Monthly Commentary 2nd February 2018

Equities started 2018 on the front foot, where they left off last year. With the exception of the UK, most regions were up strongly, especially the US and Emerging Markets. This coincided with an acceleration in USD weakness, with the world's dominant currency losing more than 3% in January, adding yet another significant tailwind to US equities and commodities. Not all was good in asset markets however as fixed income had a bad start to the year, almost across the board. And for those who might care, Bitcoin fell 27%.

More good than bad for now

So will this equity euphoria continue or will the rise in bond yields spoil the party?

Let's start with the "bad". On a technical level, many equity markets are "overbought", meaning that they have risen too far, too fast. This has created a lot more bullishness among investors, which is never a good sign. Markets like to climb "walls of worries" and they tend to stall and fall when there is too much optimism as there is today.

On the fundamental side there is valid skepticism that rising inflation expectations will cause policymakers (Central Banks) to become a lot more aggressive with monetary policy, which may, in turn, make bond yields rise even more. This would have a negative dual effect. First, corporations and individuals might become more reluctant to borrow in order to invest and grow their earnings. Investors might also decide to pull money out of equities in order to invest in (safer) bonds whose yields will become more attractive after years of being very low.

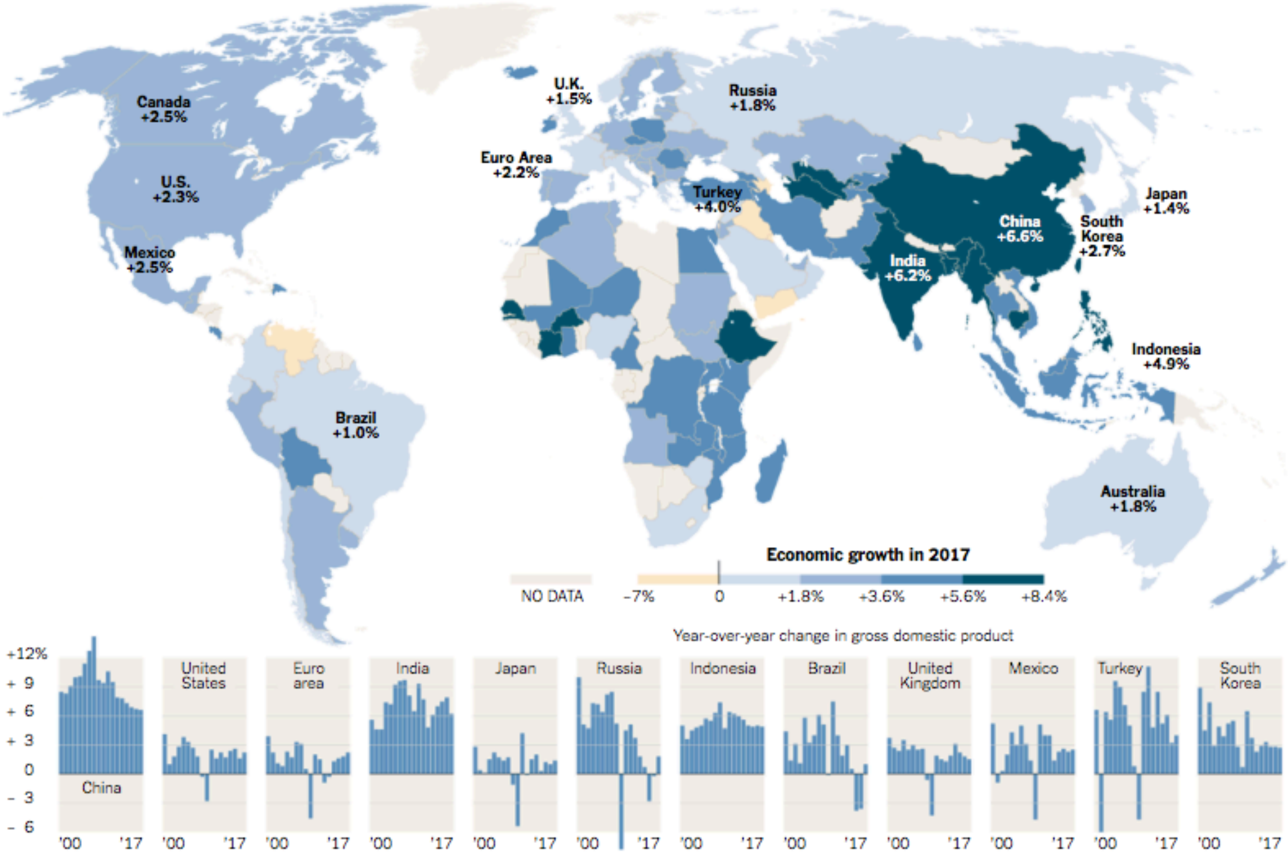
Having not had a meaningful correction for a very long time, the market might search for a reason to pull back 5-10%, and the above may prove to be the catalysts.

While such a correction will hurt all portfolios to varying degrees, in a bizarre way it would be welcome as it could shake off some of the market excesses and build a base for continuing strong market returns in the medium term.

The optimists' case, which we subscribe to, is that globally synchronous economic growth (as we are experiencing today) creates a virtuous cycle of more consumer spending, which feeds into continuing strong corporate earnings growth. The world map below from the Wall Street Journal shows quite clearly that the world economy is in a good place. Pity Venezuela, Iraq and Yemen.

Growth Across the Globe

For the first time since the financial crisis a decade ago, all of the world's major economies are growing.



Some figures are estimates

Source: The Conference Board; Bureau of Labor Statistics | By Karl Russell

This growth should benefit equity markets.

On Emerging Markets

In last month's commentary we expressed our opinion that emerging market equities are poised to add to last year's strong gains. Indeed since our commentary, EM equities are up by 7%.

We also mentioned that we had created a targeted EM managed portfolio that is available through the Interactive Broker's online platform. Since then we have received applications from many clients who are putting some spare cash into this portfolio. In the next page, we repeat what we wrote about our offering:

We believe this EM up-cycle has years to run so we decided to create a ***very accessible and extremely attractive dedicated EM offering*** *with the following attributes:*

- *The use of Interactive Brokers (IB) online platform – consistently rated by Barron's as the best online broker*
- *Managed portfolio using best-in-class EM ETFs (market cap, fundamental and multi-factor strategies)*
- *Very low fees*
- *Extremely liquid portfolio with no exit penalties*
- *Very low entry level (from USD 15K)*

If you are interested in opening an account please let your advisor know. It is very easy to set up an account with IB.

Of course, this is a risky proposition, and only part of one's portfolio should be allocated to emerging markets.

To conclude, it is worth noting that Ajay Kapur, the head of Global Emerging Markets strategy at Bank of America Merrill Lynch, predicted that the "*MSCI EM Equity Index will double in two years*". We'll be happy with a 25% gain over the next two years, let alone a 100% gain that he forecasts.

The Elgin Analyst Team

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