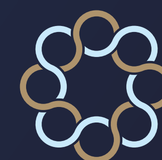

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POINTS OF VIEW

MONTHLY MARKETS REVIEW
MARCH 2018

In March, the 'Beast from the East' became a media storm, and before we knew it, we were closing schools and airports, cancelling trains and filling our fridges in fear of 'snowmageddon'.

Whether the nation's reaction was justified is debatable, but there's no question the media played its part in fuelling panic. By the time the Beast left our shores, it was predicted that first quarter growth would be halved as a result.

If you're in any doubt about the influence the media can have over investor outcomes, just ask Mark Zuckerberg. Within two days of media reports suggesting that the Facebook profiles of 50 million users were harvested for data, more than $50 billion of value was wiped off the company's stock value. Bitcoin is another example. The astronomical rise in Bitcoin prices doesn't appear to be due to any underlying usefulness in the 'coin' itself being suddenly realised by the masses – it was solely propped up by sentiment, which has since waned, along with media interest.

Why is this relevant? Well, we think we're entering a sustained period of increased volatility, and the media will likely have its part to play. Whatever the story of the day happens to be, we'll stay focused on the outlook for global economic growth and the impact this will have on company earnings and interest rates. The outlook for company earnings is strong, but we're watching for signs of softening as elevated valuations provide little room for error. Meanwhile, central banks are raising interest rates, giving rise to market jitters. We think these worries are premature.

We remain positive about the opportunities in emerging markets. Valuations are more reasonable, demographics are better and they're beneficiaries of strength in developed markets. As part of that outlook, we're particularly interested in anything connected to the Chinese consumer – where we see phenomenal growth spilling out into the wider region.

We can't always predict the next headline-making story, so we stick to what we know – the art of marrying the price of every region, sector and business we're invested in to the basic, underlying fundamentals.

"Exceptional employment and manufacturing data are confirmation that global economic growth outlook is robust. Yields have been rising thanks to the central banks beginning the process of reversing their quantitative easing programmes, and the markets are not sure how to handle it. If yields grind higher, we should expect a sustained period of higher volatility." – Philip Smeaton, Chief Investment Officer

INVESTMENT VIEW: THE TIP OF THE DATA ICEBERG

When the Facebook storm took hold in March, the world woke up to the consequences of sharing personal data. As Jack Ma, the inspirational founder and executive chairman of Alibaba put it, "the world is going to be data. I think this is just the beginning of the data period." Ma says, "information technology aims to control, while data aims to share."

Ma likens it to when electricity was invented. Back then, we knew electricity was going to change the world, but we couldn't begin to imagine to what extent. Similarly, today we're at the very

beginning of the data story, and while we recognise its potential, we have no idea what direction it will take us.

As well as denting investor confidence, the short-term fallout of the Facebook scandal will be a focus on regulation. The onus is on individual governments to put the right amount of consumer protection in place, without stifling innovation. They need to find the balance between allowing data to deliver better products while protecting people's privacy. At the end of the day, it's not an option to sacrifice human rights for business purposes, but where that line is crossed is complicated.

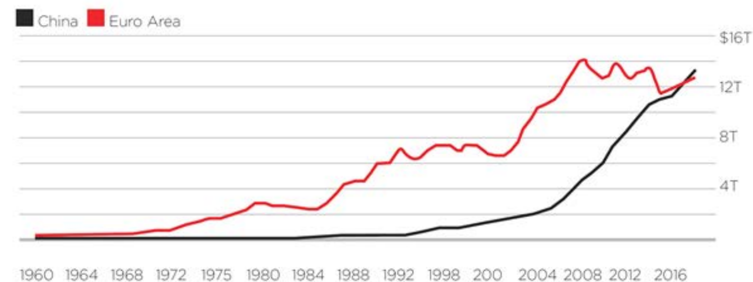
There's no getting away from the fact that our personal data will be at the centre of business and politics for decades to come. The sooner we, as consumers, understand how valuable that data is, the better.

FOCUS ON... CHINA

The Chinese economic story has been an impressive one over the last 40 years. As the graph below shows, its Gross Domestic Product (GDP) is expected to exceed that of the whole of Europe for the first time in 2018 – firmly stamping its authority on the global economy.

While the pace of growth looks set to slow, it will remain high, compounding from a very high base, and there's little to suggest that China is anything other than a great place to invest. While the removal of the two-term limit on the presidency – effectively meaning that Xi Jinping could remain president for life – is one to watch, we don't think it changes the core themes for this juggernaut economy. Jinping is known for championing anticorruption and favouring a move towards the free market (with 'state oversight'), and these policies will appeal to global investors in the short term.

The longer-term view is whether the debt concerns can be effectively addressed without impacting the competitiveness and potential of the economy. But who knows what China has up its sleeve – particularly in a world that will become dominated by Artificial Intelligence.



Notes: Charts nominal GDP levels; 2017, 2018 Bloomberg survey medians used where official data unavailable as of Feb 26, 2018. IMF GDP deflators used to convert from real levels. Sources: Bloomberg, world bank, International Monetary Fund.

First published on 5th April 2018 by Sanlam UK. Source: Sanlam UK April 2018 Market Review

WHAT RETURNS DO YOU EXPECT FROM INVESTMENTS OVER THE NEXT 10 YEARS?

ISA investors expect better returns from multi-asset than equities. Andrew Oxlade examines the expectations of investors, offered in the Schroders Global Investor Study.

Accurately forecasting returns for investing is not just difficult, it's impossible. However, the guesses that people offer can tell their own story.

We put an impossible question to 1,104 UK investors as part of our most recent Global Investor Study. We asked relatively experienced investors what returns they expected for their ISAs over the next decade, based on the money being invested in different assets.

SHARES VS THE REST

The anticipated return for a stockmarket-based ISA was 5% a year, slightly ahead of bonds at 4.5%.

A better result was expected for commercial property at 5.2%. This involves investing in shops and offices with tenant rental paying steady income. The expectation is pretty punchy. British faith in bricks and mortar is, it seems, deeply ingrained.

Hopes were highest, however, for "mixed assets" where returns of 5.3% were expected. Historically, global equities have been a strong performer, on average, over long periods so it is, perhaps, surprising that investors expect better returns elsewhere.

It is, however, encouraging to see some faith in the wisdom of spreading your money around – the mixed assets approach. If done shrewdly, diversification can smooth the ups and downs of an investment portfolio's performance. Beating the performance of equities over the very long-term, however, is more of a challenge.

Perhaps more startling is the expectation of investors that a cash ISA will produce annual returns of 3.2%. This would be something of a marked turnaround from the past five years.

AVERAGE ANNUAL RETURN EXPECTATIONS OVER THE NEXT 10 YEARS

Type of Isa	Expected annual return
Stocks & shares Isa in mixed assets	5.3%
Stocks & shares Isa in commercial property	5.2%
Stocks & shares Isa in equities	5.0%
Stocks & shares Isa in bonds	4.5%
Cash Isa	3.2%

Forecasts included should not be relied upon, and are not guaranteed.
Source: Schroders Global Investor Study2017. Question: What average annual returns do you expect over the next decade?

The average interest rate on variable-rate cash ISAs has been just 0.9% over the past five years, according to Bank of England data. Of course, cash ISAs have advantages over investments. For one, you can safely assume the full return of your capital, which isn't always the case for investments, and savings are covered by the Financial Services Compensation Scheme (FSCS) up to £85,000 per person with each firm.

Investors are constantly reminded that past performance does not offer a guide to future returns, and they seem to be listening.

Their forecasts are considerably more bearish than recent history. Over the past five years, the MSCI World index has grown by 7.7% a year, before the boost from dividend income is considered. This may have just been a particularly good spell for equities, although performance over the long-term has also been strong.

Interestingly, younger investors had more confidence in savings than older investors. Those aged under 36, a loose definition of millennials, expected a 4% return from cash ISAs while those aged 36 or over expected just 2.8%. Baby boomers, the over-65s, only expected 2.5% from cash.

Our Global Investor Study put a second question to the same UK investors, each of whom planned to invest at least €10,000 (or the equivalent) in the 12 months ahead, which points to a certain level of experience.

HOW ISA MONEY HAS BEEN INVESTED

We asked: where do you hold the majority of your ISA money?

Unfortunately 14% of investors didn't have any money in ISAs. They will be missing out on a range of benefits with protection on income tax and capital gains tax normally of most importance to investors.

Nearly half (47%) named cash ISAs as their biggest holding. It was 19% for ISA funds and 18% for individual shares. It would seem the low-risk nature of savings is still a big draw. Historically, that benefit has come at the cost of lower returns.

MOST POPULAR TYPES OF ISA

Type of Isa	Proportion of investors
Cash Isas	47%
Isa funds	19%
Individual shares	18%
Don't have Isa money	14%
Other	1%

First published 3rd April 2018 by Andrew Oxlade, Head of Editorial Content at Schroders.Source: Schroders Global Investor Study 2017. Question: Where do you hold the majority of your ISA money?

IS THE ROAD TO INFLATION TAKING US BACK TO THE 1960S?

The 1960s are remembered for radical social reform, political upheaval and war. Often forgotten is that they were also a time of rising inflation – and in this they may hold disquieting lessons for us today.

One of our key calls for 2018 is that consumer price inflation in the US will become an increasing issue for markets.

In a turnaround from 2017, when unexpectedly benign inflation helped create a Goldilocks environment for risk assets (not too hot and not too cold), this year we expect prices to surprise on the upside.

Our conviction has been reinforced by recent rises in the oil price. But we also expect "core" inflation, which excludes food and energy, to increase as pressures late in the economic cycle force up labour costs and allow capacity-constrained firms to increase prices more rapidly. Although historical comparisons are never perfect, there are worrying parallels here with the 1960s, when inflation picked up sharply in the second half of the decade.

As in the 1960s, initially low inflation last year puzzled many as it came against a backdrop of a tight labour market, leading to much debate amongst economists about whether the traditional link between unemployment and inflation had broken. It had been clear for some time that wages were not picking up in response to low unemployment and last year's experience led some to herald the death of the Phillips curve, which says the two should be correlated.

In our view this apparent disconnection reflected a mix of structural factors, such as globalisation and the increasing impact of technology, along with problems in accurately measuring the amount of slack in the labour market.

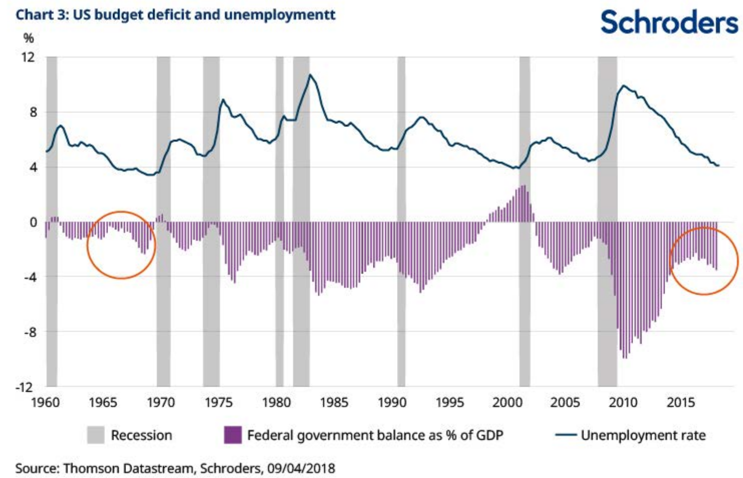
For example, on the question of measurement, we recently drew attention to the sharp drop in participation rates in the US which began to reverse as more people came back into the labour force. This meant that the low unemployment rate did not capture the availability of labour. Such analysis still holds, but there are limits to how far the US can keep pulling people back into the labour force, a view supported by surveys which show skill shortages becoming ever more acute (chart 1).

The comparison with the 1960s seems particularly relevant as it was also a period when inflation appeared to be unresponsive to developments in the economy before taking off sharply. Unemployment fell steadily in the first half of the decade, from 7% to 3.5% by 1968, with little impact on wages or prices.

However, in a warning for today, this changed after 1965, when prices picked up significantly and core inflation accelerated 6% towards the end of the decade (chart 2).

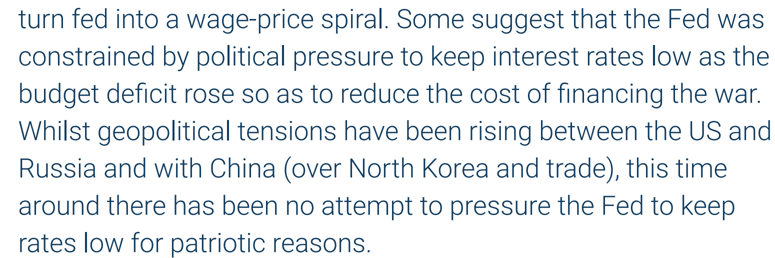
One of the triggers for that shift was fiscal expansion as the US pursued the war in Vietnam and domestic expenditure rose to fund the Great Society programme, a set of unprecedented initiatives launched by President Lyndon Johnson to alleviate poverty and racial discrimination. The extra stimulus pushed unemployment down even further, creating a tipping point where wages and prices began to take off.

We are not seeing the same scale of stimulus today, but we do have the same combination of a significant fiscal expansion meeting a late cycle economy. Following the recent Tax Cuts and Jobs Act and the Bipartisan Budget Act, US government borrowing is headed for 5% of GDP by 2019. This expansion in fiscal policy is set to keep demand rising in the US as the economy faces ever tighter constraints on supply (chart 3).



Two other factors played a part in the 1960s inflation. First, there was a material pick-up in healthcare inflation due to the introduction of the Medicare and Medicaid schemes, which aimed at bringing medical insurance to the poor, elderly and disabled. The rise in prices was broad-based across the economy, but these new programmes contributed significantly by raising demand for healthcare (particularly doctors' services), with the result that medical care inflation tripled from 3% to 9% between 1965 and 1967. In recent times, healthcare inflation has slowed as a result of cuts in Medicare payments and has been an important factor in holding back the general rise in prices. The risk today would seem to be less than fifty years ago, unless there were renewed efforts to repeal President Barack Obama's Affordable Care Act.

Second, in the late sixties, the Federal Reserve (Fed) did not tighten monetary policy rapidly enough to prevent inflation from rising and fuelling expectations of further increases, which in



turn fed into a wage-price spiral. Some suggest that the Fed was constrained by political pressure to keep interest rates low as the budget deficit rose so as to reduce the cost of financing the war. Whilst geopolitical tensions have been rising between the US and Russia and with China (over North Korea and trade), this time around there has been no attempt to pressure the Fed to keep rates low for patriotic reasons.

The control of inflation is a greater priority for the Fed and is more firmly embedded in the framework of the central bank. Nonetheless, the Fed could still fall behind the curve and lose control of inflation for a period.

It is often with the benefit of hindsight that errors are revealed. In the late 1960s there was a belief that the unemployment rate could continue to decline when more recent estimates show that the economy was already operating above capacity. Today's debate reflects the same uncertainty. Some reassurance can be found in the fact that Janet Yellen, who served as Chair of the Board of Governors of the Fed from 2014–2018, continued to raise rates last year, even as inflation surprised and undershot its target. It remains to be seen though whether the new chair of the Fed, Jerome Powell, can show similar resolve as political pressures to keep policy easy will only intensify as we move toward the mid-term elections and the next presidential election in 2020.

First published 17th April 2018 by Keith Wade, Chief Economist & Strategist at Schroders. Source: Schroders www.schroders.com/en/uk/private-investor/insights/economics/is-the-road-to-inflation-taking-us-back-to-the-1960s/

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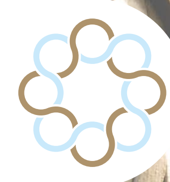

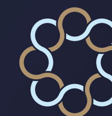

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