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GLOBAL ECONOMIC GROWTH AND THE INVESTMENT MARKETS?

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The fourth quarter of 2016 was positive for financial markets and growth assets in particular. The two major drivers over the quarter was the Trump win in the US election and the anticipation of tax cuts, increased infrastructure spending, and more relaxed regulation; the second driver was a strong rally in commodity prices principally on the back of increased Chinese demand, and for oil OPEC's decision to curb production. As a result we saw rises in global shares, emerging markets, and Australian shares; on the flip side we saw interest sensitive assets such as bonds, listed property and infrastructure struggle as interest rates rose and the US Federal Reserve lifted its interest rate in December.

Investors are a fickle lot, they are happy to jump on the negative bandwagon but quick to question positive outcomes. Share markets have risen substantially since their GFC lows, leading many to question further upside potential. I harp back to previous articles where I have emphasised that markets are driven in the long term by economic fundamentals, so what are these telling us?

Typically at the end of a bull cycle we would have seen a period of strong economic growth and corporate profitability, over investment, full capacity utilisation, high private debt, and high inflation; all leading to tighter monetary policy (interest rate hikes) from central banks. So where do we stand currently? It is difficult to contend that we are suffering the excesses of an economic boom either globally or domestically, with core inflation globally ranging from zero to below 2% e.g. compared to Australia's Reserve Banks target of 2-3%; we have seen depressed wage growth inhibiting consumption and investment; generally higher unemployment providing surplus capacity; there are no signs of over investment, on the contrary most central banks have accommodative interest rate setting to encourage investment; and, with the exception of corporate debt in the US and China private debt has had only modest growth. Finally, global monetary settings continue to remain accommodative to facilitate economic growth, with tight monetary settings some way off.

But aren't share prices fully valued? It is true that in the US and Australia the P/E (Price to Earnings) ratio are above long term averages, however earnings growth has been subdued over recent years and there is an expectation of earnings growth supporting rising equity valuations; so as economic activity picks up forecast earnings will be keenly watched. Further, when current share market earnings are compared with current low bond yields, shares are still seen as attractive.

We know that news moves markets, so things to look out for in 2017;

- Markets have rallied on the back of the Trump US election win and the promise of reflationary spending on infrastructure, and US corporate tax cuts; now that the inauguration is over the

markets will vote on his team and whether they can fulfil on the promises.

- there are important Euro elections this year in France, Italy, and Germany; any fears that the results might affect the strength of the Eurozone would cause short term market volatility.
- The process of the British EEC exit is about to commence which will be watched closely by the markets
- Concerns over the rise of global public debt levels (another ratio which will likely be covered in a later article)

As the preceding information would suggest we are of the view that there remains significant capacity for economic growth and that we are only part way through the investment cycle, whilst we have continually warned investors to expect short term corrections and barring some external shock, we believe that growth assets still have some way to go.

Clients are encouraged to call me if you have any questions or concerns.

As with any investment decision one should seek advice from your professional adviser before investing!

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