Select Wealth Management

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Investment Update – February 2018

Prepared by JMIS, investment consultant to Select Wealth Management

Global GDP growth of 3.3% (last year 3.2%) is expected in 2018 broadly to support share markets, but it may still be a pivotal year for the markets as many of the larger central banks around the globe are moving in unison on a path towards monetary normalization, and therefore higher interest rates.

The US Federal Reserve (the Fed) is forecasting three further hikes to the Fed Funds rate along with its balance sheet reduction, which would take the Fed Funds rate (currently 1.5%) higher than New Zealand's Official Cash Rate (currently 1.75%).

The European Central Bank (ECB) is expected to modify its quantitative easing programme alongside the Banks of England and Canada who have already increased their benchmark interest rates.

As macro risks tilt gradually toward growth being too fast rather than being too slow, the theme of inflation expectations is likely to rise in importance for the markets too

US

US GDP growth of 2.7% is expected in 2018.

Nonfarm payrolls rose 148,000 in December, 42,000 below consensus but above-average snowfall in the US during the survey period likely weighed on this month's job growth. The recent acceleration in wage growth, which triggered the February market sell-off, was probably nothing more than a weather-related distortion too. The unseasonably cold January explains both the surge in average hourly earnings and the drop in average weekly hours worked. If history is any guide, these distortions will be unwound in February.

In January, the US dollar traded at fresh 3-year lows: the reasons for this include; higher expected US debt levels following the tax cuts, withdrawal of cheap money stimulus by other central banks on the global reflation theme and commodity gains favouring currencies like the CAD, NZD and AUD. In January, the US 2-year bond yield moved above 2% for the first time since the GFC.

This persistent dollar weakness is forcing global central bankers to step up their efforts to warn about the cost of currency appreciation on their economies. The decline in the global reserve currency matters greatly for other economies that have rebounded thanks to stronger exports, such as Europe and Japan.

China

China GDP growth of 6.5% (last year 6.9%) is expected in 2018.

China's housing market has defied gravity and government restraints for two years, floating on a tide of bank loans and speculation, until now. In Beijing and Shanghai—two of the country's largest markets—and other megacities, sales have stalled and prices have dropped, falling slightly in some pockets and dramatically in others. Demand has dried up in these areas as a result of government measures including higher mortgage rates, higher down-payment requirements and limits on buying a second or third home.

In January, the renminbi rose after Germany's central bank said it would include the currency in its reserves, a move seen as boosting the internationalisation of China's currency.

As China's December 2017 and fourth quarter 2017 economic growth data were both stronger than market consensus forecasts, we believe that the growth momentum will likely stay solid in 2018.

Europe / Japan

The euro area is expected to grow by 2.6% in 2018, while Japan's number is 1.0% of economic recovery.

The ECB recently indicated that it is preparing to cut its crisis-era stimulus programme faster than anticipated, joining monetary policymakers in most developed economies in expressing increased confidence in the global economic recovery. This signal came just days after the Bank of Japan sent a similar message by disclosing it had purchased fewer bonds than investors had expected as part of its quantitative easing efforts.

Australia

In January, the RBA left interest rates unchanged at 1.5%, but delivered a slightly more hawkish statement, pointing to an uptick in CPI inflation beyond 2% by the end of 2018.

Consumer sentiment rose 1.8% month-on month in January to 105.1 points, the highest reading since late 2013. The increase reflected rising confidence about the outlook for future economic conditions and is consistent with Australia's strengthening labour market. Overall, the recent improvements in both consumer sentiment and retail sales are encouraging and bode well for a pickup in consumption heading into 2018.

New Zealand

In February, the RBNZ left interest rates unchanged at 1.75% and said:

"GDP growth eased over the second half of 2017 but is expected to strengthen, driven by accommodative monetary policy, a high terms of trade, government spending and population growth. Labour market conditions continue to tighten. Compared to the November Statement, the growth profile is weaker in the near term but stronger in the medium term.

Annual CPI inflation in December was lower than expected at 1.6%, due to weakness in manufactured goods prices. Monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly."

Summary

Although we believe price pressures will ultimately remain contained in 2018 and even into 2019, there is scope for expectations of inflation to rise further as economic growth continues and central banks move towards monetary normalisation.

The preconditions for strength in share markets largely remain, i.e. global economic growth is strong and synchronised, inflation is still modest, recession risks remain low and company earnings are expanding.

However, it is hard to see the excellent share market returns of 2017 being replicated in 2018. Nevertheless, we do not see that we are in "bubble" territory just yet i.e. values are high but not extreme, companies continue to grow corporate earnings and the wider economic environment continues to improve. We favour the view of being cautious rather than negative or extremely positive.

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