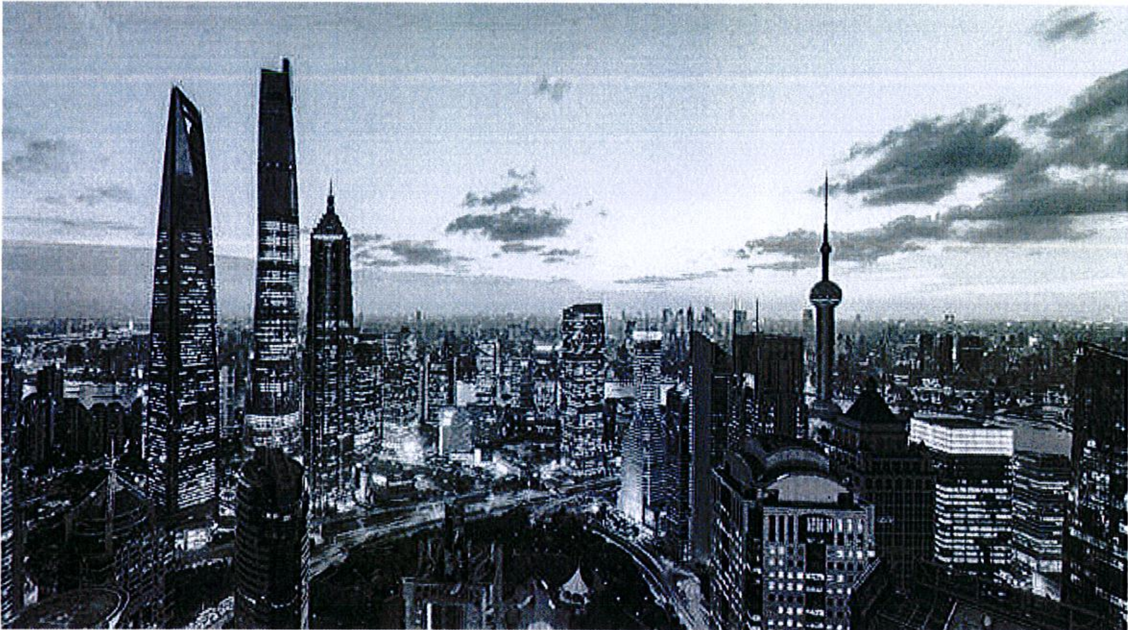
AXIS MARCH 2018



Top 5 investment themes for 2018

Investors spent 2017 monitoring activity in the US, political rhetoric and disruption, economic turmoil in the UK, North Korean activity and the impact of a range of natural disasters. So what should they consider in 2018?

Here are our top 5 themes.

1. Synchronised global economic growth

Not since 2010 have we seen coordinated economic growth occurring across most regions and countries. According to the Organisation for Economic Cooperation and Development (OECD), the global economy is now growing at its fastest pace since 2010. The OECD projects that the global economy will grow by 3.6 % this year and by 3.7% in 2018, before easing back to 3.6% growth in 2019.

The OECD expects the United States economy to grow at 2.2% in 2017, rising to 2.5% in 2018, then dropping back to 2.1% in 2019. The Eurozone is projected to grow at a 2.4% rate in 2017 and a 2.1% pace in 2018, before slowing to a 1.9% pace in 2019. Growth in China is projected at 6.8% in 2017, 6.6% in 2018, and 6.4% in 2019, as China rebalances its economy to a more domestic focused services-led growth model.

Japan has sealed its longest stretch of economic growth in 23 years, helped by a rise in business investment, racking up an annual growth rate of 2.5% in the September quarter, but that might be as good as it gets for a while, according to the OECD: it forecasts 1.5% growth for the Japanese economy for 2017, with growth lapsing back toward 1% in 2018 and 2019 as the decline in the working-age population accelerates.

The ECD also expects the emerging markets to help drive global growth. In particular, it believes India will show 6.7% growth this year, before accelerating to 7% in 2018 and 7.4% in 2019, on the back of reforms that are expected to boost investment, productivity and growth. Russia is well and truly out of recession, with the OECD seeing 1.9% growth in 2017 and 2018, and 1.5% in 2019. The politically troubled Brazil is also expected to exit recession, with a 0.7% growth rate in 2017, before solid improvement to 1.9% in 2018 and 2.3% in 2019. This level of economic growth should support strong growth in company earnings, and underpin improving global trade and commodity prices.

2. Chinese growth is still strong

China's economy surged in 2017, supported by government economic initiatives. With huge infrastructure spending expected to continue, China's economy is expected to keep humming along - although at a slightly lower rate, as per the OECD forecasts above. But China-watchers have to bear in mind that a lower growth rate in China applies to a much larger economy, all the time: although the 2016 growth rate, at 6.7%, was the slowest since 1990, when the country faced international sanctions in the wake of the 1989 Tiananmen Square massacre, the far larger economic base means that the 6.8% growth rate expected this year is equivalent in absolute terms to 10% growth just a couple of years ago.

Beijing is also seeking to manage the transition of its economy from being powered mainly by fixed-asset investment, manufacturing and export industries, to a more consumer-oriented and services-heavy economy. In addition, the ambitious "One Belt, One Road" global infrastructure program is at least partially designed to export China's spare capacity. The impact of China's growth will continue to be felt in Australia, but not only in commodities exports: China will increasingly be a large buyer of Australian services, as well. You only have to look at tourism, where this year China has become the largest contributor to inbound tourist numbers, with 1,347,400 tourists coming to Australia from mainland China, surpassing tourist numbers from New Zealand for the first time. Businesses supplying this growing market - or even just facilitating it, like Sydney Airport - should thrive.

3. Quantitative tightening is here

World markets had plenty of warning earlier this year that "quantitative tightening" - the unwinding of "quantitative easing" - was on the way. Unlike the "taper tantrums" of 2013, at least this was largely understood by investors as being recognition that the improving US (and now global) economy could handle less money being fed into economies, and the running-down of bloated central bank balance sheets. With the Federal Reserve firmly in quantitative tightening mode, the European Central Bank beginning to follow - but with the Bank of Japan lagging, and the Reserve Bank of Australia unlikely to consider raising interest rates until later in 2018 - the world is likely to have a year of monetary policy divergence. Inflation should make a comeback in the US, but spare capacity in the Eurozone and Japan will mean this will not be uniform. In any case, even with quantitative tightening having begun, there is still an estimated US$18 trillion ($23.7 trillion) in the system, so share prices are not likely to come under undue pressure in 2018: if anything, asset prices should remain strong in 2018.

4. In the long run, politics does not drive markets

Virtually anywhere an investor looks around the globe, politics is front page news, mostly for the wrong reasons. Washington is stuck in a theme of extreme partisanship; Germany doesn't have a formal government at present, and may have to re-run its election; "Remainers" in the British parliament seem to be working with Brussels to circumvent the British electorate's expressed desire to leave the European Union; Australia's political conversation daily plumbs new depths of inanity relevant only to its participants; and everywhere, populist fringe parties seem to be the only ones profiting from a free-falling trust in politicians. On the geo-political front, North Korea's regime is increasingly erratic and bellicose; the Middle East is as restive as ever; religious extremists

increasingly affect the way modern societies live; and political crises continue to hold back African economic development. But to share markets, none of this matters, as long as company earnings can rise on the back of real economic growth.

5. Amazon unlikely to kill Australian retail

Amazon's impending - now actual - arrival in Australia has weighed heavily on the retail sector in 2017, having a definite impact on some companies' (and retail landlords') share prices. Amazon will definitely cut into the revenue and earnings of some Australian players, but it won't blow the whole sector away: Ruslan Kogan, of Kogan.com.au, puts it best, when he says that Amazon tends to expand the online retailing market wherever it goes. Australian online sales are growing at more than three times the rate of physical sales, at almost 10% a year, compared to 3%. If a company doesn't have a capable online strategy, it will likely suffer, but those who do - like Kogan.com.au - feel that they can benefit. Amazon is also an e-commerce platform through which other retailers can sell.

The advent of Amazon will be a good thing if it urges retailers to invest in ways to drive efficiencies, improve customer experience and lower prices - and influence real estate investment trust (REIT) landlords to change their tenancy mix and offerings to make shopping more of a lifestyle experience - and we're already seeing these trends in Australia.

These trends shouldn't alarm investors, as they have also been prominent factors in 2017 and in some cases, years previous to this. Many investors may have positioned their investments to access international, or Australian investments with global revenue over the past few years for exposure to any opportunities they see from these themes, or positioned to manage the risks from these themes.

Managing these themes and any 'unknown' market events that may arise in 2018 will come down to having a clear and up-to-date investment strategy, with carefully researched diversified investments, that are constantly monitored and reviewed.