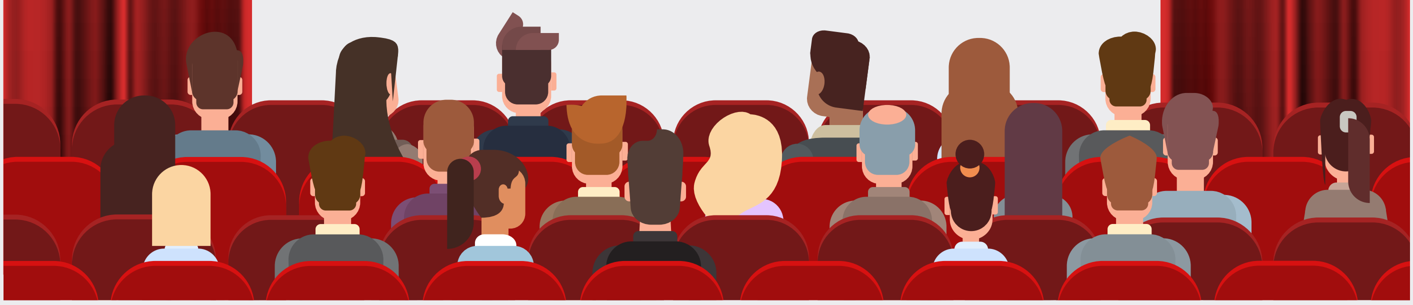
Bank of Ireland Investment Markets

Plenty for investors to digest at halftime in 2018

By Tom McCabe, Global Investment Strategist, Bank of Ireland Investment Markets

For investors 2018 has so far felt like the blockbuster movie sequel that fails to live up to its predecessor. 2017 contained the perfect mix of lows (inflation, interest rates and volatility) and highs (economic growth, corporate profits and stock prices) to sustain a not too hot, not too cold 'goldilocks' market for investors, one where strong gains were the norm.



2018 so far…

However, so far 2018 has delivered a softer economy, rising inflation, potential trade wars and numerous geopolitical scares. At halftime in 2018 the riskier asset classes have outperformed cash and bonds, but this has come with something of a struggle.

…looking ahead

Looking into the rest of the year, the global economy will be key for investors. Compared to the very strong growth picture in 2017, global economic momentum has eased. The Eurozone's slowdown was the most visible example of this but the Chinese economy also appears to have lost impetus. In contrast the US economy is still growing strongly and last year's tax cuts should extend this recovery further.

Outlook remains positive

Overall the global economic outlook remains positive and recession risks are low – consequently, equities still look capable of outperforming deposits and government bonds over the next year or so. The 15% growth in stock market profits forecast for 2018 is another clear reminder that the market backdrop is still supportive. However the economic evidence so far this year raises the possibility that this may be as good as it gets for the global economy in this cycle. If this is the case then further stock market gains could be more modest and hard-won than was the case earlier in this bull market.

Geopolitics

Geopolitical concerns were widespread the first half of the year but in our view some pose more of a threat than others. We see the graver threats to the equity bull market coming from issues that could upset the balance of the global economy. The trade spat involving the US, China and the EU is the best example of this. So far the potential economic fallout from this looks manageable. However, a meaningful escalation to a full blown global trade war would be a game changer from an economic and market standpoint.

The US withdrawal from the Iran nuclear deal also falls into this bucket as it should help keep oil prices higher for longer. This will push inflation higher and could create more uncertainty about central banks' interest rate policies. We think that higher oil prices won't by themselves significantly change central banks' expectations for monetary policy. But they will keep inflation, the catalyst for the first quarter market correction, at the forefront of investors' minds through the remainder of the year.

Other geopolitical events have the potential to create headlines but are less likely to significantly change the investment outlook. Prime Minister Conte's assurance that Italy has no plans to leave the euro should alleviate some anxieties around Italy although the 5 Star/La Lega coalition remains a highly unstable one. The main electoral event will be the US midterms in November. Here the key issue is whether the Republicans can retain their Congressional majorities, thereby helping President Trump press on with his legislative agenda. Brexit will continue to rumble on in the background but will affect UK markets much more so than global ones.

In summary, investors face a packed second half of the year, especially when it comes to the economy and geopolitics. On balance we remain confident that the global economy is strong enough to carry equities higher on a twelve month view but the journey may be more volatile than in recent years. In short, the goldilocks market isn't in imminent danger yet, but investors should still keep an eye out for stray bears lurking in the woods.

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