Monthly Commentary 5th March 2018

February was not at all kind to financial markets. In fact, the only gauge that was up meaningfully was volatility as measured by the VIX Index. Equity markets took it on the chin, with falls of between 3.9% and 5.7% in major markets. US and Emerging markets were on the low end of the range while the likes of Germany's Dax fell almost 6%. Bonds were not spared as high grade corporate bonds especially in the US and the UK also got hit, and if anyone still believes that gold serves as a safe haven during market turmoil, it was not the case this time, with gold falling almost 2%. The only beneficiary, and that was only slightly, was the USD as measured by USD Dollar Index (DXY).

Indeed, the sharp correction that occurred in February was global in nature. Below is a headline from the Wall St Journal on February 5th:

MARKETS

As Stock-Market Rout Spreads, Investors Fear Markets Falling in Lockstep

Some investors worry that markets moving in tandem raise the chances of a more severe selloff than what still-positive fundamentals would warrant

It is only natural that headlines like these create a lot of nervousness. As the sharp falls were indeed contagious, it is worth looking at whether some of the falls were overdone and could not readily be justified by fundamentals. Citi provided the table on the next page. It shows which markets fell much harder than fundamentals justify. In the last column, the more negative the number, the more the falls deviated from fundamentals. So, China and Emerging Market equities fell much harder than they should have according to Citi.   Is this an opportunity? Only time will tell, but we are inclined to agree.

Throwing out the baby with the bathwater?

	Perf. from Jan 26 peak	Relative performance (a)	PE (x) 2018e	PE (x) 2019e	EPSg (% y-o-y) 2018e	EPSg (% y-o-y) 2019e	3m change to 12m fwd EPS (b)	Price perf relative to earnings revisions (a-b)
China	-13.0%	-5.3%	12.7	11.0	19.6%	15.6%	10.3%	-15.6%
EM	-9.4%	-1.7%	12.2	10.9	15.2%	11.1%	8.3%	-10.0%
Russia	-5.8%	1.9%	6.4	6.2	13.4%	3.4%	11.7%	-9.8%
DM	-7.7%	0.0%	15.8	14.4	14.0%	9.5%	7.8%	-7.8%
US	-7.5%	0.2%	17.2	15.5	18.4%	10.7%	7.9%	-7.7%
South Africa	-10.3%	-2.6%	16.1	13.7	18.9%	17.1%	4.5%	-7.1%
Canada	-8.4%	-0.7%	14.3	13.0	11.2%	9.6%	4.6%	-5.3%
Hong Kong	-9.2%	-1.5%	15.4	14.4	8.7%	6.8%	3.8%	-5.3%
Japan	-7.6%	0.1%	13.9	12.9	9.7%	7.6%	5.0%	-4.9%
Korea	-9.2%	-1.5%	8.2	7.8	14.2%	4.7%	3.3%	-4.8%
Italy	-7.4%	0.3%	12.0	10.7	16.5%	12.0%	4.7%	-4.4%
Germany	-9.0%	-1.3%	12.7	11.7	8.3%	8.5%	2.7%	-4.0%
Spain	-9.1%	-1.4%	12.4	11.4	6.5%	9.1%	1.7%	-3.1%
UK	-8.8%	-1.1%	13.4	12.5	7.4%	6.6%	1.5%	-2.6%
Brazil	-9.7%	-2.0%	13.4	11.7	18.2%	14.1%	0.3%	-2.3%
India	-6.2%	1.5%	18.7	15.7	17.9%	18.5%	3.7%	-2.2%
France	-7.9%	-0.2%	14.1	13.0	10.0%	9.0%	1.7%	-1.9%
Switzerland	-7.4%	0.3%	16.2	14.8	16.7%	9.5%	2.1%	-1.8%
Australia	-6.5%	1.2%	15.3	14.7	6.8%	4.1%	2.6%	-1.4%
Taiwan	-7.0%	0.7%	13.3	12.4	8.5%	7.3%	1.4%	-0.7%
Mexico	-7.2%	0.5%	15.8	14.0	6.5%	13.4%	0.3%	0.2%

Source: Bloomberg, MSCI, Factset, Citi Research. Data as of 12 February 2018. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events. Past performance is no guarantee of future events. Real results may vary. For illustrative purposes only.

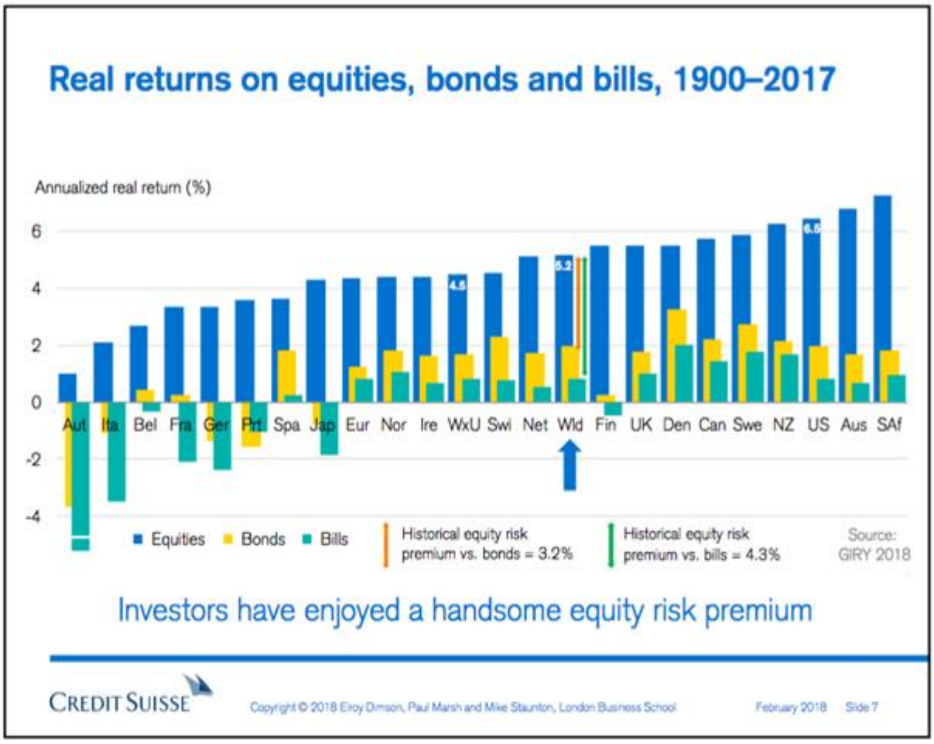
Strong earnings growth

The US expansion cycle is both strengthening and likely to endure through 2019. Rising profits continue to be a catalyst. In the last quarter of 2017 earnings rose almost 15%. More importantly sales growth was also very strong, coming in at 8%. So unlike in the past, profits are not just a factor of cutting costs. Continued strength in capital expenditure, M&A and buybacks bodes well for the near and medium-term future. The good news is that the earnings and sales story is not limited to the US but is largely global in nature.

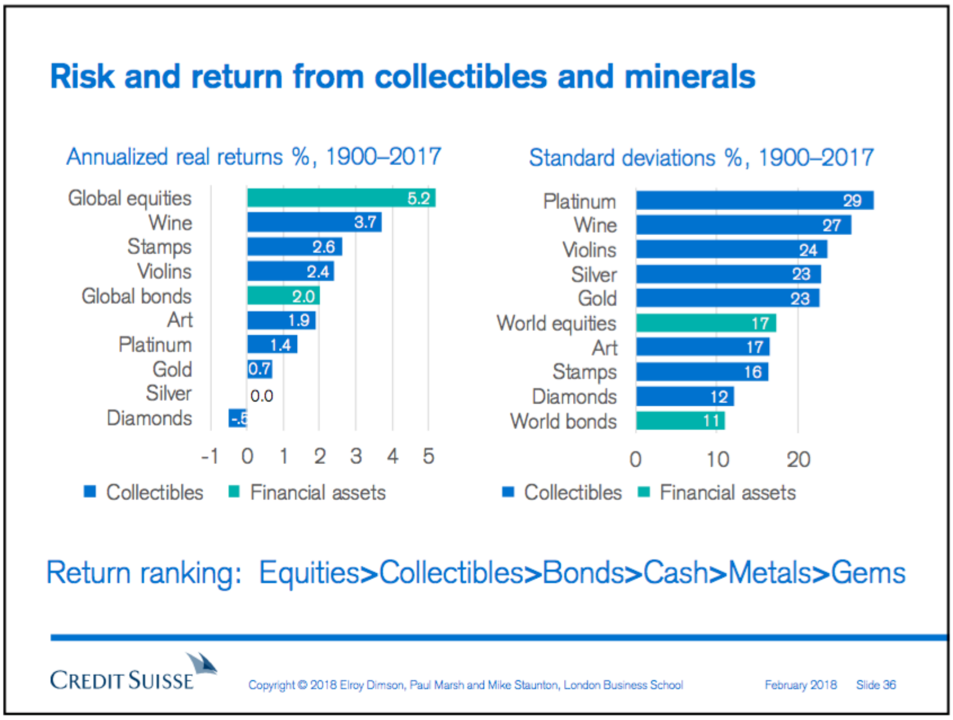
Looking at the big picture

The investment industry urges investors to think long term and very much like Warren Buffett, we subscribe to this mantra. In February, Credit Suisse published their annual Global Investment Returns Yearbook 2018. It is a market statistician's dream. Below we highlight four visuals that we found most informative.

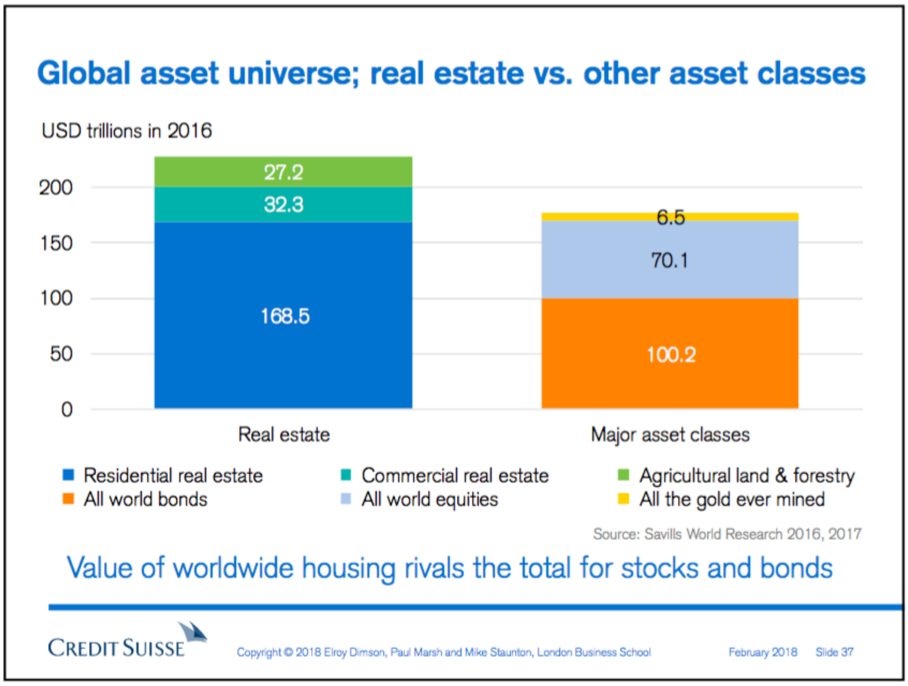
There is a lot of information in these graphics and we have made only one comment below each one. You may draw your own conclusions.



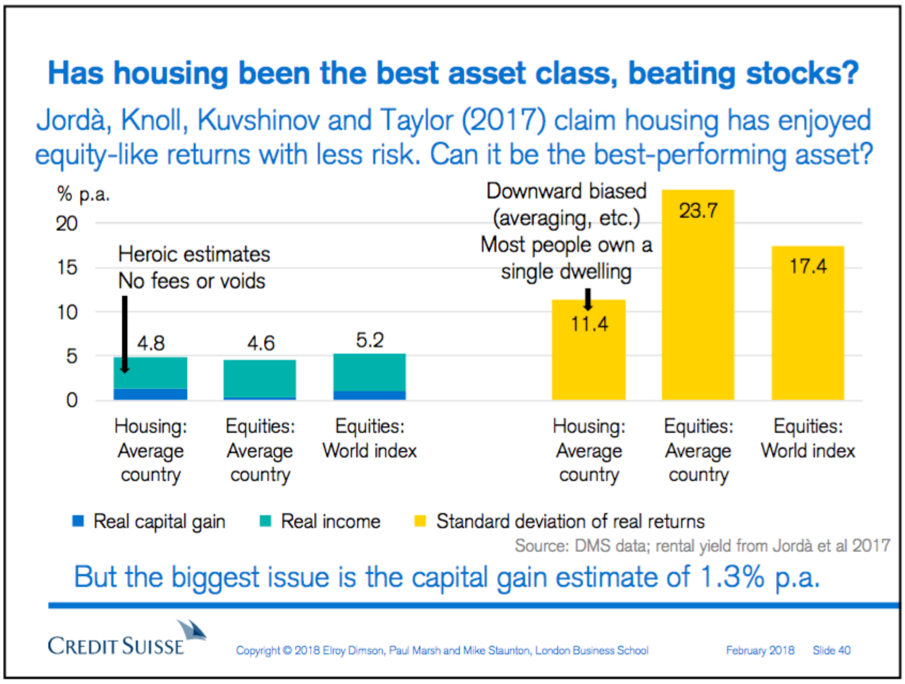
South Africa on top! But what happened to the Rand in that period?



Diamonds, Gold and Silver did not exactly shine!



Yes, the bond universe is bigger than the equity one.



Housing has appreciated only 1.3% annually!

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