Winter

Market outlook.

Brought to you by the Investment Management team at my wealth WEALTH at work

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The UK Economy

Although the UK equity market lagged most other major markets throughout 2017, a pickup in December saw the market end the year in good shape and BREXIT dooms day predictions have so far failed to severely hinder the UK equity market. The economy expanded over the year, the labour market remains buoyant and wages are improving (albeit still lagging inflation).

However, whilst the equity market and economy seem to be ticking along, BREXIT negotiations are far from over and this year will enter a more difficult and complex stage, which will likely lead to volatility in markets.

As it stands, the market is anticipating a soft BREXIT which, coupled with recent jobs data fueling expectations of an interest rate rise, has led to an appreciation of sterling, which should help keep a lid on inflation.

Currently, the market expects an interest rate rise mid-2018; however, despite the creation of jobs, with wages continuing to lag, and evidence of pressure on the consumer (Christmas trading updates from clothing retailers and the supermarkets were disappointing), should inflation cool as well, the UK is unlikely to be at the beginning of an aggressive rate rise cycle and the Bank of England is more likely to remain accommodative, with interest rates lower for longer.

The Japanese Economy

Following a rally in Japanese markets after the snap elections in the 4th quarter of 2017, seeing Prime Minister Abe win the 'super majority', whilst stability in leadership added buoyancy, concerns remain. Uncertainty surrounding stimulus plans are key amongst many, as with attentions already focused on building out the military and still no sign of significant domestic level policy, threats of a reversion in the Japanese markets are apparent. These concerns are compounded by uncertainty over policy throughout January 2018, as with global bond markets coming under pressure, managing bond purchases based on yield curve manipulation has become infinitely more difficult. This resulted in them un-expectantly announcing they would be buying significant proportions of 3 to 5 year bonds, suggesting they have reverted to backing unprecedented quantitative easing. With all of this indecisiveness, the uncertainty shrouding the Bank of Japan's (BoJ) governor Haruhiko Kuroda does not help. Architect of modern day Japanese policy, and close friend to likeminded Abe, Kuroda's term as BoJ governor ends in April 2018, and although it is likely he will be invited to stay on for another term, at the age of 73 he has yet to announce whether he will retire. This would be a blow to the planned market resurgence, and the country's continual battle to ward off deflation. This is all against a backdrop of low wage inflation, despite employment data that is supportive of it!

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The Emerging Markets & Asia Economy

Emerging Markets and Asia finished 2017 as some of the strongest and most consistent performing equity asset classes starting 2018 with much the same breath. With its correlation with the US markets and currency subsiding in recent times, it has given many countries such as China, India and Korea the opportunity to forge a genuinely more independent path forward. In line with this, we have seen the Chinese currency (Renminbi) strengthen in 2018 despite fear of weakness following a rate rise cycle in the US. With the US rate rise path appearing to be priced into many markets and currencies for the longer term, a weaker dollar coupled with strong and robust sets of Chinese growth data (expected to be within the range of 6.5% to 6.8% in 2018) has led to a strong start to the year for markets and the Renminbi. The 40 year growth plan outlined by Chinese President Xi Jinping last year has seen China soften its previous stance in regards to global political ties and trade relations; seeing the potential for it to strengthen trade data, service sector data and growth data, whilst stabilising the previously planned decline in manufacturing.

Elsewhere in the region, there remains a contrast in expectations. India remains one of the fastest growing major economies globally, with its recent forecast expecting an acceleration in growth of between 7% to 7.5% for 2018. With a general election in 2019 looming, and 'short term pain, long term gain' policies such as demonetisation and the introduction of the Goods and Services Tax (GST) negativities now priced in to equity markets, the benefits of these policies coupled with election friendly domestic policies are likely to benefit markets as they gain traction in the run up to the 2019 elections. On the flip side, the broader Latin American block is still riddled with uncertainties and corruption. With Mexican elections due in July 2018 and the incumbent President Nieto not eligible for a second term, the economy remains in limbo. Likewise, with Brazil's elections due in October, and with the leading candidate Lula da Silva still caught up in corruption scandals (similar to that of impeached President Dilma Rousseff), a fear of 'more of the same' in addition to uncertainty makes volatility a key risk in the country. All of this being said, in the right countries, opportunity and attractive valuations suggests the Emerging Market and Asian asset classes are well positioned for 2018.

The US Economy

Concerns over US stock market heights have been rife over the past few years. However, the broader market backdrop is different than anything that has gone before; with the results of supportive measures such as quantitative easing no longer conducive to current inflation data. In addition, whilst valuations in the US appear high, current earnings and growth levels, when coupled with government driven stimulus give a very different outlook. Whilst one should never be complacent, the current backdrop appears positive for corporate earnings and indeed for improving economic data, residing the current highs of the S&P500 to being 'just a number'. Other than minor interest rate hikes, 2017 saw very little stimulus by either the Federal Reserve Bank (Fed) or the government, with the latter likely due largely to the number of scandals President Trump was caught up in. However, with the midterm elections coming up in November (2018) and Trump having little to show by way of policy implementation, it is likely multiple buoys will be injected into the market prior, to try and gain support. We have already had the announcement on tax reform that will see the average rate of corporate tax decrease for many medium and small size businesses to around 21%, and whilst it is questionable whether or not the broader range of tax cuts do indeed benefit everyone as Donald Trump claims, it is a massive boost for the domestic businesses. So, whilst we have seen taxation reform penalise multinationals' utilisation of tax safe havens, domestic America still stands to benefit ensuring growth remains strong. However, confusion around economic data is still apparent, as although headline employment data appears strong, there still appears to be plenty of slack in the labour market suggesting the data is inaccurate. In addition, in Janet Yellen's last testimony as head of the Federal Reserve Bank, she cited concerns over inflation, but confusingly she also stated that unemployment would improve... and, whilst this is contradictory and even some what irrelevant, it does highlight that there are elements of the US market that still have lingering uncertainties that investors should always be aware of.

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The European Economy

The past quarter has been relatively muted for European markets given the level of political volatilities in the first 3 quarters of 2017. Whilst it is true to say that Germany is still without stable leadership following Angela Merkel's Christian Democratic Union party's failure to form a coalition, and the prevailing Italian elections barrelling down on us in March of this year, these are stacking up to be 'non-events' over the longer term (as we saw last year with the French and Dutch elections). The devil is in the detail, as with polling data suggesting the same outcome if the German electorate go to the polls again, it is highly anticipated that Merkel will eventually forge an agreed coalition, reintroducing stability in the largest EU economy. In addition, following an abysmal set of results for the anti-establishment 5 Star party in last year's Italian local elections, polls are now suggesting the threat of a 5 Star victory is highly improbable... even so, this election was more about detaching Italy from the EU and single currency, and given 5 Star (the protagonists of this) have backed away from this proposal, the elections now become more of a buying opportunity for investors than a true economic threat! With this in mind, and with the head of the European Central Bank, Mario Draghi's term ending in 2019, it is likely policy for the majority of 2018 will remain relatively sanguine, allowing pent up relative value in European markets to come to the fore. So, with inflation steadying, growth strengthening, and employment improving in the core, European markets have the foundation with which to build.

Fixed Interest

Recent months have been quiet in terms of policy, with only marginal expectations shifting yields and valuations in the asset class. With interest rates in the UK likely to remain static for longer and the US rate rise cycle likely to be prolonged, it is the upward pressure on the US ten year that is coming to the fore (encroaching on 3%, its highest in nearly 4 years). In addition, with trading volumes heading into equities, a recent rout in the global bond market, and central bank policy maintaining an environment that is not conducive to positive bond market performance, bonds seem an unlikely recipient of global asset flows in the near term. That being said, corporate bonds continue to offer better opportunity than government debt partly due to equity correlations.

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