CANACCORD Genuity
Wealth Management

December 2018

Investment
market update

Waiting for Godot – how long until markets recover?

It had been hoped that the US midterm elections on 6 November might prove to be a cathartic moment for markets and provide a positive turning point following the brutal October battering.

Unfortunately, conditions remain challenging and sentiment is fragile. In performance terms, the S&P 500's 9.1% decline between 30 September and Thanksgiving is the third worst showing for this particular period since 1950. While the falls are nowhere near those experienced in 1987 (-24.2%) and 2008 (-23.9%), this volatility remains deeply unsettling.

As you would expect, we have spent a considerable amount of time re-examining our investment strategy to assess whether adjustments are necessary. Our conclusion remains that now is not the time to make significant changes and, unlike the protagonists in Samuel Beckett's Waiting for Godot who wait endlessly and without success, the 'Godot' of a market recovery will eventually appear.

Our positive belief stems from a number of sources, although we concede that some market concerns may not be resolved in the short term and it is possible the current period of volatility may persist into the first quarter of next year.

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So, what's holding up the market recovery?

Interest rates

The primary market fear at present seems to stem from the US Federal Reserve (Fed) who, even in the face of current market conditions, are likely to have raised interest rates four times in 2018, and are set to hike further in 2019. However, we view it as entirely possible that the Fed will pause next year, and we were particularly comforted by Chairman Powell who recently likened raising interest rates to moving around in a dark room, especially when you have no shoes on. In this scenario, you move slowly to avoid stubbing your toe.

Inflation

While policymakers continue to closely scrutinise inflation – as we anticipated they would do in our 2018 investment themes published this time last year – it remains of little concern. While there are signs that price increases in certain areas are having a dampening effect on demand, this does not seem to be an environment where inflation expectations are likely to rise uncontrollably.

Oil prices

There has been a focus on the slump in oil prices which have fallen by 30% in eight weeks. The concern in some quarters is that this signals a pronounced growth slowdown is either underway, or imminent. While any forecasts on oil prices should be viewed with a healthy dose of scepticism, what is clear is that the price fall is due to a significant increase in supply rather than a demand deficiency, as over a million barrels of Iranian oil returned to the global market almost overnight. Further, the inflationary benefits of lower oil prices should not be forgotten, particularly as this may allow the Fed to take their hoped for pause for breath.

Trade wars

Meanwhile, the dinner between Presidents Xi and Trump at the G20 summit achieved broadly what was expected. A 90-day ceasefire is now in place, which was accomplished by the Chinese agreeing to purchase a substantial amount of US goods and negotiating further on issues such as forced technology transfers and intellectual property rights. In exchange, the US has agreed to postpone the increase in tariffs on Chinese imports. This is a truce, rather than a meaningful breakthrough, but the fact that both sides are committed to negotiating further is a positive development. Pragmatism could yet defeat idealism.

Company confidence

Finally, corporate fundamentals remain strong and ultimately it is earnings which matter to stock markets. Year-on-year earnings growth for the S&P 500 reached 23% at the end of the third quarter according to Bloomberg figures. While this pace of growth cannot continue indefinitely there are also few reasons to expect earnings to collapse in the near term, even with trade tensions in evidence. There are also signs that other governments have taken notice of the US fiscal boost from the tax cuts enacted earlier this year and are considering similar stimulus programmes.

Ultimately, we acknowledge that some form of catalyst may be needed to spark the market recovery and a revisit of October's lows may be required. The possibility that this catalyst could be trade, interest rates or earnings related should not be discounted, no matter what the headlines might currently imply. We believe Godot will eventually arrive; he's just running a little behind schedule.

"Corporate fundamentals remain strong and ultimately it is earnings which matter to stock markets."

This article was written for you by Justin Oliver, our Deputy Chief Investment Officer, Offshore.

Our investment views as at December 2018

The view in this table refers to our balanced, risk profile 5 model portfolio. This risk profile has a benchmark with 61.5% in equities, 22.5% in bonds, 13% in alternatives and 3% in cash.

Indicative positioning of £ 'balanced' portfolio.

Asset class positioning	--	-	=	+	++	Outlook	
Alternatives				■		→	Viewed as a way of moderating portfolio risk at a time of high volatility in equity markets and rising bond yields.
Bonds (Govt)	■					↓	Yields in the UK and US have recently fallen, but the overall risk and return profile remains unattractive.
Bonds (Other)			■			→	Greater returns appear to be available for strategic bond managers, but we should be aware of the additional risks taken to achieve them.
Commodities			■			→	Bears watching due to weaker US dollar and reduced supply. Most industrial metals are in contango (future prices below spot prices).
Convertible bonds				■		↑	Convertibles offer a good mix between the defensive characteristics of bonds, while retaining exposure to equity upside.
Equities					■	↑	Equity markets should continue to be supported by solid economic fundamentals, despite rising interest rates and recent turbulence.
Property (Direct)			■			→	Income, rather than capital growth, should be viewed as the primary reason for investment, given rising bond yields.
Cash			■			→	Cash levels have been reduced.

Equity allocation	--	-	=	+	++	Outlook	
Emerging markets				■		↑	Emerging markets have struggled, but offer value. Fundamentals generally sound, although pockets of weakness exist.
Europe			■			→	Growth moderated in first half of the year, and political and trade risks have risen. Some stock specific opportunities remain.
Far East				■		↑	Valuations appear cheap; China and global trade are key to the region's outlook. Chinese debt levels and housing bubble are a concern.
Japan				■		↑	Stock market offers value and some sectors of corporate Japan are in good shape. Macro data slowly improving. Leveraged to world growth.
North America					■	→	Economic and earnings momentum has justified an increase in exposure, augmented by US exposure in healthcare and technology themes.
Sector specific					■	↑	Healthcare and technology remain long-term themes. May consider further thematic opportunities.
UK	■					↓	Economic fundamentals are not compelling and political and Brexit concerns are pronounced.

Currency allocation	--	-	=	+	++	Outlook	
US dollar				■		↑	Growth and interest rate differentials will likely continue to support the US dollar; Donald Trump will increasingly rail against strength.
Euro			■			→	Upside could be capped by Brexit concerns and by any escalation of Italian debt concerns.
Sterling		■				→	Sterling's prospects remain heavily dependent upon the Brexit outcome and hence the outlook is binary.

'=' Weighting within 1% of benchmark. '+ / -' Weighting between 1% to 5% away from benchmark. '- - / + +' Weighting in excess of 5% away from benchmark.

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