Select Wealth Management

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Investment Update – October 2017

Prepared by JMIS, investment consultant to Select Wealth Management

Although economic activity has gathered pace this year and many advanced economies are approaching full employment, surprisingly there is no general evidence of a pick-up in wage inflation around the world. Average wages growth has remained exceptionally sluggish even in countries such as Germany and Japan, where the unemployment rate is at multi-decade lows. It has actually fallen in recent months in the US.

This is a positive for bond and sharemarkets.

US

As expected, the central bank left the Fed Funds rate on hold in late September: however, it did announce that it would begin to reduce its balance sheet in October. Following on from the global Financial Crisis, the Fed undertook a massive quantitative easing and balance sheet expansion. Thus, the Fed's massive $4.5 trillion balance sheet will soon begin to shrink and it remains on track for one further rate hike later this year. There are likely to be three further rate increases in 2018.

The Fed's reversal of QE is another sign that the world is inching away from ultra-loose monetary policy, but it is planning to proceed slowly and avoid surprises, while no other central bank is likely to start reversing QE for at least two years. As such, the fallout for the global economy should be modest.

The number of jobs in the US grew by 156,000 in August, less than analysts had expected, and unemployment ticked up to 4.4% from the 4.3% in July.

China

China is starting to unwind some of the extraordinary measures aimed at bolstering its currency, after the yuan's recent surge in value began taking a toll on Chinese exporters and adding to economic headwinds.

In late August, the People's Bank of China scrapped a two-year-old rule that made it more expensive for traders to bet the yuan will fall in value. The move, which ends a deposit requirement on trades called currency forwards, will make it cheaper for companies and investors to buy dollars while selling the yuan and thereby help rein in the Chinese currency's steep ascent in recent weeks. The step is designed to "fend off macro-financial risks" in China.

Japan

In late September, Prime Minister Shinzo Abe called a snap election in Japan. He gave no date for the election and speculation is that he wants to consolidate power to get a stronger mandate to deal with the North Korean crisis. He also took the opportunity to announce a US$18 billion economic package.

In Japanese economic news, the flash manufacturing PMI index hit a four month high, rising to 52.6 for September, the third consecutive month of expansion.

Europe

We expect growth in the euro zone to be around 2% annualised in the second half of the year and the ECB to wind down its asset purchases next year, though it will probably not set out the details of its actual taper plans until October, at the earliest.

Australia

The minutes of the RBA's August meeting highlight that the RBA is becoming increasingly optimistic on the outlook for the labour market and is content with the progress of the housing market but there are no real hints that it is thinking about raising interest rates yet.

In October, we believe that the Reserve Bank of Australia (RBA) will leave interest rates at the current record low of 1.5%. However, even though it may indicate that it is now becoming more optimistic on the outlook for GDP growth and inflation, it is likely to leave interest rates at 1.5% throughout most of 2018.

New Zealand

As expected in late September, the Reserve Bank today left the Official Cash Rate (OCR) unchanged at 1.75% and said:

Global economic growth has continued to improve in recent quarters. However, inflation and wage outcomes remain subdued across the advanced economies and challenges remain with on-going surplus capacity. Bond yields are low, credit spreads have narrowed and equity prices are near record levels. Monetary policy is expected to remain stimulatory in the advanced economies, but less so going forward.

Annual CPI inflation eased in the June quarter, but remains within the target range. Headline inflation is likely to decline in coming quarters, reflecting volatility in tradables inflation.

Monetary policy will remain accommodative for a considerable period.

Summary

Even though the current bull market in shares is now over eight years old, we believe that the risk of an imminent global bear market is not high. There are two main reasons for this.

First, inflation has played an important part in rising bear market risks in past cycles. Structural factors may be keeping inflation lower than in the past and central bank forward guidance is reducing interest rate volatility. Without monetary policy tightening, concerns about a looming recession – and therefore risks of a 'cyclical' bear market – are lower.

Second, financial imbalances and leverage in the banking system have been reduced post the financial crisis. This makes a 'structural' bear market less likely than in the past.

Notwithstanding, we acknowledge that equity valuations are historically high at present and require a continuation of good earnings and dividend growth to justify and support the current levels.

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