Investment Insight

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ARIA | CAPITAL

Sugar rush: *The synchronised global expansion, which shifted into higher gear in 2017, will almost certainly enter its tenth year this June and is unlikely to derail over the next year. However, as we face into a weekend of egg-induced sugar rushes, we pause to consider whether the recent acceleration is just a cyclical sugar rush fuelled by easy financial conditions, fiscal expansion in the U.S. and a recovery in many emerging markets, or the early stages of a supply-side productivity renaissance leading to higher trend growth and helped by lower marginal tax rates, deregulation and animal spirits.*

In other words, is this the beginning of the end of the global expansion…or of The New Neutral? In ***The Inside Track*** *we take a look at PIMCO's views on the matter.*

Place your bets: *The sands of the global economy are shifting slowly, but quite perceptibly. This has major implications for long-term investment strategies. According to research produced by Robeco, Asian middle-class spending power is set to mushroom between now and 2030, dwarfing the anaemic growth forecast for the US. In* ***Pic of the Week*** *we take glance into the future.*

Quoted...

"There are two times in a man's life when he should not speculate: when he can't afford it, and when he can." – Mark Twain

The Inside Track

Is current economic growth more demand-led and cyclical than supply-driven? This, and the implications for asset allocation, are questions pondered at PIMCO's quarterly Cyclical Forum earlier this month. The following are some highlights summarised by Joachim Fels and Andrew Balls.

While there are some early signs in business surveys that the global trade and manufacturing cycle may have peaked around the turn of the year, and despite a bout of volatility in asset prices in February, still-favourable financial conditions and fiscal support suggest that rumours of a sudden death of Goldilocks are exaggerated. We continue to think that central bank tightening will lead to higher levels of volatility more sustained and widely felt than the February equity volatility spike. In an environment of increasing volatility and tight valuations we want to be cautious in our overall portfolio positioning, looking to generate carry from a broad range of sources, without direct reliance on corporate credit risk. We seek to be prepared and flexible.

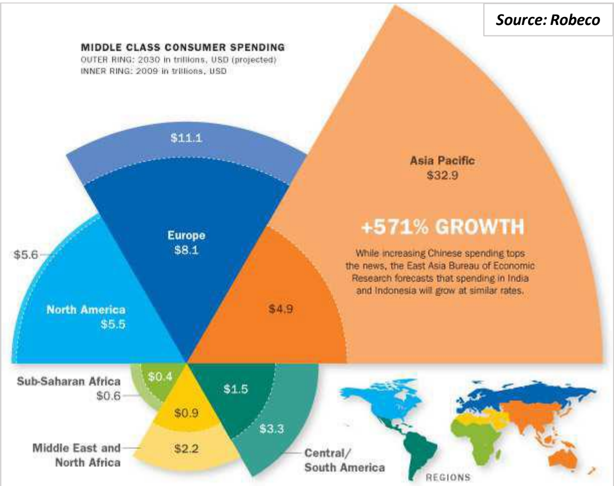
Our inflation forecasts have been nudged slightly higher in response to a higher oil price trajectory, but we continue to expect both headline and core inflation to end the year below target in the U.S. (just), the eurozone and Japan. It is important to note that both our benign growth and inflation forecasts are broadly in line with consensus (for more regional details, see the section on our regional forecasts) and appear to be baked into asset prices. This implies that there may be little room for error if economic growth would disappoint on the downside or inflation on the upside – another reason for relatively cautious portfolio positioning.

Another key topic for investors is the further path of emerging markets (EM), now that the recovery from a major slowdown or, in the cases of Brazil and Russia, a deep recession is firmly established. The case for further EM outperformance rests on an expected further widening of the EM versus DM (developed market) growth differential, the emergence of new drivers of growth – in particular consumption – to replace the commodity supercycle, the more structural elements of the inflation decline, and much lower external imbalances than in the past. Against this, we note the EM cyclical recovery may be more advanced than the consensus believes: Potential growth is slowing due to deteriorating demographics, the policy space for further stimulus is now more limited, political risks abound as major EM economies such as Mexico and Brazil will have elections with populist candidates polling strongly, and external conditions may turn less favourable with DM monetary policy heading toward the exit and protectionist sentiment on the rise. On balance, our macro baseline for EM remains cautiously optimistic, but we are mindful of the risks and the fact that valuations have become less compelling.

More broadly, on asset allocation, we have a neutral outlook on U.S. equities given that currently the market almost fully prices in the expected tax benefits – with earnings per share growth expected at around 18% and limited room for further upgrades. Japan stands out positively with prospects for 20%-plus earnings growth this year and relatively cheap valuations, in our view.

Pic of the Week

We have already witnessed a big improvement in Chinese people's living standards and consumption level over the last decade. However, the impact of increasing Chinese, and wider Asian, affluence on middle-class purchasing power is only just beginning. As the Robeco infographic shows, consumer spending by Chinese, Indian and Indonesian citizens will dwarf that of developed market areas including the US and Europe. Investment strategies that are poised to take advantage of this trend should be well rewarded.



Source: Robeco

Market View

	Last 7 days (€)	Last 12 mths (€)	YTD (€)	5Y Ann. (€)
Global equities	-2.3%	-0.4%	-4.8%	+10.2%
US equities	-3.7%	-0.6%	-5.1%	+13.5%
European equities	-0.5%	+1.1%	-4.3%	+7.3%
EM equities	-4.0%	+7.8%	-1.6%	+5.2%
Irish equities	-0.8%	-0.6%	-6.9%	+10.6%
Commodities	-0.9%	-8.1%	-3.9%	-8.8%
Hedge funds	-0.3%	+0.0%	-2.1%	-1.4%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.2307	+2.6%
EUR:GBP	0.8761	-1.4%
EUR:CNY	7.7358	-0.9%
GBP:USD	1.4047	+4.0%
Bitcoin	7,858	-45.8%

Commodities	*Current*	*YTD Δ*
Gold	1,322.10	+1.5%
Copper	6,601.00	-7.8%
Oil	69.83	+3.5%
Wheat	442.38	+3.7%

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

Week ahead: Key events

02/04 Japan & US Manufacturing PMI
03/04 Eurozone Manufacturing PMI
04/04 UK Construction PMI & Eurozone Inflation
04/04 Eurozone Unemployment & US Employment
05/04 Eurozone Services PMI & Retail Trade
05/04 US Consumer Comfort & Initial Jobless Claims
06/04 Eurozone Retail PMI

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.9%	+0.5%	+7.2%
Germany	+0.5%	+1.4%	+2.9%
USA	+2.8%	+2.2%	+2.2%
China	+2.0%	+2.9%	+6.8%

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