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the investor's choice

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Monthly Commentary 3rd February 2014

Bloomberg could not have summed it any better:

"*The start of the year in financial markets went as almost no one expected, with fixed-income assets worldwide posting their biggest January returns since 2008 and equity prices falling the most since 2010.*

Bonds beat stocks last month for the first time since August as fixed-income securities worldwide enjoyed their best start to a year since 2008, rising between 0.5% and 2%.

With the U.S. Federal Reserve pledging to buy fewer bonds and the global economy gathering steam, the safe bet going into 2014 was to avoid debt markets in favour of equities. What few saw coming was the turmoil in emerging markets from China to Argentina that followed a slowdown in U.S. jobs growth, upending even the best laid strategies of investors."

World equities lost 4.1%, commodities dropped 1.6%, and the USD was the main beneficiary in currencies, rising 1.2%.

So is January's performance a prelude of what to expect for the rest of the year? After all, there is a saying on Wall Street that "as goes January goes the year". According to the Stock Trader's Almanac, January has called the tune for the year some 88.9% of the time since 1950, a pretty impressive hit ratio.

We are less inclined to agree with projecting a negative outcome for the rest of 2014. Yes, there is a wall of worry that equities need to climb, but there always has been.

The main issue that worries investors is the gradual reduction, and eventual end of the US Central Bank's Quantitative Easing policy (QE). No doubt the extra liquidity that the Fed is providing has further fuelled the rise of risk assets. It has also helped many emerging markets to muddle along, often masking underlying weaknesses.

Nevertheless, there are a lot of arguments that counter-weigh the end of QE. Some of these are:

- Policy rates are anchored globally – low rates are still very stimulative.
- Japan's massive QE is still ongoing.
- The European Central Bank has indicated adopting "unorthodox" measures in order to ensure that Eurozone's tepid growth does not reverse.
- Inflation globally remains low, and labour pressures are non-existent
- Companies are still spending billions in share buybacks and dividends have been growing. Corporate profits are expected to be much stronger this year than they were in 2012 and 2013.
- There is expected to be a pickup in merger activity, which is often a good sign, and not indicative of a market peak.
- The rotation from bonds into stocks, while temporarily on hold, does not seem to be over. On the contrary a more orderly rise in long term yields would be welcomed by investors.

So while emerging market equities are still vulnerable - and we shall generally avoid them - the US, European and Japanese markets could continue where they left off at the end of 2013. Markets are undergoing what might be termed a "healthy correction", and might still fall further. While this is uncomfortable, markets are still holding above their longer-term trend, and we believe this trend will remain in place.