Standard Life

# What will drive markets in 2018?

For financial advisers only

**What has 2017 taught us about markets? And what may lie ahead in 2018? Andrew Milligan, Head of Global Strategy at Standard Life Investments, answers these questions.**

## What's the main investment lesson we can learn from 2017?

Profits were more important than politics. It was understandable that for many commentators, the investment scene was dominated by political issues: Trump's tweets, Macron vs Le Pen, the ever-spinning Brexit negotiations, events in the Middle East and North Korea, to name just a few.

Yes, some of these events prompted a market reaction, for example the underperformance of Spanish assets during the Catalonian episode. However, investors merely directed their sizeable firepower into other areas. These included emerging market and Japanese equities, with investors reassured by the appearance of strong profits growth, and healthy prospects ahead.

## What should investors pay most attention to in 2018?

Financial markets have priced in a steady economic recovery and reasonable profits growth next year. But is this correct? There are several drivers to consider:

- Profits could be supported by a sizeable tax-cutting package in the US
- On the other hand, profits could be squeezed, for example by disruption in the Middle East leading to a sharp rise in oil prices, or developments in China affecting commodity prices
- And for some companies, especially in the tech sector, government decisions on taxation and regulation could have an effect

While companies using cash to support business investment would constrain cash being returned to shareholders, it would reassure many investors that this recovery does have legs.

## What do you view as the main investment challenges and opportunities of 2018?

2018 isn't going to be as easy as 2017. Yes, a world of synchronised growth, low inflation and steady central bank policy-making looks set to evolve. The growth engines are picking up speed in some areas, such as Europe, but look to be slowing in others, such as China, which may lead investment managers to change how much they're invested in these areas. Headline inflation is slowly rising, core perhaps less so. However, any upside surprises in either would give ammunition to central bankers to be more aggressive with their interest rate policies.

Slowly falling unemployment is keeping populist pressures at bay but governments in many countries face difficult decisions to balance conflicting demands. Meanwhile, several structural trends are becoming ever more apparent:

- high profits for a small array of tech companies
- the inexorable rise of the digital economy - putting many old industries under pressure
- taxation, regulation and industrial policies

These factors all lead to a new list of winners and losers.

## How are your portfolios positioned?

Against this backdrop, Standard Life Investments retains a cautious medium-term outlook in our House View. While there are areas of particular value, we believe that investors should be highly selective when making decisions on how best to position their portfolios.

### Equities

Within equities, we favour Europe and emerging markets, and to a lesser extent the US and Japan. The uncertainty around Brexit means we're less positive on UK equites.

### Fixed income

In fixed income, record low interest rates and central bank policies, such as quantitative easing (QE), have been very supportive of bond markets in recent years. Now, with the world's major central banks looking to raise interest rates or withdraw QE, we see limited value in most government and corporate bond markets.

### Commercial property

Finally, we hold a neutral view on the major commercial real estate markets. In a world of moderate growth, the income the asset class offers remains attractive but there appears to be limited scope for real estate prices to rise significantly from their current levels.

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