Monthly Commentary 4th September 2017

August was quite tepid for financial markets. Equities were largely flat, with the exception of Europe, which fell almost 1% and emerging markets that rose almost 2%. Other notable movers were gold (up more than 4%) and the pound sterling that fell more than 2% against both the dollar and the euro.

Quite a few clients have contacted us recently to voice their unease about North Korea. We address the issue with excerpts from the Wall St Journal and Citigroup.

North Korea and markets

HEARD ON THE STREET

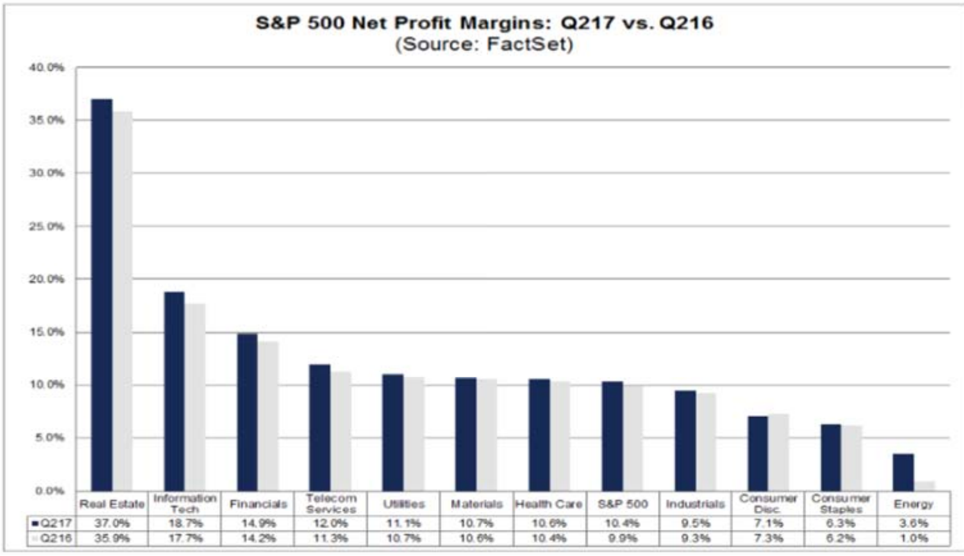
Why Markets Don't Care About North Korea—Yet

WSJ: *North Korea conducted its sixth and largest nuclear test just a week after firing a ballistic missile over Japan. Once again, though, markets shrugged. Although Korea's benchmark Kospi index fell nearly 2% in early trade Monday, it had clawed back about 1% of that by midday. The Japanese yen had gained 0.7% by late afternoon.*
The tepid reaction from stocks and currencies says little about how dangerous the situation on the Korean Peninsula has actually become: Markets are supposed to predict the future, but are notoriously bad at pricing risk of the political variety.
Of course, that's partly because there is no meaningful way to hedge against catastrophic risk, such as a nuclear war. Markets will therefore likely continue to focus on improving economic fundamentals in Asia and the West, unless an actual shooting war breaks out.

Citi: *As we consider these issues, it seems notable that even real episodes of geopolitical conflict have rarely led to lasting turning points in financial markets. If one excludes World War II and the Arab oil embargo - which caused a rationing of critical energy supplies -* ***initial declines in share prices have on average taken just one month's time to reverse****.*

Meanwhile, the 12 US equity bear markets of the post-World War II era generally coincided with 11 periods of economic contraction. In contrast to the troubling political news, leading indicators of both US and world economic activity suggest a modest acceleration and a broadening global expansion.

Our take. We tend to agree with the above. The current synchronized world economic expansion helps to drive corporate earnings growth and this is what really matters to the markets. US corporate profits are expected to grow by 10-11% in 2017. This has been accompanied by profit margin expansion. Evidence from the second quarter of 2017 vs Q2 of 2016 shows that 10 out of the 11 sectors in the US market had higher profit margins. This is remarkable considering that most pundits have been warning for years that margins are too high to be maintained.



	Real Estate	Information Tech	Financials	Telecom Services	Utilities	Materials	Health Care	S&P 500	Industrials	Consumer Disc	Consumer Staples	Energy
Q217	37.0%	18.7%	14.9%	12.0%	11.1%	10.7%	10.6%	10.4%	9.5%	7.1%	6.3%	3.6%
Q216	35.9%	17.7%	14.2%	11.3%	10.7%	10.6%	10.4%	9.9%	9.3%	7.3%	6.2%	1.0%

Non-US earnings growth is expected to be even more impressive at an annual clip of 15%. When one also considers that equities offer far better value than government bonds, then we suggest that geopolitical "noise" should be seen as just that. Of course if there is major conflict, all bets are off.

On Emerging Market equities

Emerging market equities continue to do well and having underperformed their developed market peers for 5 years, they have been doing very well this year. We believe that this outperformance will continue and have thus allocated a portion of our client portfolios to EM equities.

The Elgin Analyst Team

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