

Growing pains

Weekly Digest

15 January 2018

– Richard Stutley, CFA

The growth outlook looks better at the start of 2018 than it has done in recent years. But while ‘growth is good’, investing is about that key confluence between what you’re buying on the one hand and what you pay for it on the other; and markets are currently paying for a lot of growth. While economists and commentators clamour to be heard by making bold predictions, thankfully it’s easy to see what our view is: just look at the portfolios. While prices are high (and in some cases, like US stocks, already extended), the environment remains supportive. We believe the current cycle has further to run and hence we’re staying invested, while at the same time seeking uncorrelated opportunities in order to insulate the portfolios from the inevitable return of volatility.

There’s been a tendency for growth expectations to be revised down in recent years. Bloomberg tracks economists’ expectations for global growth two years into the future; hence today economists are now being asked about their thoughts for global growth in 2020. Consistently in recent years these estimates have started high, before slowly, but with the certainty of a London commuter train running behind time, being revised down. But something changed last year – the expectation for 2017 reported growth started to go up – as did the expectation for 2018.

Growth expectations are up; purchasing managers’ indices are up in all parts of the globe; the balance of countries whose growth is increasing versus those where growth is either slowing or already in negative territory is at its highest level since 2004; company earnings revisions are outstripping downgrades; and the list goes on.

Investing, however, isn’t about good or bad economic outcomes; it’s about what reality brings and how this compares to what you paid. With the price-to-earnings ratio of the MSCI World Index standing at over 22 times, we’re paying a lot for this good news, which leads us to sound a note of caution. The World Bank have suggested that global growth may well have peaked at what is still a fairly modest level by historical standards, due to long term structural headwinds like demographics. And there are nagging doubts about not only the quantum of growth but also its quality. Given the record levels of employment we have currently, why aren’t we seeing runaway growth? Why aren’t we as productive seemingly as we were in the past? And is this growth still being fuelled by too much debt, which has been passed around – most recently from the private sector to governments post the financial crisis – but hasn’t gone away.

We have a list of 10 tail risks we’re tracking but we believe the current cycle has further to run. With prices higher today than they were 12 months ago (but not yet extended), periodic bouts of weakness will present opportunities to buy. With careful diversification, making use of the increasing range of asset classes which exhibit relatively low correlation with traditional assets, we aim to construct portfolios that should be able to navigate a range of outcomes as we move through 2018.

The Marketplace

- Brent crude oil finished the week at 69.8, up 3.3%
- Gold was up 0.9% standing at 1331.9
- Household names join the blockchain craze, governments push back
- US Dollar slides, EUR gains

Market Focus

US

- The Dow Jones was up 2% closing at 25803.2, another all-time high close on the week
- The Nasdaq rose 1.6% and again closing the week at a new all-time high of 6758.5
- Benchmark yields rose for a 5th consecutive day with the US 10 yr hitting 2.6% on Thursday. Investors fear that QE stimulus will be cut back by central banks. On Friday the 2 year yield breached 2% for the first time since 2008
- The S&P 500 has risen 4.3% so far in 2018 compared with 1.5% over the same period last year
- US Securities and Exchange Commission delays the launch of several Bitcoin ETFs and funds on liquidity grounds
- USD slides nearly 1% even as US core consumer price inflation (CPI) rises 0.3%

UK

- Manufacturing posted a seventh consecutive month of expansion, and continued the longest run of growth in 20 years. Ten out of thirteen manufacturing sectors posted increases
- London house prices fall to a 2 ½ year low this year. Nationally there was a slight increase of 0.7%
- The FTSE was up 0.7% on the week, closing at 7774.2
- Carillion Plc files for liquidation after attempts to attract more than £300m capital fail putting 43k jobs at risk worldwide

Europe

- The Eurostoxx rose 0.1% closing at 3612.6
- ECB announces cautious, gradual guidance on any future monetary policy decisions. No interest rate increases expected until 2019
- The Euro hit a three year high today against the dollar, standing at 1.22
- After 24 hours of talks Angela Merkel's CDU party finally reach a preliminary agreement with the Social Democrats to form a coalition government

Asia

- The Nikkei was up 0.9% at 23714.5
- Cryptocurrencies slump as China cracks down on bitcoin mining and South Korea restricts trading venues
- The Hang Seng was 3% up finishing the week at 30814.6, a near all-time high

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Asset Class/Region	Currency	Currency returns			
		Week ending 12 Jan. 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	1.6%	4.3%	4.3%	24.4%
United Kingdom	GBP	0.8%	1.3%	1.3%	10.8%
Continental Europe	EUR	0.2%	2.9%	2.9%	14.1%
Japan	JPY	-0.2%	3.2%	3.2%	24.8%
Asia Pacific (ex Japan)	USD	0.5%	3.6%	3.6%	35.7%
Australia	AUD	-0.9%	0.1%	0.1%	9.9%
Global	USD	1.3%	3.9%	3.9%	24.9%
Emerging markets equities					
Emerging Europe	USD	1.7%	6.3%	6.3%	25.9%
Emerging Asia	USD	0.7%	4.5%	4.5%	43.2%
Emerging Latin America	USD	0.6%	5.7%	5.7%	25.2%
BRICs	USD	1.5%	6.5%	6.5%	44.5%
MENA countries	USD	1.7%	3.0%	3.0%	3.6%
South Africa	USD	-1.7%	-1.4%	-1.4%	29.6%
India	USD	0.8%	1.9%	1.9%	37.7%
Global emerging markets	USD	0.6%	4.3%	4.3%	37.7%
Bonds					
US Treasuries	USD	-0.3%	-0.7%	-0.7%	1.3%
US Treasuries (inflation protected)	USD	-0.5%	-0.7%	-0.7%	1.7%
US Corporate (investment grade)	USD	0.0%	-0.4%	-0.4%	5.3%
US High Yield	USD	0.0%	0.7%	0.7%	7.1%
UK Gilts	GBP	-0.7%	-1.1%	-1.1%	1.8%
UK Corporate (investment grade)	GBP	-0.6%	-0.5%	-0.5%	4.5%
Euro Government Bonds	EUR	-0.3%	-0.2%	-0.2%	0.5%
Euro Corporate (investment grade)	EUR	-0.4%	-0.2%	-0.2%	2.4%
Euro High Yield	EUR	-0.2%	0.4%	0.4%	6.8%
Japanese Government	JPY	-0.1%	-0.2%	-0.2%	0.1%
Australian Government	AUD	-0.6%	-0.3%	-0.3%	2.6%
Global Government Bonds	USD	0.4%	0.2%	0.2%	6.3%
Global Bonds	USD	0.3%	0.2%	0.2%	6.9%
Global Convertible Bonds	USD	0.9%	2.7%	2.7%	11.1%
Emerging Market Bonds	USD	-0.3%	-0.1%	-0.1%	6.7%

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Property					
US Property Securities	USD	-3.0%	-5.2%	-5.2%	-2.0%
Australian Property Securities	AUD	-2.2%	-2.8%	-2.8%	0.6%
Asia Property Securities	USD	2.0%	6.2%	6.2%	28.8%
Global Property Securities	USD	-0.5%	-0.6%	-0.6%	14.0%
Currencies					
Euro	USD	0.7%	0.9%	0.9%	14.3%
UK Pound Sterling	USD	0.9%	1.2%	1.2%	12.6%
Japanese Yen	USD	1.7%	1.2%	1.2%	3.1%
Australian Dollar	USD	0.3%	1.0%	1.0%	5.4%
South African Rand	USD	-0.8%	-0.3%	-0.3%	8.7%
Swiss Franc	USD	0.4%	0.2%	0.2%	4.1%
Chinese Yuan	USD	0.4%	0.8%	0.8%	6.6%
Commodities & Alternatives					
Commodities	USD	1.0%	2.0%	2.0%	5.5%
Agricultural Commodities	USD	-1.0%	0.0%	0.0%	-7.2%
Oil	USD	3.3%	4.5%	4.5%	24.7%
Gold	USD	0.9%	2.0%	2.0%	11.4%
Hedge funds	USD	0.5%	1.7%	1.7%	7.2%

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