Select Wealth Management

Sophisticated investing made easy

Investment Update – September 2017

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We are of the view that the nine-year equity bull market is not yet over with global stocks posting modest gains amid healthy corporate earnings reports and improving outlooks**.** The momentum of the world's three main economies (US, China and Europe) is positive, with growth lifting all nations through accelerating trade volumes. This positive momentum is likely through to 2018, although the outlook is not without risk. At current company valuations, the US equity market is susceptible to the Fed starting to raise the policy interest rate. Additionally, political risk has been an increasing feature of the investment landscape in the last 12 months. Recently, the election-weakened UK government is facing imminent and difficult Brexit negotiations, US President Trump coming under sustained investigative pressure from Congressional committees, and deterioration in relations with nuclear renegade states such as North Korea and Iran, create an environment in which markets could prove more vulnerable to negative news shocks.

US

In late July, the Federal Reserve kept interest rates unchanged and said it expected to start winding down its massive holdings of bonds "relatively soon" in a sign of confidence in the US economy.

The Fed indicated the economy was growing moderately and job gains had been solid, but it noted that both overall inflation had declined and said it would "carefully monitor" price trends. Steady job creation in the economy has pushed the US unemployment rate to 4.3%, near a 16-year low.

China

The annual rate of Chinese GDP growth has been on a gradual upward trajectory over the past year, rising to 6.9% in the last quarter to June 2017. Tighter credit conditions imposed were expected to slow real estate investment. On the positive side retail sales and industrial production was up 11% and 7.6% respectively. This supports our contention over the last few years of extreme China angst that the authorities have the will and the means to support the economy when required.

Japan

Japan's GDP second quarter figures showed that it has expanded for the sixth consecutive quarter, led by a strong rise in private consumption. This may be a positive for the Japan sharemarket but the BOJ pushed out any chance of rate rises for another 12 months (2019). This points to keeping monetary policy extremely accommodative for some time yet.

Europe

The region's economy is expanding as year on year growth was up 2.1%, the highest level seen since 2011. Confidence indicators are positive and business sentiment is at levels not seen for a long time. Unemployment across the region is at a nine-year low of 9.1%, GDP growth is expected to be 2.1% for 2017 and inflation of 1.5%.

A lot of this positivity appears to be from a pickup in world trade. The Euro has been one of the best performing currencies over this period increasing against the USD and most of the main crosses.

It is expected that the ECB's monetary policy will begin to ease, but this is not expected to start until 2018.

Australia

The outlook for Australia is moderate growth over the next one to two years, low inflation and an 'on hold' central bank, with the risks to growth still to the downside. The Australian economy managed to steer away from a negative GDP result in the March quarter thanks to a modest rise in consumer spending, higher business investment and a bounce back in inventories. Activity data in the second quarter has improved with retail sales spending and exports up, strong business conditions, but growth in 2017 is still likely to be about 2.0%.

Another positive is that the decline in resource sector spend will fade and momentum from other sectors outside of resources will support wage and employment growth in 2018.

The RBA left the cash rate unchanged at 1.50% in its August meeting with an indication they are in no hurry to move the cash rate from here, but the next move could be up.

New Zealand

The New Zealand economy has come through a relatively subdued six months. A series of one-off negatives impacting the final quarter of 2016 (dairy production) and the first quarter of 2017 (transport and construction) conspired to deliver below trend growth of 0.9% over the six months to March. Two consecutive quarters of low growth begs the question of where to from here? With financial conditions supportive, tourism booming and migration strong, we assume a modest rebound over the next few months to around the 0.7% per quarter we think underlying growth is running at. A key implication of the recent Monetary Policy Statement is that, if the economy struggles to reach this growth rate, the Official Cash Rate (OCR) may have to be cut further to deliver the demand pressures required to hit the RBNZ's inflation target.

Summary

Earnings momentum is now positive for all major equity regions and we expect this to continue, supported by a solid economic backdrop. A normalising global economy should allow central banks to unwind their ultra-accommodative interest rate policies. We believe that long bond yields are set to rise further during 2017 and 2018.

Improving economic growth around the world will generally support equities and challenge bonds. That's because this growth is more 'traditional' in nature, arising from better employment and demand, and thus allowing prices (and potentially profits) to rise.

For the remainder of 2017 we are not anticipating further significant upside in either Australasian or global share markets. Investors are aware of high valuations and may well move to protect the capital gains in their portfolios, rather than take on additional risk. An alternative scenario – market 'euphoria' in which investors simply become too complacent and push markets up into a climax marked by narrowing leadership and mounting volatility – remains a distinct risk, but it is still not our main case. This assessment could change if monetary policy normalization were to be interrupted and put on hold yet again, whether for economic or geopolitical reasons. Given the clarity with which the major central banks are now preparing markets ahead of policy moves and the robustness of the global expansion, any significant interruption seems unlikely.