HAMILTON
wealth management

Investor Insight 60 – May 2018

Increased market volatility is testing animal spirits at the moment. This is further complicated by what central banks may do, with respect to both raising short term interest rates and the gradual unwinding of QE. Global political tensions around trade are also clouding the outlook.

Investors should not fret over the increased volatility. What we are seeing is the market environment returning to a more normal state compared with the subdued volatility of last year.

The United States (US) is adding economic stimulus through tax cuts and higher budget deficits. Doing this to an economy which is near full employment and which still has historically low interest rates (albeit they are on the way up) concerns us longer term as it means they still have little monetary and fiscal ammunition to draw on if required in the future. This contrasts with Europe where deficits are being reduced, the current account is in surplus and the unemployment rate is still high at more than 8 per cent. There is still spare capacity there, unlike in the US.

US GDP should be 2.8 per cent for 2018, prompting the Fed to deliver four interest rate increases over the calendar year, before a slowdown in economic conditions becomes apparent in 2019.

The ECB has stated that its policy shifts will be “predictable and measured” yet interest rates are still negative and political instability prevails, particularly in Italy and with respect to Brexit.

We are maintaining our **neutral** position overall for International Developed Markets but with a bias towards non-US equity markets. Equity market valuations in Europe are at 15.1 times forward earnings and at 14.1 times for Japan, versus the US at 21.1 times. We maintain an **overweight** to Emerging Market equities, which are trading at 12.5 times forward earnings.

In the March Bank of America Merrill Lynch survey, trade wars emerged as the number one investor concern ahead of inflation (bearing in mind that tariffs by their nature are inflationary).

Investor Insight 60 – May 2018, continued

We cannot ignore the potential trade wars however we are not prepared to discuss the detail as we believe this is not relevant. Tariffs being introduced in the US is a populist move with no economic benefit for the country. China will simply introduce its own tariffs to counter the US move, the overall impact of the “war” being detrimental to growth and inflationary – and counter to Trump’s vision to grow the US economy. It is interesting to note that US equities on average fell by more than those in other developed and emerging markets after Trump first triggered the conflict with China.

Despite all the rhetoric, so far, no tariffs have been introduced. China has made some concessions and both sides seem keen to avoid an all-out trade war. Importantly, any economic impact has been muted and global growth looks like holding for the remainder of the calendar year and into 2019.

While the last three months has been dominated by macro risk events we believe that the soothing of the trade wars will put the focus yet again on fundamentals of underlying earnings and this will provide markets with some support. This has been compounded by:

- The S&P500 valuations which have returned to reasonable levels.
- The simple fact that US company earnings will come back into focus and will continue to be strong, underpinning existing market valuations.
- First quarter earnings revisions in the US for the S&P500 have been revised up 5.6 per cent since the beginning of the calendar year.

In discussions with fund managers during April there is a sense of excitement from many of them as they are communicating back to us that they see absolute value for the first time in over a year.

This has been a difficult start to the year for equities and we are entering the time where the northern hemisphere starts to focus on their summer holidays, hence the saying “sell in May and go away”. We feel this year may be different and that equity markets, whilst continuing to be volatile, will start an upward trend from here albeit a more moderate upswing than what we saw in the second half of 2016.

One eye must remain on geo-political uncertainty but, provided there are no surprises on that front, then the value which is now being seen should provide support to the market.

Investor Insight 60 – May 2018, continued

Hamilton Wealth Management is a Fee for Service, independently owned Wealth Management business and as such our advice is built around the conviction to our process and philosophy and our strong belief in diversification.

We would be happy to discuss this further with you, please don't hesitate to contact us.	Will Hamilton CEO and Managing Partner P +61 3 9275 8808	Ian Gillies COO and Founding Partner P +61 3 9275 8809