MERRION
INVESTMENT MANAGERS

CANTOR Fitzgerald

# Strategy & Outlook MARKET UPDATE

January 2019

**2019**

There are three pillars to our investment process at Merrion Investment Managers: Macro Economic Analysis, Valuation Analysis and Technical Analysis. What are they telling us about the outlook for 2019?

Valuations are attractive so long as a severe recession is avoided, whilst from a technical perspective equity markets are displaying patterns which historically have marked the start of 12 month periods with positive outsized returns. Added to that the fact that monetary policy across the globe is beginning to no longer be a headwind whilst investors are as lightly positioned as they have been for years all results in a combination of factors which could see a material year of performance from markets globally.

Below we look at each of these pillars in more detail, as well as the output from the process in terms of how we are positioned as we enter into 2019.

**The Three Pillar process:**

**Macro Analysis**

While global growth has indeed slowed, it remains materially stronger than during the last growth scare of 2016, and incomparable to the events of late 2008. Concerns about a material slowdown in global growth still abound, as the stimulus effect of the US tax cut fade amid tighter financial conditions. However the cumulative effect of recent stimulus measures by the Chinese authorities, lower bond yields coupled with a lower oil price should more than offset these concerns. Our expectation is that global growth has scope to surprise to the upside relative to pessimistic expectations. This belief is reinforced by the recent statements from Federal Reserve chairman Powell in regards to pursuing both a more patient and more market sensitive approach to US monetary policy. The so called “Policy put” would appear to be back and should help sentiment across the economy and financial markets. Other fears which caused the initial sell off appear to have been at least partially solved. In Europe the Italian budget situation appears a lot closer to a resolution, although Brexit remains a thorny issue. A positive resolution in trade talks, which is becoming more and more likely would undoubtedly make for a significant reversal in sentiment.

**Valuation Analysis**

The major equity indices declined by on average 12% in the last quarter of the year, and this has resulted in a significant de-rating of equity markets of up to 30%. This de-rating has resulted in equity valuations across the globe now below their long-term averages. They are discounting a severe deceleration in the economic backdrop. There are some of the most attractive multiples on offer for the medium term investor for a number of years.

**Technical Analysis**

Numerous measures indicate equity markets reached extremely oversold levels, levels from which historically markets have delivered strong returns, including over a relatively short time frame. The MSCI world index has held medium term support including the rising 200 week moving average and market breadth was strong coming off the recent low with December 26th seeing a 28:1 up volume day, a breadth reading we witnessed at prior market lows. Bearish sentiment outweighs bullish sentiment in the US by the most since the market lows following the 2016 growth scare, with readings reaching contrarian buy signal levels. Other measures like the put/call ratio also traded at extremes during December’s sell-off. Equity investors pulled a record amount of money from equity funds while those still invested currently have record low levels of risk and exposure to the market. These extreme negative readings have historically marked a turning point for equity markets.

**Positioning**

Given our macro outlook, attractive valuations and technical support, we are overweight growth assets within our multi-asset portfolios, and we remain underweight bonds. Within our growth assets, we hold overweight positions in cyclical sectors such as industrials, energy, materials and technology. These sectors continue to benefit from both cyclical and structural growth tailwinds. The relative valuation of cyclical sectors have reached extremes usually associated with the depths of recessions. We hold underweight positions in defensive sectors such as consumer staples, telecoms and utilities.

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CANTOR Fitzgerald

2nd Floor, Heritage House, 23 St Stephen’s Green, Dublin 2. Tel: +353 1 670 2500.

**email :** info@merrion-investments.ie **web :** www.merrion-investments.ie / www.cantorfitzgerald.ie