Standard Life

January market Review 2018

An outlook on worldwide markets

For financial advisers only

In this month's market review Andrew Milligan, Head of Global Strategy at Standard Life Investments, looks at how global markets are performing, including what the recent falls mean for investors, and what Angela Merkel's coalition deal means for Germany and the EU. He also takes a closer look at the important issues investors need to consider throughout the year.

US markets – a correction, at last

It's always a good idea to keep a close eye on your investments but recent market falls aren't a big negative unless you needed to raise a lot of cash this month. In fact, we've been highlighting for some time now that a downwards correction in stock markets wouldn't come as a surprise. Not just in the US but across the world.

Share prices in most countries have experienced significant upward moves over the past 12 months and there were signs that they had moved too far, too fast. With that in mind, this type of sell-off in the market just reminds investors that investing in stocks and shares does involve some risk and uncertainty. And it's worth noting that the recent correction in equity markets has generally only taken them back to last autumn's levels, after an extremely fast start. More importantly, there are few signs that a major sell-off is likely as the world economy has room to motor ahead, supporting company profits.

Trump's tax cuts

Following Trump's tax cuts there will be an inflow of repatriated cash into the US economy. Where this money will be invested is one of the most important questions we face for the coming year.

For now, it's uncertain. This is partly because senior management at US and overseas companies benefitting from the tax cuts are still analysing the full impact of the complex legislation. Markets would be reassured if much of the cash went into capital spending, lengthening this economic cycle.

However, it's possible that these managements will instead start a new mergers and acquisitions campaign – for some firms it's easier to buy a new factory or distribution system than build one from scratch. And, at a time of slowly rising interest rates in the US, many investors will also warn companies that higher dividend payouts and share buybacks are needed. This would create an incentive to buy equities rather than bonds.

At the moment the range of outcomes remains broad; stock picking requires some deep analysis.

US markets wake up to the likelihood of an interest rate hike

One of our key questions when making an investment decision is what is in the price? Money markets are already assessing whether the Federal Reserve (the Fed) will move interest rates up three or four times this year. On top of the economic recovery and some signs of wages growth, we need to take into account the impact of the major package of tax cuts and spending announcements on the economy and public sector finances.

With all that in mind, we expect financial markets will only move significantly more than expected if there's a rather sharp rise in inflation in the US. That, in turn, would suggest the Fed needed to be much more aggressive with interest rate rises than what's already priced in.

What’s next for bond markets?

Looking ahead, we expect bond markets to remain under stress in 2018. Pressures include strong growth, evidence of headline inflation, higher oil prices, and central banks withdrawing much of their quantitative easing.

As a result we’re underweight in most government and corporate bonds. The exceptions are some of the higher yielding emerging and US debt markets.

However, on the other side of the demand and supply equation, there’s still strong demand from institutional investors for bonds. For example, some pension schemes are actively looking for asset liability matching programmes.

All said and done, it would seem the markets have priced in a lot of bad news on future rate rises so we don’t expect a major sell-off in bonds to happen soon.

Merkel reaches coalition deal with Germany’s Social Democrats

Financial markets have been looking carefully at events in Germany in anticipation of Angela Merkel putting a government in place. In fact the markets had already priced in that the Christian Democratic Union (CDU) and Germany’s Social Democrats (SPD) would form a grand coalition. Now that they’ve successfully struck a deal, it’s expected that Angela Merkel will remain as Chancellor, although there is one final hurdle of a vote within the SPD’s membership which could still hold a surprise.

Nevertheless, divisions within the German Parliament may make it more difficult for Germany to press ahead with important issues such as major changes on immigration or the development of the Eurozone. As a result, tensions will remain in place across the EU.

And there’s no doubt that the delay in reaching agreement on a German government has been one factor in the slow progress towards the next round of Brexit negotiations.

Looking forward

As we move forwards we expect equity markets, whether emerging and developed, to show positive growth in 2018. However, we don’t expect to see the same sort of performance as we saw in 2017; after all, emerging markets soared over 25%, last year. We also expect to see much greater day-to-day, week-to-week volatility in markets; early February’s price action is just such an example.

It’s worth recognising that 2017 was a rather unusual year. After all the last time the S&P 500 Index showed consecutive monthly increases over a whole calendar year was back in the early 1950s!

For an in-depth look at what’s happening in global markets, read the
Aberdeen Standard Investments Global Outlook February 2018

The information in this blog should not be regarded as financial advice. Please remember that the value of your investment can go down as well as up and may be worth less than you paid in.

Information is based on our understanding in February 2018.

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