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Global Markets Overview

Despite a tumultuous month for equity markets, the current period of steady expansion of the global economy continues. The expansion, however, has become less balanced and may have peaked in some major economies. Downside risks to global growth have risen in the past six months while the potential for upside surprises has receded. According to the IMF's recent world economic outlook report, global growth is projected at 3.7% for 2018 to 2019, 0.2 percentage points lower for both years than forecast in April of this year. This is due to recently announced trade measures such as the tariffs imposed on \$200 billion of US imports from China.

In the US, the economy continues to support strong corporate earnings, however, investors are increasingly concerned about the future amid signs of rekindling inflationary pressures and rising interest rates, along with the consequences of the US-led trade protectionism.

US

US-China Trade tensions continue. The White House's top economic adviser, Larry Kudlow, has accused Beijing of doing "nothing" to defuse the tensions ahead of a likely meeting between Donald Trump and Xi Jinping at the G20 in Argentina, dampening expectations of a truce in the economic conflict between the countries. In an interview with the Financial Times, Mr Kudlow said China had offered no sign that it was willing to meet US demands in a way that could lead to a breakthrough between the countries. Mr Trump has demanded sweeping changes to Chinese economic policy, including a reduction in their bilateral trade deficit and a clampdown on practices such as industrial subsidies. But so far these have been met with resistance by Chinese officials, who judge them as unrealistic and contrary to their interests.

The US Federal Reserve (the Fed) is settling into a quarterly tightening routine that could see the federal funds rate rise above 3%. So far the Fed has delivered no surprises and has continued its plans as forecasted. A December Fed funds rate hike is looking likely with increased pressure on wages. More important will be the message that investors take from the FOMC statement. Markets are pricing in additional tightening in 2018 and further hikes in 2019. Unexpectedly high inflation readings in the United States could lead investors to abruptly reassess risks and cause a shift to a more aggressive outlook which would put upward pressure on the US dollar and Treasury yields. It also would add to the stresses in emerging markets.

Existing home sales in the US fell 3.4% month-over-month in September to a seasonally adjusted annualized rate of 5.15 million units, the lowest level since 2015. Sales growth was also revised down modestly for August. The data suggests a decline in third-quarter housing investment and a softer housing market in the US generally. It is likely the reason for weaker sales data was due to rising interest rates but could also suggest a weakening in investor sentiment toward the broader economic growth outlook.

China

President Xi Jinping is focused on deleveraging and structural reform in China, but he is also likely to implement policy stimulus to counteract the impact of US tariffs. More stimulus is coming in a mix of fiscal spending and credit easing. It is unlikely, however, to be close to the substantial easing that took place in 2009 and 2015.

UK

Negotiations on the UK's withdrawal from the European Union (EU) are moving towards their final and most uncertain phase. A sanguine "soft Brexit" outcome seems likely but there is potential for volatility along the way.

Europe

There are ongoing risks to Europe from escalation of the trade wars. Exports to emerging markets account for 9.7% of GDP for the Euro-area (compared to only 3.6% of GDP for the U.S). Also there is the risk that President Trump enacts additional tariffs against Europe on top of the 25% steel and 10% aluminium tariffs already imposed. However, balancing this, Trump sounded conciliatory in his recent meeting with European Commission chief Jean-Claude Juncker. Another mitigating factor is that the US Congress is not generally supportive of further trade sanctions against Europe, in contrast to the broad Congressional support Trump is receiving for his stance against China.

The European Central Bank (the ECB) has signalled that market turmoil and mounting risks to the eurozone economy will not deter it from withdrawing one of the most important parts of its crisis-era stimulus, as it confirmed plans to halt its quantitative easing programme by the end of this year. Speaking in Frankfurt on Thursday, ECB president Mario Draghi highlighted the eurozone's "broad-based" economic growth. He added he was "confident" the Italian government, which is defying EU spending rules with its budget plans, would reach agreement with the European Commission. The nationalist coalition of Lega and 5 Star Movement political parties seemingly seek to avoid triggering a bond market crisis created by the stand-off.

The ECB president, Mr Draghi, also acknowledged the "weaker momentum" of the eurozone economy, noting the threats posed by a global trade war, trouble in emerging markets and the worsening political climate in Italy.

Germany's chancellor, Angela Merkel, recently announced that she was preparing to stand down as leader of the Christian Democratic Union, a move that spelt the beginning of the end of the 13-year Merkel era. The events have the potential to undermine the stability of Europe and has the a to further undermine the stability of the euro.

Turkey continues to be a risk as further devaluation in the lira could return the spotlight to the exposure of Spanish banks. These, however, appear manageable and seem unlikely to create broader contagion within the Euro-area banking system.

Australia

Australian growth has been strong so far in 2018, but that may start to slow as the economy faces the headwinds of falling housing prices, political uncertainty and potential weakening of the Australian consumer's confidence. On the positive side, business confidence remains elevated and the recent political events (i.e. the deposing of the prime minister) may not have significant impact given the continuation of policy. The 2019 Australian federal election could inject some volatility into markets, however.

New Zealand

In recent years, the New Zealand's economy has been driven by increases in immigration and housing, both of which are now set to slow (due in both cases to expected discouraging government policy). Policy uncertainty has already weakened business confidence, which is at 10-year lows, according to the ANZ Business Outlook Survey as of September 2018.

Given the recent softening in net migration, credit growth, housing prices and business confidence, GDP growth may moderate from the current pace of 2.7%. However, continuing support from strong terms of trade, fiscal stimulus and ongoing monetary stimulus from low interest rates and exchange rates is still likely to support decent domestic growth. While the RBNZ has sent a strong message about their willingness to cut the OCR if required, relatively solid economic activity and building inflation pressures will likely keep the OCR on hold until the RBNZ is confident that the threat from weak business confidence has passed and a range of core inflation measures are at or above 2%.

Summary

Looking forward, the main thing to watch out for is the prospect of recession. At this point, we do not see this as likely until well into 2019, or early 2020. Of course markets anticipate this and maybe what we are seeing now is an adjustment which reflects, on balance, that risks are rising, and we are getting closer to that point.