Investment Insight

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ARIA | CAPITAL

***Around the corner:** It is hard to believe, but 2018 will be upon us soon. Steven Bell of BMO Global Asset Management is feeling about the year upbeat for a variety of reasons. While it might seem a little premature, in **The Inside Track** we thought we would share some extracts from his early commentary on what's in store for investors in the year ahead.*

***Moving targets:** Entitlement to the Irish State contributory pension used to accrue at age 65. However, following changes introduced in 2010 anyone currently under the age of 57 will have to wait until they reach age 68 before they become entitled. There have been rumblings recently that the age target could be extended further to age 70. The reason: a combination of finance and demographics.*

*France, with its indulgent welfare system has long recognised the impending "pensions timebomb". However, according to recent OECD research, the ageing population and the resultant "dependency ratio" is a global concern. To ameliorate the anticipated difficulties, the OECD recommends reforms to retirement income systems including measures that will sound noticeably similar to many of the issues raised in Irish political debate: pension adequacy for women, making home care affordable and providing better support to informal carers. In **Pic of the Week** we take a closer look.*

Quoted...

"All I ask is the chance to prove that money can't make me happy." – Spike Milligan

The Inside Track

Steven Bell – Chief Economist at BMO Global Asset Management – offers his perspectives on the prospects for global economies, financial markets and more.

State of the world

Last May the world economy troughed, ending an extended period of disappointment which began at the end of 2013. Since then there have been a steady stream of improvements which have fed through to rising corporate earnings. It is encouraging to note that growth isn't restricted to a particular region or single economic powerhouse. It is worldwide and forecasts are for it to remain so. Importantly, no country is booming so growth that is neither 'too strong' nor 'too weak'. Inflation is similarly synchronised with most countries seeing price rises below 2% and fewer with inflation below 1% or in negative territory. In other words, we have a 'goldilocks' scenario in inflation too. In addition, financial imbalances both within and between countries are generally modest.

What does this environment mean for investors?

Well, there are always risks in projecting past performance trends forwards but analysis of similar scenarios over the last 50 years suggests that a 'goldilocks' backdrop favours risk-on investing, particularly in equities and the emerging markets.

A hard landing for China seems unlikely

China's trend growth rate is slowing. Firstly, the labour supply has peaked and is set to decline; China has reached maturity in this respect particularly quickly as a result of the one child policy. Secondly, productivity has been falling – following the path previously trodden by other Asian 'growth miracle stories. Just like Japan and Korea's did, the $7,000 gross domestic product per capita threshold has signalled the transition to a slower rate of trend growth. We don't believe that a hard landing is in store for China but it seems reasonable to assume that growth of around 5% is likely to be sustained in the next few years – well below the 8% achieved in the past.

A cyclical upturn in Europe

Even in a world of synchronised growth, the improvement of Europe's economies stands out. The reasons behind the upturn are self-evident. Europe is at the end of a period of fiscal austerity and this alongside massive monetary expansion is feeding through into a sustained economic upswing. Italy's forthcoming 2018 election and key wage negotiations in Germany loom on the horizon but we do not foresee either derailing Europe's cyclical upturn.

Earnings on the up

What of the prospects for companies and importantly, the profits they make? Currently, profits are well above historical averages and although some may be wary of earnings coming under pressure we feel that there are a number of reasons why they should hold up. Factors keeping profits high include:

- Low interest rates, meaning it is relatively cheap to secure finance and service debt (even given likely rate hikes).
- Corporate taxes are low and, in countries like the United States and France, are set to trend downwards.
- Labour power is weak.
- Monopolistic conditions prevail in many sectors with barriers to entry that allow companies to maintain margins.

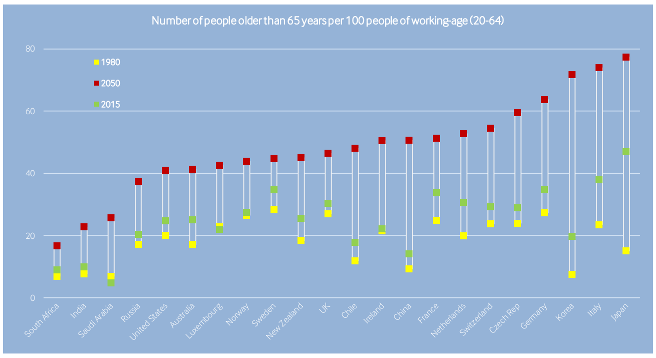
Looking forward we expect earnings to grow during 2018. As a result we are reasonably upbeat on the prospects for equities but less so on the outlook for bonds, where much of the market looks expensive.

Pic of the Week

In 1980, the "dependency ratio" – the number of people aged 65 and over for every 100 of so-called "working-age" (defined by the OECD as 20-64) people – was just 21; by 2015 this ratio had barely changed. However, by 2050 it is projected to more than double to 50. In the future people will live longer but there will be greater inequality. As has happened in Ireland, raising the retirement age often becomes an economic necessity when the dependency ratio increases. However, it also tends to widen inequality in total pensions between low and high earners. Unfortunately for today's younger workers, State support for retirement will probably be a case of "less, later", emphasising the importance, where it's affordable, of making good private pension provision.

Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	-0.1%	+18.3%	+13.9%	+10.5%
US equities	-0.1%	+19.7%	+14.4%	+12.6%
European equities	-0.5%	+13.0%	+6.7%	+7.0%
EM equities	-0.3%	+22.3%	+29.2%	+2.4%
Irish equities	+1.5%	+14.9%	+5.1%	+16.1%
Commodities	+0.6%	-0.3%	-1.8%	-9.7%
Hedge funds	+0.1%	+6.0%	+4.9%	+2.1%



Week ahead: Key events

30/10 Germany CPI
30/10 Eurozone Business Climate & Economic Sentiment Data
31/10 Japan Industrial Production & UK Consumer Confidence
31/10 Eurostat GDP & US Retail Sales Data
31/10 US Consumer Confidence & PMI Data
01/11 Japan, UK & US Manufacturing PMI
01/11 US Federal Reserve Interest Rate Decision
02/11 Eurozone Manufacturing PMI & UK Construction Data
03/11 UK PMI Data
03/11 US Employment

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.6%	+0.2%	+5.8%
Germany	+0.4%	+1.8%	+2.1%
USA	+2.5%	+2.2%	+2.2%
China	+3.8%	+1.6%	+6.8%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.17	+10.8%
EUR:GBP	0.89	+3.7%
EUR:CNY	7.77	+5.9%
GBP:USD	1.32	+6.7%
Bitcoin	5,862.17	+513.7%

Commodities	*Current*	*YTD Δ*
Gold	1,265.00	+9.8%
Copper	6,983.75	+26.4%
Oil	59.54	+1.4%
Wheat	431.75	-7.2%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.25%

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