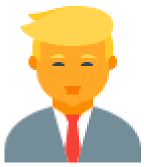
Stepping gently into a New Year

Following on from our review of 2016, we now turn our thoughts to what lies in store for the remainder of 2017.

There is a famous phrase attributed to the economist John Maynard Keynes that could be quite apt this year: "the market can remain irrational longer than you can remain solvent." In 2016, we saw many surprises from the Brexit vote to the arrival of President Trump. I am quite confident that we can expect many further surprises this year.

Trump



It is difficult to gauge what impact President Trump will have on the markets. To date, we have seen a positive reaction in equities with **the Dow Jones Index breaching 20,000 for the first time.** Bond markets have moved in the opposite direction as investors look at a future positive trajectory for interest rates in response to reflationary policies in the White House. But will the President be able to deliver on all of his election promises? Already we have seen difficulty for Republicans in repealing the Affordable Care Act, also known as Obamacare. The President's announcement of a ban on individuals from seven countries has incensed Democrats and might make the passage of further legislation even more difficult, particularly when bipartisanship is required.

Banks and construction companies were two sectors that benefited from Trump's victory. Likely increases in interest rates and tax cuts underpinned gains for companies like **Goldman Sachs who has seen its share price grow by 36% from early November.**

The burning questions are what will happen if all of Trump's policies are not implemented or if there are delays in navigating their way through Congress? There are a number of signs that should encourage caution: Gold has recovered its shine and there have been substantial inflows into gold funds. Gold is often seen as a safe haven, particularly in times of rising inflation. Increasing nervousness is captured by the Global Economic Policy Uncertainty Index, which has reached record levels. I recently saw an estimate for the cost of implementation of Trump's plans set at $10 trillion over the next ten years. An already heavily indebted economy may not have the stomach to write such a big cheque.

Politics and the Markets

Turning closer to home, we can see elevated geopolitical risk on the horizon. Elections and referenda are rostered to take place across Europe with particularly important **polls due in France and Germany**. Parties from the hard left and hard right have been gathering increased support which could make markets increasingly nervous.

Following the crisis of 2008/09, the US quickly took some hard medicine and implemented policies that created a strong economic recovery. It has now moved to a tightening phase (increasing interest rates to temper growth.) There are many measures used by investors to assess whether shares are overvalued or do they continue to offer good value. There are certain industry sectors and individual shares that have been particularly "hot" recently and their valuations may be a little frothy. This means that they are **susceptible to a sharp sell-off if they do not deliver on very high expectations.** As an example, Under Armour announced sales growth of 12% compared to the typical 20% growth rates of the past. The market response was a sell with its share price falling as much as 28%.

Brexit

The UK market is harder to assess as the cloud of Brexit hangs over it. Economic news has been very mixed and it is hard to get a clear picture of how business will cope during what could be a protracted exit process. **One of our fund managers Schroders are predicting a transitional period of four to five years**. Sterling weakness should be increased inflation which would have a negative read for household consumption. This could lead to lower growth expectations.

Emerging markets

Emerging markets have benefitted from improving commodity prices, particularly oil. **Many are showing decent economic growth rates.** However, this is likely to be tempered somewhat by a strengthening dollar.

Property

The supply of commercial property in Ireland will not catch up with demand for some time. This, allied to the continuing strength of the Irish economy, particularly in Dublin, should support rental income and capital growth.

In summary…

While there are plenty risks to the upside, equity markets have proven to be very resilient. They withstood some major shocks last year and rebounded substantially. I fully expect further challenges in 2017.

Bond markets are likely to struggle as quantitative easing comes under pressure and interest rates tick up in certain economies. Traditional funds took a long term view and selected a mix of assets which was adjusted to reflect prevailing market conditions. More recently, we have introduced Absolute Return Funds that typically utilise a higher level of risk management. These funds could show their worth in a more uncertain investment landscape in 2017.

Bernard Walsh

Bernard has over 20 years' experience in life and pensions industry and has followed the ebbs and flows of the markets closely during that time. He enjoys Gaelic football and rugby when he's not reading the financial times.

He frequently writes here on Life online, using his knowledge and experience to put the greater world of investment markets into context. Nothing happens in the world of Investment and Pensions without Bernard knowing about it!

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