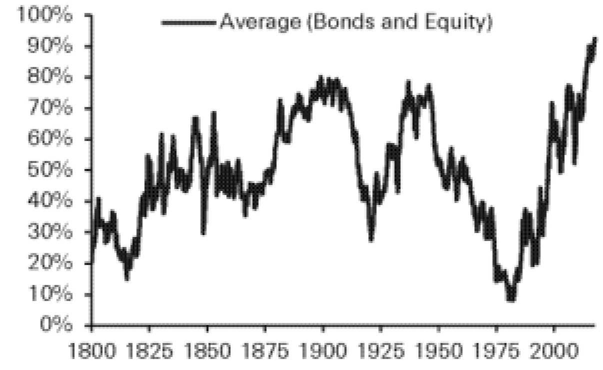
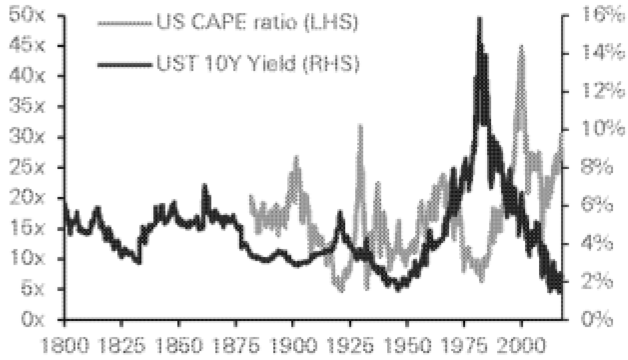
Figure 7: Percentile Valuations of 15 DM Bond and Equity Markets back to 1800 (left) and US CAPE ratio vs. US 10Y yield (right)

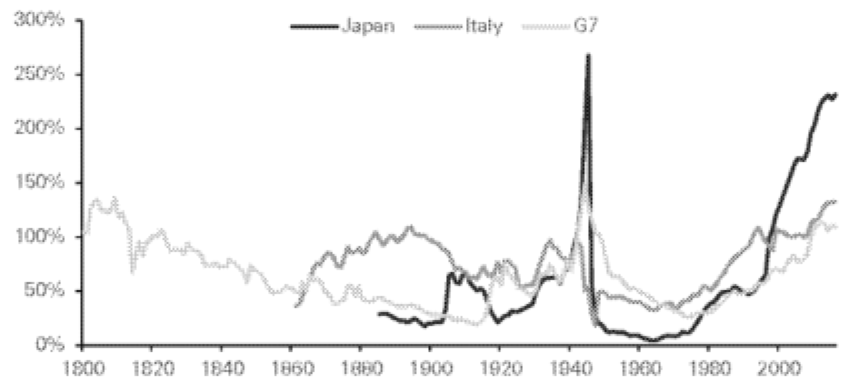




Source: Deutsche Bank, Global Financial Data, Bloomberg Finance LP

- Global central banks have facilitated these elevated asset prices. A long series of global financial problems have now been passed through all parts of the financial system with most of these problems stacked up and now resting with central banks and Governments. The buildup of debt that this has created has forced central banks to keep yields at ultra-low levels, thus raising the prices of a variety of other global assets.
- Italy and Japan have seemingly unsustainable debt burdens and are likely vulnerable to a crisis outcome. However both have had this for some time which mitigates short-term risks. Italy is perhaps more vulnerable because of precarious and fragile politics, elevated levels of populism and a central bank that is regional and not domestically controlled. Japan shows how long a crisis can be avoided but that doesn't automatically mean we should be complacent, especially as the BoJ now owns over 40% of the JGB market (from under 10% in 2012).

Figure 8: Government Debt to GDP ratios – Italy, Japan and G7 aggregate



Source: Deutsche Bank, Global Financial Data, Haver

- On populism, our index (Figure 9) tracking its rise across key DM countries shows that we are close to the 1930s highs. Is this a precursor to a big crisis? Does it make for more unpredictable politics, economics and markets?