Step Forward, Look Both Ways

VOICEOVER: Growth is set to rise and equity markets continue to hit new highs.

But even the sharpest investors are struggling to make sense of everything they’re seeing.

Global CIO Rick Lacaille outlines how the market environment is shaping the thinking of our investment teams and introduces the ideas investors need now to make the most of 2018.

Rick Lacaille:
For the first time since 2011, we expect the global economy to reach its historic trend growth level of 3.7% in 2018. Although this is only slightly higher than the 3.6% growth achieved in 2017, we believe this slow but steady improvement – coupled with modest inflation – offers a macro environment that can continue to lift markets higher. Growth is also more evenly distributed around the world, and even recently struggling emerging markets, such as Russia and Brazil, seem to have turned the corner.

But beneath these positive trends, a number of anomalies and uncertainties give us pause. Despite strong growth, inflation remains persistently low. Meanwhile, there’s rising suspicion that structural shifts associated with technology, demographics and globalized markets are contributing to persistently low productivity.

As the US equity bull market enters its ninth year – the second longest on record – investors are understandably concerned about the next pullback: will it hit and how severe could it be?

Meanwhile, an uncanny absence of volatility in markets over the last few years has many investors wondering if something has fundamentally changed. Last year saw the smallest number of days in 35 years on which the S&P 500 moved more than 1% in either direction in one day. Against this backdrop, we believe the coming year will be supportive of risk assets. The equity bulls still have room to run.

Yet, there are enough structural uncertainties to suggest that investors should adopt a more defensive posture in 2018 and consider what kind of protection they want for their portfolios.

Against this backdrop, we think investors need to look both ways as they step forward to take advantage of synchronized global growth. Here’s where we think investors should be looking in 2018.

• Steady growth and low inflation expectations should support risk assets.
Choose equities for growth, but be mindful of sector and regional valuations.
Don’t bet against bonds, as unwinding QE may not increase rates.
In an elongated cycle, consider what kind of protection you need — and at what cost.
As conditions increasingly offer opportunities for active managers, think carefully about where and when to go active
And finally, don’t underestimate China: 2018 could be a break-out year as leaders show they can manage debt and deceleration.

On balance, while we appreciate investor concerns about where we might be in this extended cycle, all leading indicators suggest that 2018 will be another positive year for investors.

In a fast-changing political and economic landscape, our 2018 outlook considers the key opportunities and risks for markets and investments.

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