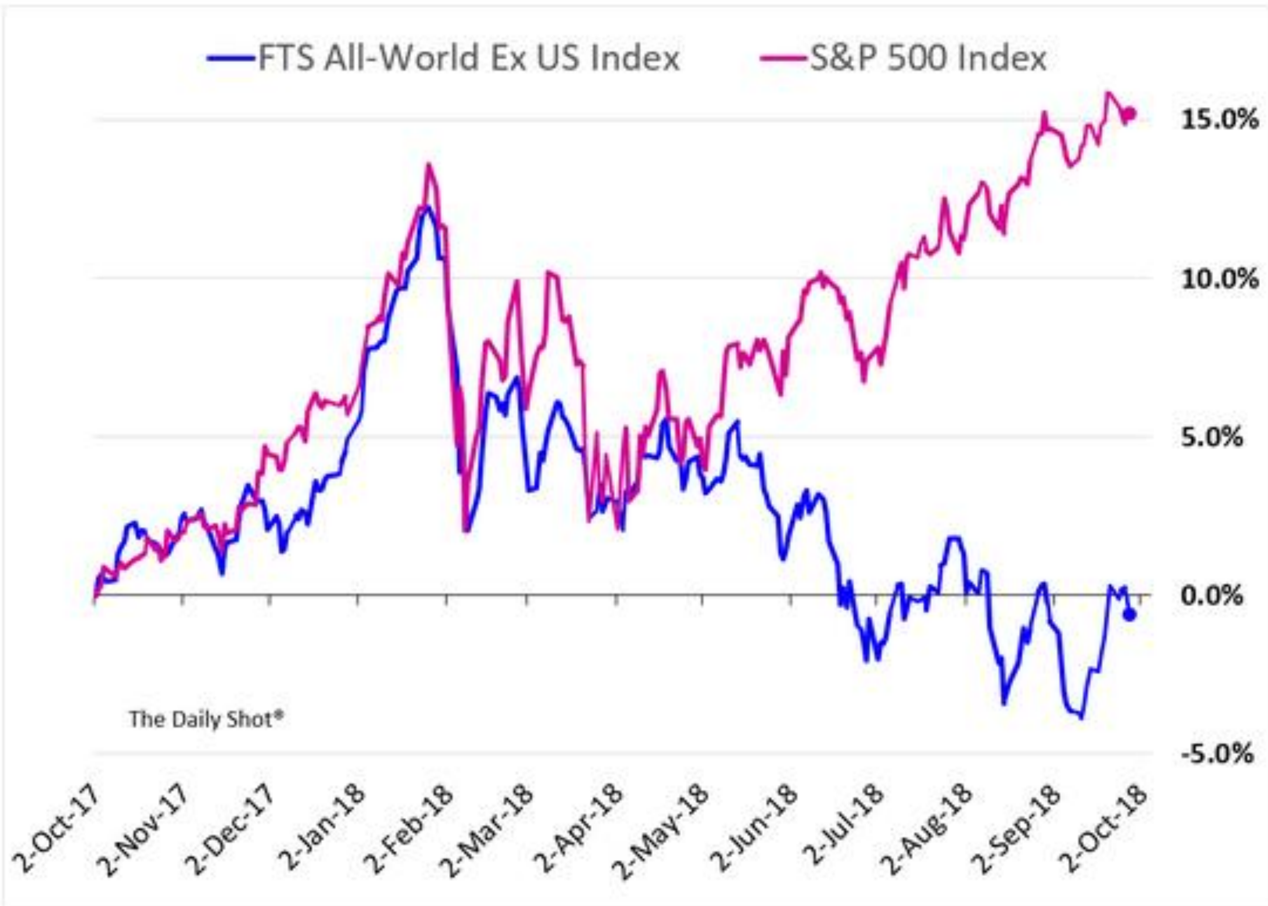
Monthly Commentary 3rd October 2018

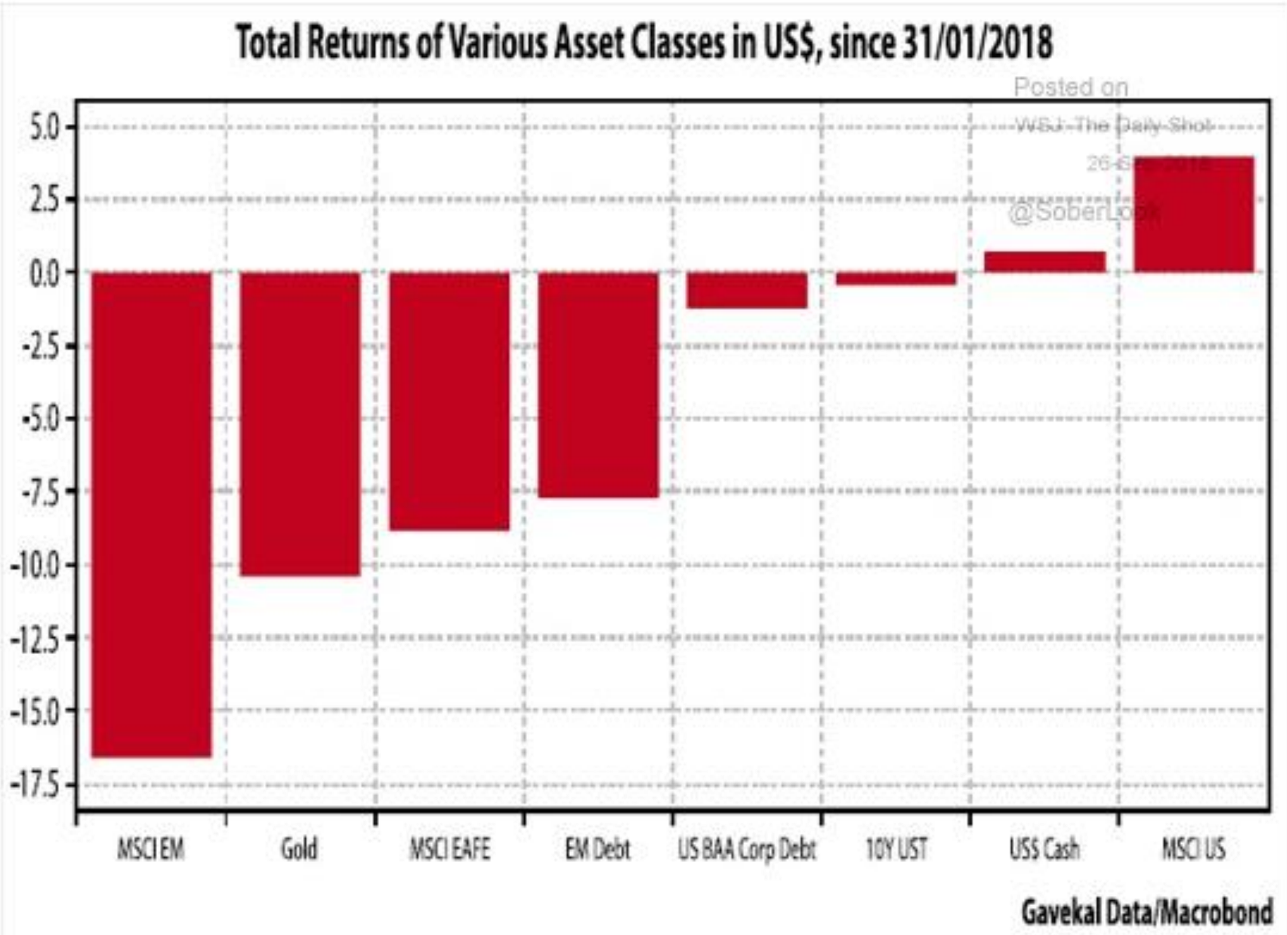
September was largely flat for world equities, with the exception of Japan that flew ahead by more than 5%. Bonds were mostly down, as US Treasuries and UK Gilts retreated by more than 1%. Currencies were more or less stable, and commodities were driven higher by a renewed interest in crude oil, which reached a multi-year high.

Two worlds - the US and the rest

For the second month in a row, we highlight how the US market has completely decoupled from the rest of the world. As you can see below, the last 12 months have not been kind to the rest of the world, but very good for US investors.



Is it an anomaly? Probably. The valuation gap (based on P/E ratios) between US equities and an MSCI index of 22 Developed Markets and 24 Emerging Markets reveals that the US is trading at a premium of 12%, which is a 10-year high. Indeed as the graphic below shows, the US equity market has done very well versus other major asset classes so far this year.



Is it sustainable? One can justify the US market's exuberance because profit growth has been very strong and it is expected to remain double-digit even in 2019. So while the US market appears overvalued by many measures, it still attracts lots of inflows due the fundamentals.

We believe that the gap in valuations is not sustainable, but rather than the US market falling, we will not be surprised if the rest of the world started catching up. This could lead to a nice rally into yearend.

On currencies

The table below from World Economics is quite revealing with regards to whether a country's currency is overvalued or not.

	Over/Under-Valuation
Greece	25.8%
Japan	20.7%
France	15.9%
Spain	7.8%
Italy	4.1%
US	0.0%
UK	-1.2%
Canada	-3.5%
Germany	-6.1%
China	-10.5%
South Korea	-12.6%
Brazil	-14.3%
Mexico	-20.9%
Russia	-30.0%
Argentina	-34.9%
India	-39.7%
Turkey	-58.9%

Source: World Economics

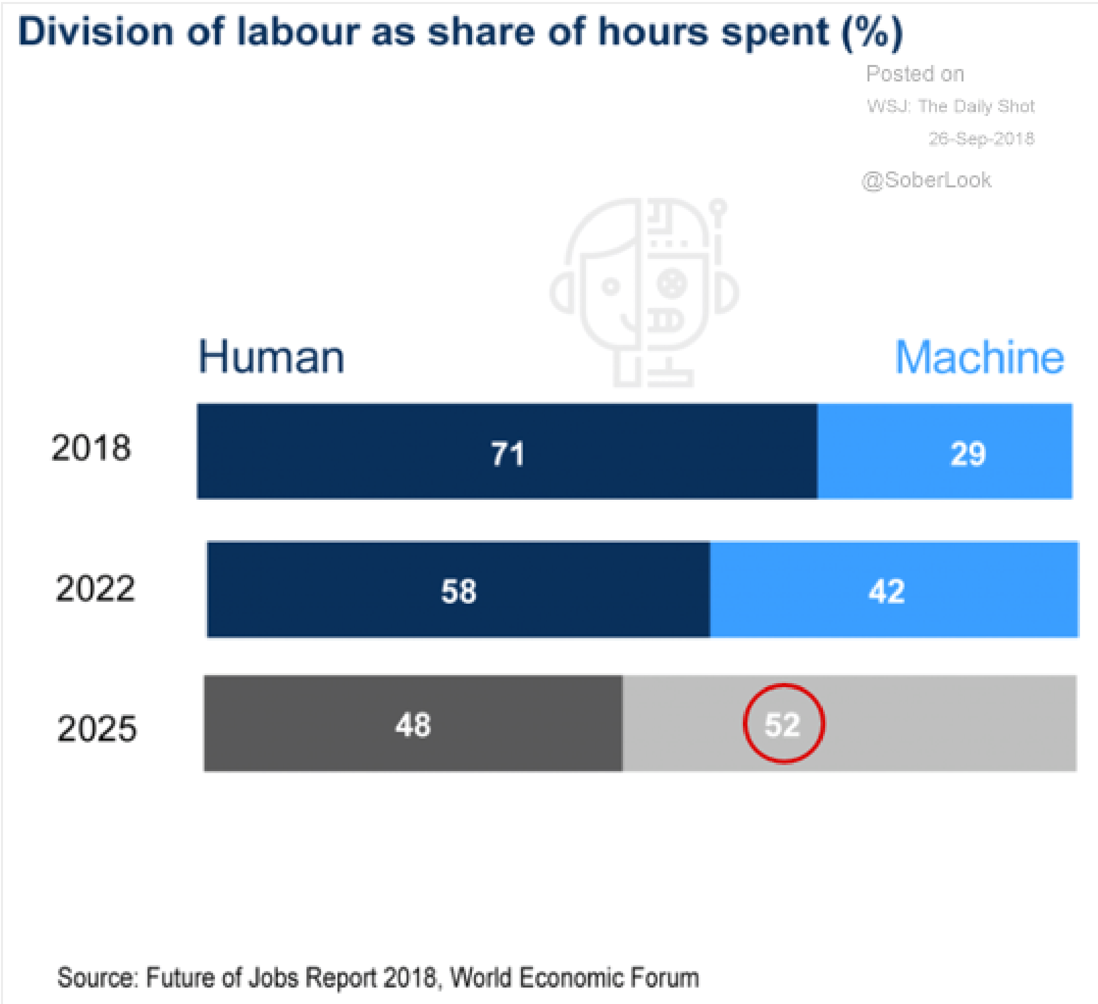
For example, while Greece, France and Germany share the euro, in Greece and France it is almost 26% and 16% more dear than it should be. Whereas for Germany, it is undervalued by 6%. Go figure!

As for bargain hunters, they might want to start looking at assets in some large but beaten up emerging countries like Turkey, India and Russia. A value trap? Maybe.

The age of the machine?

A recent report by the World Economic Forum expects that in as little as seven years from now, the amount of time spent at work by humans will be less than that spent by machines!

Hopefully this will lead to better quality of life for humans. The jury is still out if that will indeed be the case.



The Elgin Analysts' Team

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