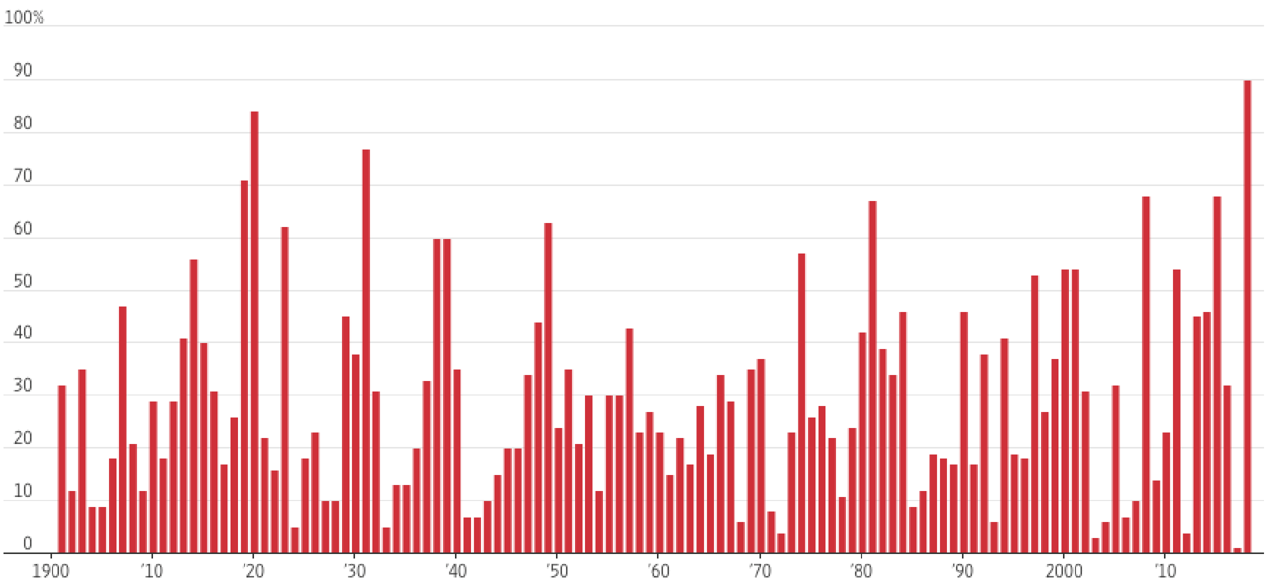
Monthly Commentary 5th December 2018

November was a mixed month in equity markets with the US, Japan and Emerging Markets gaining while the UK and Europe were down. In fixed income, US Treasuries were slightly up while most corporate bonds lost money. The biggest casualty of the month was crude oil, which fell 22%, and dragged the commodity index to an almost 5% loss. Currencies were more or less flat.

The markets have not been kind to investors in 2018, and the graphic below from Deutsche bank says it all.

Under Pressure

A record share of asset classes have posted negative total returns this year, according to Deutsche Bank data going back to 1901.



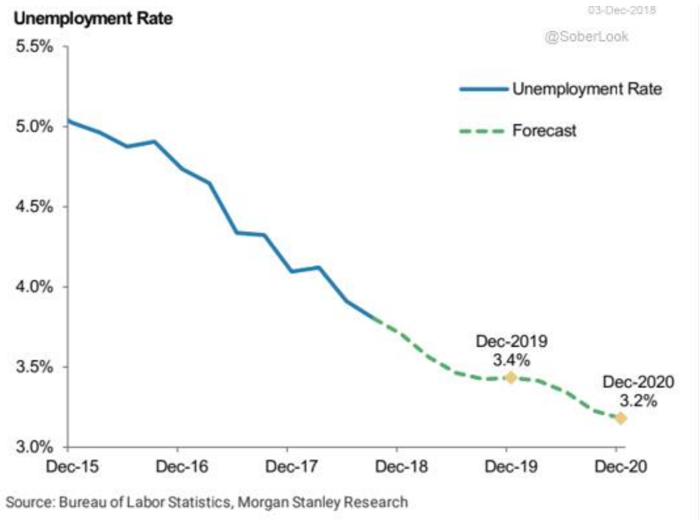
Note: Returns are in U.S. dollars. Data for 2018 are as of mid-November.
Sources: Deutsche Bank; Bloomberg Finance LP; GFD

All told, 90% of the 70 asset classes tracked by Deutsche Bank were posting negative total returns in dollar terms for the year through mid-November. The previous high was in 1920, when 84% of 37 asset classes were negative.

So there has been a lot of pain, which is also reflected in our portfolios.

Are things really that bad? There is no doubt that there are many worrying statistics and news out there, and these have certainly affected the markets. Yet we come back to the main question. *Is a recession likely to happen in the US in the next 6-12 months that will be preceded by the start of a bear market in equities*?

To answer this, let us look at unemployment. One can argue that employment trends have a lot to do with causing recessions. After all, when people have jobs, they spend more, and this is recycled into company profits, that in turn make the markets rise (assuming growing profits and reasonable valuations – something that is in place today). Below is the unemployment trend in the US:



The above bodes well for the future. And the trend in other regions is just as encouraging. In the EU, the rate has come down from 11% 5 years ago to less than 7% today. In Japan it's down from more than 5% in 2010 to 2.4%. People have jobs!

So the correction we experienced in the markets might actually have been a standard market correction that happens almost every year. According to Citigroup, in 89% of cases since 1990 when US equities have corrected while leading indicators of economic activity (see chart below) have been in a rising trend- as they are now - subsequent annual returns on US equities have been positive.

Note: The Conference Board's Leading Indicators combine economic and financial data to highlight common trends.
Source: Haver Analytics as of November 28, 2018

If one also takes into consideration that most other markets (Europe, UK, Emerging) are trading at valuations that are below their historical averages, with corporate earnings rising, then the outlook might not be as bad as many predict.

The Elgin Analysts' Team