

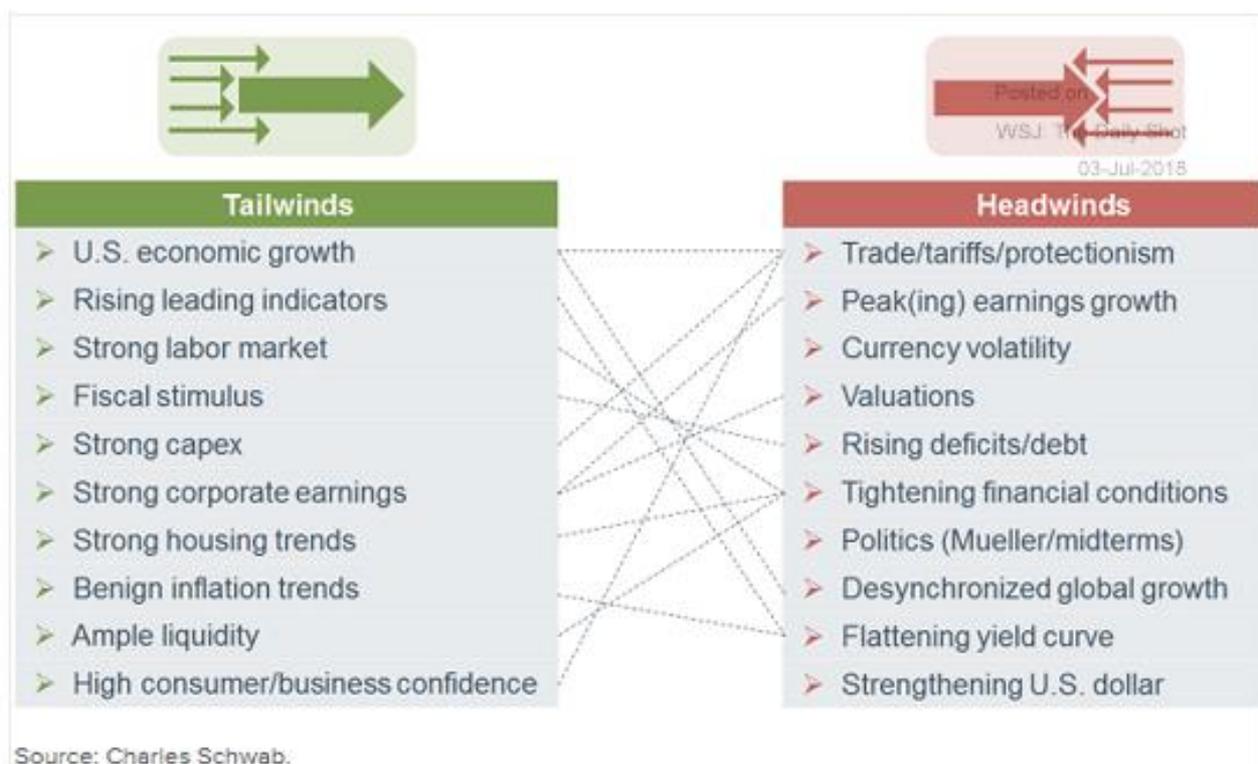
Monthly Commentary 4th July 2018

June was largely a down month for global equities and bonds. Emerging Market equities were worst hit (down 2.89%), with Germany's Dax being the weakest of the major indices, down 2.37%. Energy was very strong but most of the rest of the commodity complex was significantly weaker. The USD continued its rise, albeit more modestly.

Have we seen the peak?

While most of the world's equity markets are mostly down in the year's first half, the falls from their January peaks make for more a uncomfortable reading, with the MSCI World Index down almost 8%, and Emerging Markets down 16% to June 30th.

No one can answer the above question. The CIO of Charles Schwab came up with the below graphic with regards to US equities in her mid year outlook.



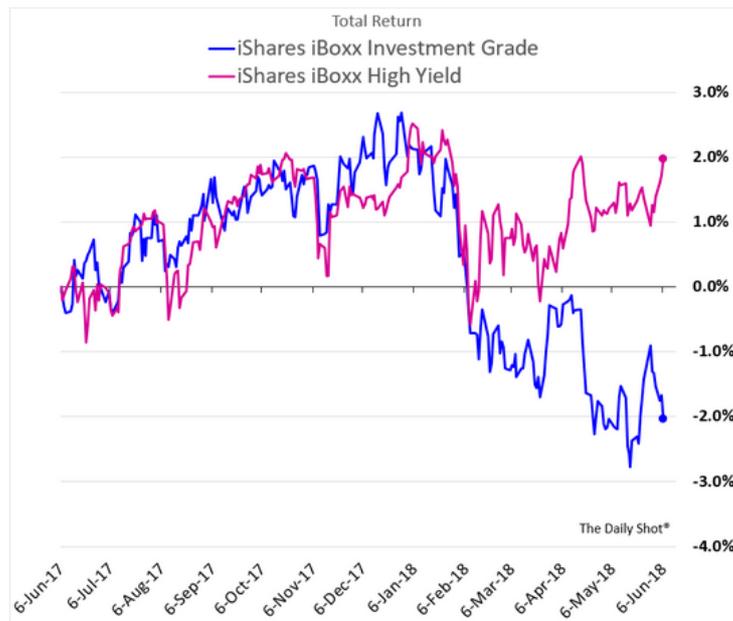
Take your pick. In her case, the conclusion tilted to a worsening outcome due to the ageing economic cycle. In fact, there is enough in the financial media to suggest that the end of the current cycle is within view and, by extension, equity markets have only one way to go: down.



Yet, when one factors in investor sentiment, which is a strong contrarian indicator, it is not at all clear that the end of the bull market is close. Merrill Lynch's "Sell Side Indicator", that tracks the market outlook of professional investors, has recently plunged very close to "buy" territory. It seems the recent market falls from the January highs have spooked many institutional investors.

Another contrarian indicator is the difference in performance between investment-grade and high-yield bonds in the US. The graph below, from the Wall St Journal, shows the big difference in performance, with high yield clearly outperforming. This possibly shows that the risk-on trade is still alive and well despite many investors professing their caution. Are markets climbing the proverbial wall of worry?

"Riskier" High yield (riskier) has outperformed "safer" investment grade bonds



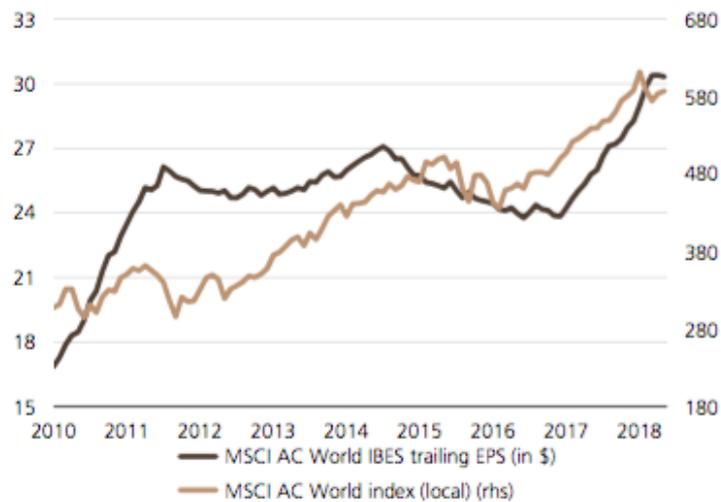
We remain sanguine. We acknowledge that there is much to worry about and we can produce a list that is much longer than the above "headwinds". Still, we see that corporate valuations, one of the most important indicators of long term market direction, have managed to keep pace with earnings growth, as the graph from UBS points to in the following page. What is important, irrespective of where the markets are going is that each investor is aware of the risk they are taking and that their risk profile reflects it. This will prevent them from losing upside if and when it comes, but also be tolerant to some downside if the markets head south.



World equities have risen in-line with earnings growth

Earnings advance supports equity markets

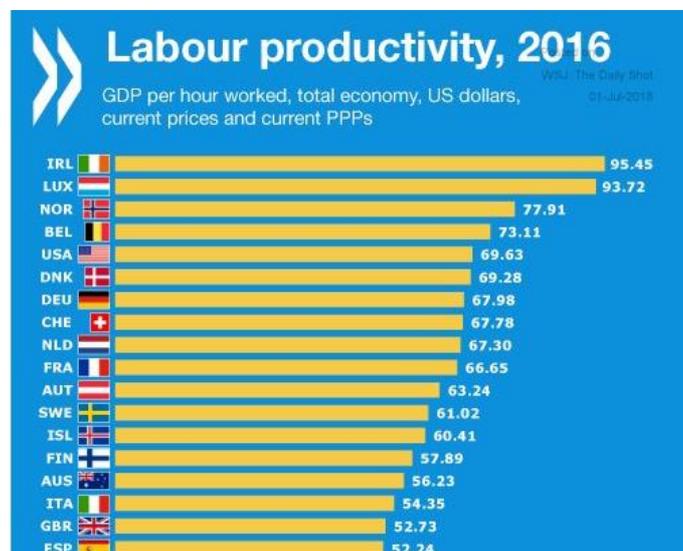
12-month trailing earnings per share (EPS) and equity index



Source: Thomson Reuters, UBS, as of 31 May 2018

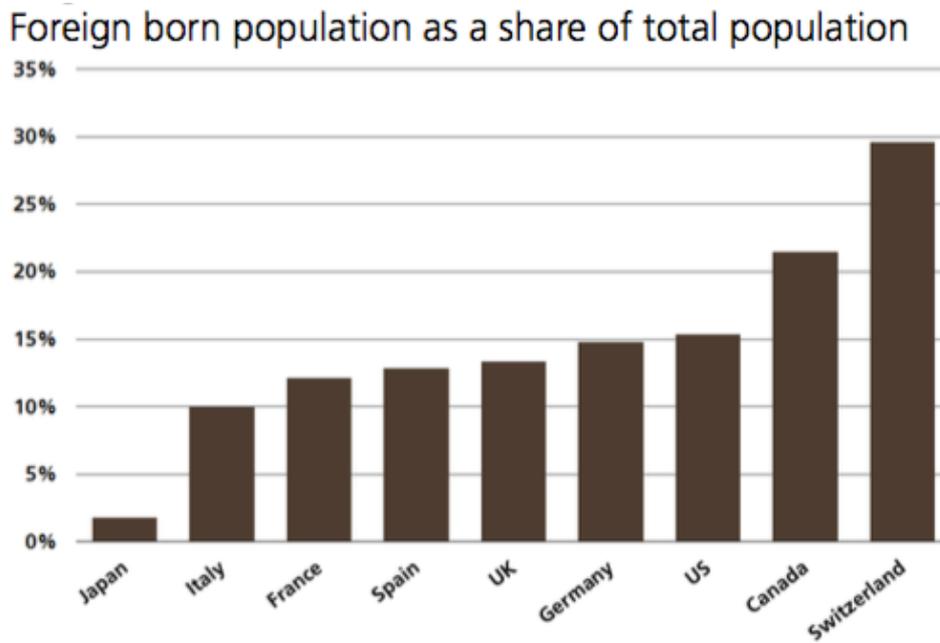
Odds and ends

Chronic UK Labour Productivity has often been cited as one of the reasons the UK has fallen behind many advanced economies. The graphic below, from the OECD clearly shows that the UK has a problem, as it clearly lags major economies like Germany, France, the USA and even Italy.





Immigration trends have been anathema to many politicians and have given rise to many populist politicians. The below chart is a powerful way of showing what percentage of major countries' populations are comprised of foreign-born nationals. It is quite obvious that Japan has not been very welcoming to foreigners.



Source: Data estimates as of end 2017. United Nations, Department of Economic and Social Affairs, Population Division (2017), UN population data via Haver, UBS

The Elgin Analysts' Team

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