FINANCIAL
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Weekly Digest

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The return of the Goldilocks?

– *Jernej Bukovec, CFA*

At the start of the year, I wrote the blog “Goldilocks! What’s next?” reflecting on a great 2017 period in markets, described by many as ‘The Goldilocks’; not too hot and not too cold. All major economies were growing at a healthy pace, inflation remained in check and monetary policy remained accommodative while post-2009 fiscal austerity eased. However, we warranted caution as there were clouds forming on the horizon and that markets in 2018 won’t be such smooth sailing.

At the time monetary policy was tightening, and the unwind in Quantitative Easing would be in full motion by the end of 2018; bond yields were moving higher as inflation was looking to surprise on the upside and global growth was expected to decelerate in the second half of 2018. Despite that, markets seemed to be complacent, valuations were extended suggesting that few risks were priced in, so we rightly became increasingly more worried. The rest of 2018 did end up being quite challenging from the perspective of market returns. In fact, 90% of the 70 asset classes tracked by Deutsche Bank are on track to post negative returns for the year which would be the worst on record since 1900, if measured as the share of asset classes that posted negative returns over the calendar year (source Deutsche Bank). Put into perspective, even during the great recession of 2008, only 68% of asset classes posted negative returns and in 2017, the Goldilocks period, all bar one asset class had a positive return. So, from the perspective of a Multi-Asset portfolio manager, 2018 was as challenging as it gets with very few places to hide.

Today, the macro-environment is not that dissimilar to what it was at the beginning of the year when markets were buzzing with optimism. Trade wars, political risks, monetary tightening were all part of the backdrop to markets then as they are now. Since then, global equities declined by over 10%, despite a solid earnings growth of 15%. Given that, market valuations today are significantly more attractive, global equities are trading at 15x forward earnings and some selective markets like the UK, trade at bargain valuations of 12x forward earnings multiples. We have not seen those sorts of valuations for quite some time and this would suggest that a lot of bad news is now priced in.

There is a lot of fear building up in the markets today, but could 2019 be a surprise and there is a return of some Goldilocks times? Most economies are expected to continue to grow next year, albeit at a slower rate. There remain few signs of excess or capacity shortages which might trigger an inflationary surge, and the constraints to growth and expected slowdown next year might well extend the cycle for some time ahead. The recent fall in the oil price should further ease the inflationary pressures and central banks might slow down the pace with which they raise rates. Indeed, 2019 could just be one of those years, not too hot and not too cold that markets typically thrive in and the recent market setback could be an opportunity to add to selective equities at attractive valuations.

With that, we would like to thank all of you for your ongoing support and we wish everyone a wonderful new year filled with success, health, joy and treasured moments. May 2019 be your best year yet!

The **Marketplace**

- ECB ends quantitative easing and trims growth projections
- Disappointing Chinese economic data weighs on equities
- Brent Crude fell 2.3%, ending the week at $60.3 per barrel
- Gold declined 0.5% to 1239 per ounce

Market **Focus**

US

- President Trump has threatened a US government shut down over funding for his proposed Mexican border wall in a budget row with top Democrats
- The US dollar strengthened on the week, boosted by the US core retail sales jumping 0.9% month on month in November
- US equities were down 1.2%, with the major benchmarks lower on the week

UK

- UK equities were boosted by Prime Minister Theresa May surviving a no confidence motion with 200 Conservative MPs expressing confidence in her versus 117 against. The Prime Minister will now be immune from a further confidence vote for another 12 months
- Prime Minister May suffered a setback in the week following her bid to make her Brexit deal more acceptable to MPs, resulting in EU leaders stating it was ‘not open for renegotiation’
- UK average weekly earnings rose by 3.3% on the year versus 3.2% expected for the three months to October - the fastest pace of wage growth since 2008
- The pound fell 1.3% against the US dollar in the week, and UK equities gained 1.0%

Europe

- European equities rose 0.6% on the week, and the Euro depreciated 0.8% against the US dollar
- The ECB left its key policy rate on hold at 0% and confirmed it is ending its quantitative easing programme at the end of the year. The ECB cut its economic growth projections and tweaked its inflation forecasts; highlighting concerns of a eurozone slowdown and the central banks caution
- The December Euro Area manufacturing and services readings both printed at 51.4 versus expectations of 51.8 and 53.4 respectively. The drop was mainly driven by France where the “Yellow Vests” movement pushed the country’s Composite PMI into contraction, falling to 49.3 in December, down from 54.2 in the previous month
- Italian 10-year government bond yields fell below 3% after Italy’s government proposed a 2.04% deficit target in the latest attempt to appease the European Commission

Rest of The World

- Chinese equities slumped at the end of the week on the back of disappointing economic data. Notably, retail sales rose by 8.1% year over year compared with forecasts of 9.0%, this represented the weakest performance since May 2003. The poor economic data outweighed the advance in equities early in the week following signs of progress in the US-China trade negotiations
- Japanese equities fell 1.7% on the week

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 14 Dec. 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	-1.2%	-5.2%	-1.5%	-0.6%
United Kingdom	GBP	1.0%	-2.3%	-7.2%	-4.1%
Continental Europe	EUR	0.6%	-2.4%	-7.9%	-8.5%
Japan	JPY	-1.7%	-3.7%	-10.6%	-10.0%
Asia Pacific (ex Japan)	USD	-0.8%	-1.9%	-13.3%	-11.1%
Australia	AUD	-1.4%	-2.1%	-3.8%	-2.8%
Global	USD	-1.1%	-4.2%	-5.9%	-4.7%
Emerging markets equities					
Emerging Europe	USD	-2.5%	0.7%	-10.0%	-7.4%
Emerging Asia	USD	-0.6%	-2.1%	-14.8%	-12.7%
Emerging Latin America	USD	-1.5%	-1.3%	-7.6%	-3.0%
BRICs	USD	-0.6%	-1.9%	-11.9%	-9.4%
MENA countries	USD	0.3%	1.8%	7.1%	9.0%
South Africa	USD	-2.3%	-5.4%	-26.8%	-16.9%
India	USD	0.2%	-1.3%	-7.6%	-4.5%
Global emerging markets	USD	-1.0%	-2.0%	-14.2%	-11.2%
Bonds					
US Treasuries	USD	0.0%	1.1%	-0.4%	-0.6%
US Treasuries (inflation protected)	USD	-0.7%	0.5%	-2.0%	-1.7%
US Corporate (investment grade)	USD	0.3%	1.1%	-2.9%	-2.8%
US High Yield	USD	0.1%	0.1%	0.0%	0.2%
UK Gilts	GBP	0.4%	2.7%	1.0%	0.8%
UK Corporate (investment grade)	GBP	0.6%	1.2%	-2.1%	-1.9%
Euro Government Bonds	EUR	0.3%	0.9%	0.5%	-0.5%
Euro Corporate (investment grade)	EUR	0.3%	0.2%	-1.3%	-1.8%
Euro High Yield	EUR	0.6%	-0.1%	-3.5%	-3.3%
Japanese Government	JPY	0.3%	0.6%	0.6%	0.6%
Australian Government	AUD	-0.1%	1.1%	4.2%	3.8%
Global Government Bonds	USD	-0.3%	1.1%	-2.4%	-2.1%
Global Bonds	USD	-0.3%	0.9%	-2.7%	-2.3%
Global Convertible Bonds	USD	-0.4%	-0.6%	-4.2%	-3.3%
Emerging Market Bonds	USD	0.6%	2.1%	-5.6%	-5.4%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 14 Dec. 2018	Month to date	YTD 2018	12 months
Property					
US Property Securities	USD	-2.0%	-0.7%	1.1%	0.6%
Australian Property Securities	AUD	-1.5%	-0.1%	1.0%	-2.9%
Asia Property Securities	USD	0.2%	2.0%	-3.6%	-2.6%
Global Property Securities	USD	-1.2%	-0.4%	-3.2%	-2.0%
Currencies					
Euro	USD	-0.8%	-0.4%	-6.0%	-4.1%
UK Pound Sterling	USD	-1.3%	-1.9%	-7.1%	-6.4%
Japanese Yen	USD	-0.5%	0.3%	-0.7%	-0.9%
Australian Dollar	USD	-0.4%	-1.6%	-8.1%	-6.4%
South African Rand	USD	-1.8%	-4.1%	-13.9%	-6.4%
Swiss Franc	USD	-0.5%	-0.1%	-2.3%	-0.8%
Chinese Yuan	USD	-0.5%	0.7%	-5.7%	-4.4%
Commodities & Alternatives					
Commodities	USD	-2.3%	-0.1%	-3.9%	0.8%
Agricultural Commodities	USD	-0.8%	0.8%	-3.6%	-2.2%
Oil	USD	-2.3%	2.6%	-9.9%	-4.8%
Gold	USD	-0.5%	1.5%	-5.1%	-1.2%
Hedge funds	USD	-0.4%	-1.1%	-6.1%	-5.2%

Source: Bloomberg. Past performance is not indicative of future returns

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