MERRION
INVESTMENT MANAGERS

Strategy & Outlook MARKET UPDATE

February 2019

Strategy & Outlook

What are the three pillars of the Merrion Investment Managers investment process telling us about the outlook?

Macro

The outlook for global growth has indeed slowed over recent months, but the change in tune from the US Federal Reserve, coupled with a renewed dovish tilt from the ECB and stimulus measures from the Chinese authorities suggests that growth will remain stronger than during the last growth scare of 2016, and certainly stronger than it was in late 2008. The US government shutdown no doubt shaved a little bit off Q1 US GDP growth, and European data is a concern, particularly with the rising threat of a no-deal Brexit on the horizon, but our expectation remains that global growth has scope to surprise to the upside relative to what appear to be quite pessimistic expectations, particularly if a trade deal can be reached between the US and China.

Valuation

Although equity indices have had a strong rally in January, the declines in the last quarter of 2018 mean that equity markets still trade below their long-term average PE multiples and are discounting a significant amount of negative news. The US market trades on a PE of 15.8x, Europe on 13x, China on 11x and Japan on 12x. If global growth can hold up, these are attractive multiples for the medium term investor, particularly if earnings can continue to grow.

Technical Analysis

Many equity indices got close to significant support levels in December, and staged a strong rally from that support. Our analysis of market sentiment showed bearish sentiment outweighing bullish sentiment in the US by the most since the market lows following the 2016 growth scare, with readings of outright bearish sentiment having reached contrarian buy signal levels. Whilst the evidence shows that significant equity withdrawals exacerbated the moves in December, positioning data suggests that equities remain under-owned. It will take some time to unwind the extreme negative sentiment and positioning of late December and as equity markets continue higher, CTAs will be forced to cover shorts and equity funds put further cash to work, which can lend further impetus to the equity market rally. Our technical analysis remains constructive for equities. Market breadth readings off the recent lows are characteristic of the start of a new cyclical bull market as opposed to countertrend rallies. In fact, the cumulative advance decline for the S&P 500 is already at a new high which bodes well for US markets to break to new highs over 2019.

Regionally, emerging markets and the US look more attractive technically compared to the Europe, Japan or the UK. The fact the dollar index is showing some tentative signs of turning lower should bode well for emerging market outperformance.

Summary

Valuations are attractive if economic growth continues (and even attractive so long as a recession is avoided), whilst from the technical perspective equity markets have bounced off significant long-term support.

Looking at the events and fears that caused the sell-off, in Europe Brexit remains the main thorny issue. In the US, the Federal Reserve has assuaged market fears and made it clear that future moves are not just data dependent, but market dependent. Their preparedness to adjust balance-sheet normalisation in light of economic and financial developments adds to the dovish message. Of the other major concerns, the US-China trade issue is not yet resolved, but all indications are that the two sides are inching closer to a deal. A positive resolution would undoubtedly give a significant boost to sentiment, particularly as concerns about trade between the world's two largest economies undoubtedly had a material impact on growth expectations.

Globally equity markets de-rated substantially over the course of 2018 as they have sold off in spite of a strong earnings backdrop, and the rally so far this year has done little to remove this undervaluation. Absolute valuations remain compelling based on any reasonable medium term investment horizon. Given our macro outlook, attractive valuations and technical support, we are therefore overweight growth assets within our multi-asset portfolios, and we remain underweight bonds.

MERRION
INVESTMENT MANAGERS

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