TENZING PACIFIC
INVESTMENT MANAGEMENT

2018 Q'1 OUTLOOK

RESEARCH

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Summary

In this report we we'll be reviewing market performance from 2017, summarizing our own views on where to invest going into Q1 2018 as well as corroborating our views with a number of large banks and investment houses we receive external research from. We'll cap it all off with a brief summary of what we like and don't like going into Q'1 2018.

2017 In Review

2017 was a fantastic year for global stock markets. Global trade, GDP growth, corporate profits, consumer sentiment, unemployment, virtually every macroeconomic metric driving stock markets, was up during the year, in most regions. The S&P 500 index was up over 21%, the FTSE 100 in London went up 6.4% and the Euro Stoxx 50 capped the year off by returning 9.18%. Emerging markets outperformed most indexes, shining with a return of +34.84% for 2017. Most EM economies, particularly in Asia, experiencing growth in exports, domestic consumer demand and confidence as well as strengthening currencies. Even struggling economies, like Russia & Brazil, managed to begin dragging themselves out of recession, got inflation under control and benefitted from higher commodity prices.

Commodities got a huge boost during the year as well, on the back of increased trade activity and overall demand, with the Bloomberg commodity index up +2% for the year.

Bloomberg Commodity Index Total Return 2017

The biggest laggards in 2017 were US bonds, returning 2.59%. With uncertainty regarding the path of inflation and an end to the 6-year overall bond bull market, investors preferred rolling into riskier assets like stocks and were handsomely rewarded.

Bloomberg Barclays US AGG Total Return Bond Unhedged 2013 - 2018

Will 2018 Be The Same?

We currently remain very bullish on equity markets in general. 2018 will be different for us when it comes to asset allocation as we will be looking to favor allocations to specific companies, which we believe to be cheap and undervalued, instead of general market allocations, which we believe could be sensitive to valuation concerns. Most key economic metrics are forecast higher, with the IMF forecasting global growth at +3.7% &

UBS expecting +3.9% growth in 2018. Geopolitical risks are far less prevalent than both '16 & '17, however, it remains important to keep an eye on the Italian election come May as well as the ascension of North Korea as a nuclear power.

What Are The Biggest Risks Going Into 2018?

The main question we receive from clients is "what are your views on the US?" mainly because there is the perception that US companies are overvalued and that there is the risk the economy will underperform which will have a large impact on stock prices. Currently, we don't see evidence of the US economy underperforming. Most metrics, like: unemployment numbers, GDP growth (consensus growth for 2018 = 2.5%), real corporate earnings (corporate profits minus inflation) & wage growth all remain healthy. Most importantly, the US congress has managed to sign tax reform into law, reducing the tax burden on households and significantly reducing taxation on corporate profits. This is a welcome stimulus and should lead corporations to re-invest capital in the US as well as repatriate capital from abroad.

Our biggest concern in the US, since the beginning of 2017, have been general stock market valuations, which have been the highest since just before the great depression of 1929. Hence, we have favored allocations to specific companies operating in high-growth industries in the US, which we deemed to be undervalued, which we snapped up at very favorable prices. We made most of our returns via stock selection in the US in 2017. We will look to continue doing the same in the US going into this year, looking to maintain an underweight allocation to US companies with an emphasis on defensive industries.

What About Interest Rates in The US?

This is the biggest risk in our opinion. The Federal Reserve will have a new chairperson in February. Janette Yellen will be leaving and will be replaced by Jerome Powell. A further 4 seats will be filled on the board during the year as well. The current consensus is for 2 – 3 further interest rate increases during this year. The risk is that inflation could be surprisingly higher (inflation has not increased as much as expected, considering unemployment is at historically low levels), leading to Fed overreaction and an additional, unforeseen rate hike. An inflation surprise, along with the Fed reducing the amount of debt on its own balance sheet, which serves to reduce money supply and remove liquidity from the economy acting like and additional rate hike, could lead to higher financing rates and a spike in volatility, with a prolonged decline in stock prices. We will be evaluating this theme very closely during the quarter, and prepare a hedge for our clients by keeping volatility futures on their watch lists which will allow them to profit from a spike in volatility.

What about outside of the US?

The biggest risk outside of the US will likely be China's ability to come to terms with slower growth than it is used to as well as the process of de-leveraging and getting rid of excess manufacturing and production capacities. China's domestic private debt has ballooned to over 200% of GDP, which is extraordinary. There has also been evidence of a bubble within the real estate market. The ball is in the government's court to ensure these systematic risks are avoided at all costs. A policy error, one of the natural causes of a recession, primarily an in-ability to curb new debt issuances, leading to unsustainable levels of debt in the economy, could end badly. We, however, see many opportunities in the economy, primarily in the technology sector, which is already becoming a similar size and scope to that of the US, where many companies are also undervalued compared to their US counterparts.

What Are the Biggest Themes We Will be Working On in Q1?

1. **US inflation surprise**
2. **Chinese technology & their embrace of renewable energy**
3. **The sustainability of an oil bull market**
4. **Developing Asian healthcare**
5. **US Dollar upside surprise**
6. **Asia's transition from the producer to the consumer.**
7. **European rate hike surprise**
8. **The realized benefits of tax reform in the US**

	What We Like	What We Don't Like
Stocks	- US value & defensive stocks. US small cap value - General EM Stocks - Brazil - Russia - European banks - Chinese technology - Asian healthcare - Indonesia	- US broad market allocation - UK - South Africa - Australia
Bonds	- Local currency Asian debt - Junk bonds and some high yield debt - Treasury inflation protection	- Government bonds - Investment grade corporate bonds
Commodities	- Natural Gas - Copper	
Alternatives	- Hedge Funds - Invoice financing	- Bitcoin

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