Bank of Ireland
Investment Markets

Global equities … Are we nearly there?

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The S&P 500 Index of the largest US companies has just marked its longest ever bull run since the Index began in 1932. This long rally of 3,453 calendar days began in March 2009 following the worst Financial crisis since the Great Depression of the 1930's. This is the longest stretch without a 20% correction traditionally associated with a bear market.

Next month we will pass the decade anniversary of the Lehman bankruptcy which is a sobering reminder of the depths of the crisis, forcing Central Banks to cut interest rates to zero. This long rise also mirrors one of the longest US economic expansions which have resulted in record job creation, rising capital expenditure and moderate inflation. The latest leg of this upward move has been dubbed the 'America first' rally as the recent tax cuts have boosted profits, dividends and investment.

Although it may be the longest in history it has not delivered the highest returns. The 19% per annum achieved is below the 24% average achieved in previous bull runs including the previous record set between November 1990 and March 2000. These figures include dividends.

If we include the rest of the world Global equities have risen 14% per annum since the market low of 2009 but if we go back a year earlier returns are a more normal 7% per annum.

Year to date global stocks are up 7% led by technology and healthcare sectors with telecoms and financials the weakest. At a country level the US leads whilst Europe and Emerging markets are in negative territory. This continues a longer term trend where European equities have underperformed US equities in both US dollar and local currency terms with some periods of outperformance in between.

Much of this performance gap is due to the composition of the respective indices. The US stock market has benefited from a higher weighting in technology stocks at 26% of the S&P Index including five stocks (Facebook, Apple, Amazon, Google and Microsoft) accounting for 60% of that weight. The technology weight in Europe is much lower at 6% with SAP the largest constituent. This also accounts for the bulk of the valuation gap at 16.6x forward price to earnings for the S&P Index versus 14.2x for Europe. Naturally the rise of the technology sector has reignited worries of another 'dot com' boom.

The trade tensions have strengthened the US dollar which has risen 5% year to date. This strength has put pressure on many Emerging economies whose borrowings are denominated in dollars.

MERGER AND ACQUISITIONS ACTIVITY

The first half of 2018 also marked a new high in M&A activity at $2.5trn across all sectors and geographies. Companies are taking advantage of lower interest rates whilst responding to digital disruption and consumer trends. Walt Disney recently bought Twentieth Century Fox to improve its content and compete with Netflix.

The Amazon effect has sparked increasing retail consolidation with the recent announcement that Sainsbury and Asda are to merge. The shopping mall 'anchor tenant' is now more likely to be a trendy coffee shop than a fashion retailer. Not all takeovers have run smoothly, Broadcom's proposed takeover of Qualcomm came to an abrupt halt when President Trump blocked the deal on security concerns. One of Qualcomm's key competitors is Chinese company Huawei.

Private equity is also active in the public space, Blackstone acquired the financial terminals and data unit of Thomson Reuters and Carlyle bought Akzo Nobel's specialty chemicals unit. PepsiCo this week said they were buying Soda Stream to move away from 'single use plastic bottles' embracing the environmental lobbying of consumers.

COMPANIES ARE ALSO BIG BUYERS OF THEIR OWN SHARES

The largest buyers of global equities are companies themselves. Since 2011 companies have spent U$4trn, retiring 14% of market capitalisation. John Deere, maker of farm machinery, announced with its quarterly update last week that it had reduced its share count by 35% since 2004. Apple, flush with $160bn of net cash, said it will retire 20% of its shares in the next three years. Tesla is not enjoying the public spotlight and has indicated it may go private. This isn't just a US trend; Bridgestone, Samsung Electronics and Unilever are amongst the many global companies reducing their share count.

CAPEX IS INCREASING

The recovery in the oil price has boosted the more traditional sectors and capex budgets are finally increasing. This has been boosted as cash has been repatriated back to the US with Google and Apple spending record amounts on data centres and emerging technologies such as autonomous driving and artificial intelligence. Overall Citi estimate that global capex will rise 5% in 2018 to U$3trn.

CORPORATE PROFITS ARE STRONG

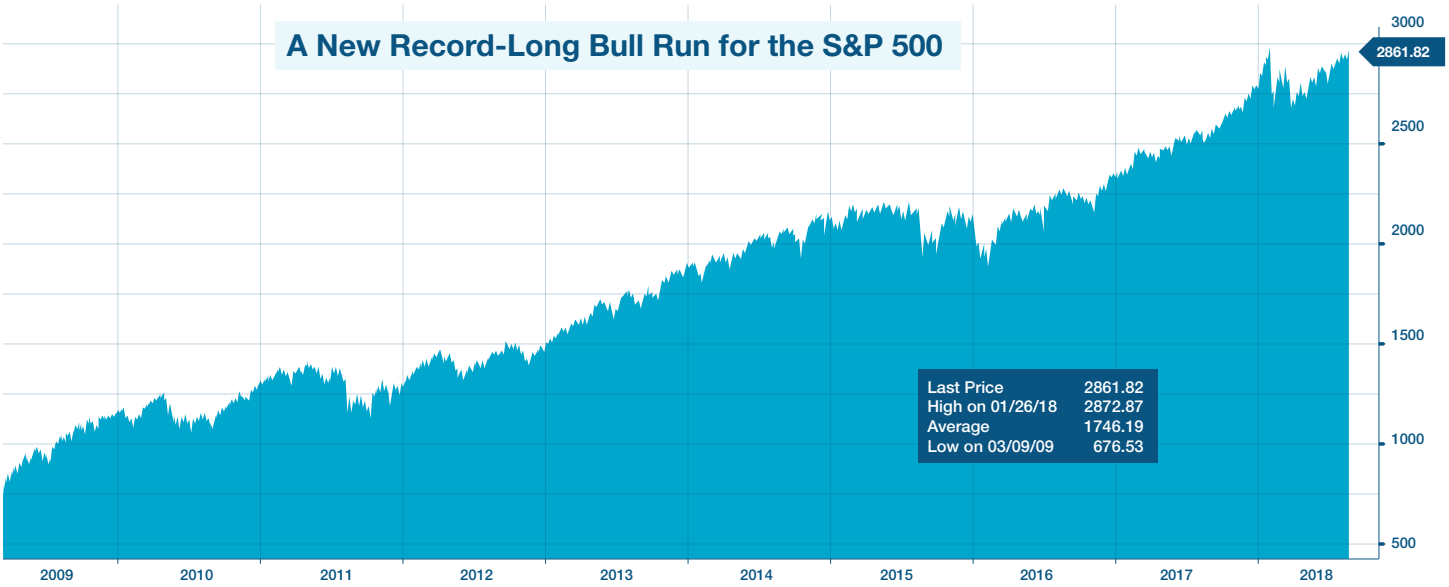
US earnings are forecast to grow 23% in 2018; globally earnings are set to rise 15%. This will normalise in 2019 to 9% as the benefit of the tax cuts fall out.

VALUATIONS ARE REASONABLE TO HISTORY

Currently the price to earnings ratio is 15x for global stocks against a long term average of 16x. At the market low in 2009 it was 9x; the peak price to earnings ratio was 30x back in 2000. The dividend yield is also attractive with the global dividend yield of 2.7%.

As we enter the fourth quarter of 2018 we still have negative interest rates for many developed countries, including Ireland, and the ECB has indicated that the first interest rate rise will be a year from now. Given the strength of the US economy The Federal reserve is raising interest rates with a target of 3% by the end of 2019. The double digit stock market returns we've experienced since 2009 will not continue as we are further along in the business cycle and the valuation point isn't rock bottom. But low single digit returns are achievable and if you want a positive return that beats inflation you have to look beyond the safer havens of deposits and bonds.

Trade wars, President Trump Tweets, Chinese credit growth and Brexit are amongst many bricks in the wall of worry. That's why it's very important to take a selective and diversified approach to stock selection.



Warning: The value of your investment can go down as well as up.

Warning: These funds may be affected by changes in currency exchange rates.

Warning: If you invest in these funds you may lose some or all of the money you invest.

Warning: Past performance is not a reliable guide to future performance.