MERRION INVESTMENT MANAGERS

CANTOR Fitzgerald

Strategy & Outlook MARKET UPDATE

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

Macro Analysis

The outlook for global growth has not improved significantly over the last month, and it is becoming clear that the combination of trade concerns and the US government shutdown have had a reasonably large impact. However the change in tune from the US Federal Reserve, coupled with the renewed dovish tilt from the ECB and yet more stimulus measures from the Chinese authorities suggests that growth can remain stronger than during the last growth scare of 2016, and certainly stronger than it was in late 2008. A combination of these trade concerns, the US government shutdown, market gyrations in December and bad weather in the US will make it difficult to read the economic tea leaves for the next while, though one area of particular concern remains the European economy. Italy entered a technical recession in the fourth quarter (two quarters of negative growth) and Germany barely avoided one. If a no-deal Brexit can be at the very least postponed and a trade deal between China and the US concluded this would no doubt be a positive for the global economic outlook. However the possibility of renewed trade tensions between the US and Europe (auto and agriculture related) post conclusion of a Chinese trade deal cannot be discounted.

Valuation Analysis

Equity indices have had a very strong start to the year, and are clearly no longer as cheap as they were, yet valuations do not yet appear stretched. The US market trades on a PE of 16.5x, Europe on 13.5x, China on 11.5x and Japan on 12.3x. If global growth can hold up, these remain attractive multiples for the medium term investor, particularly if earnings can continue to grow. Recent leading indicators of earnings would indicate that the pace of recent downgrades has slowed considerably. Furthermore, the global equity dividend yield remains high by historical standards, which suggests further upside - over the last 30 years, when the global median dividend yield of stocks was close to the current level (2.41%), global equities averaged a return of +23% in the next 12 months.

Technical Analysis

Having staged a strong rally off significant support levels in December, most major equity markets have cleared initial resistance levels, but are now approaching heavier resistance. However as mentioned above, overall investor participation still appears quite limited. In fact, what has been most interesting to note from the year to date rally is that it has actually been accompanied by outflows from risk assets. Rather than add to exposures many market participants appear to have reduced their exposures as the year has gone on. Various surveys suggest that US Equities have seen 12-straight weeks of outflows worth north of $80bln, which is one of the largest outflow streaks on record. Technically the market is being led by pro-risk, pro-cyclical equities and certain indices have started to break above their early December resistance levels. 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

In summary then, valuations remain 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, are approaching resistance but remain under-owned. Brexit remains the main short-term risk facing markets, though it perhaps is close to being pushed out for a few months. In the US, the Federal Reserve has managed to significantly assuage 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 appears ever closer to a resolution, and all indications are that the two sides are quite close 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. However there is a not insignificant risk that President Trump's attentions turn towards Europe post conclusion of a deal with China. Given our macro outlook, attractive valuations and technical support, we have been overweight growth assets within our multi-asset portfolios, maintaining exposure towards the upper end of permitted ranges, with a cyclical bias. We have been underweight defensive assets. We are maintaining an overweight position in growth asset as an underinvested market continues to be dragged higher by a resolution on trade wars, a consistently dovish Federal Reserve and a huge monetary and fiscal policy stimulus emanating from China. However we have recently trimmed some of that overweight as markets have moved to price in a more positive outcome to trade talks.

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