

# Perennial Perspective

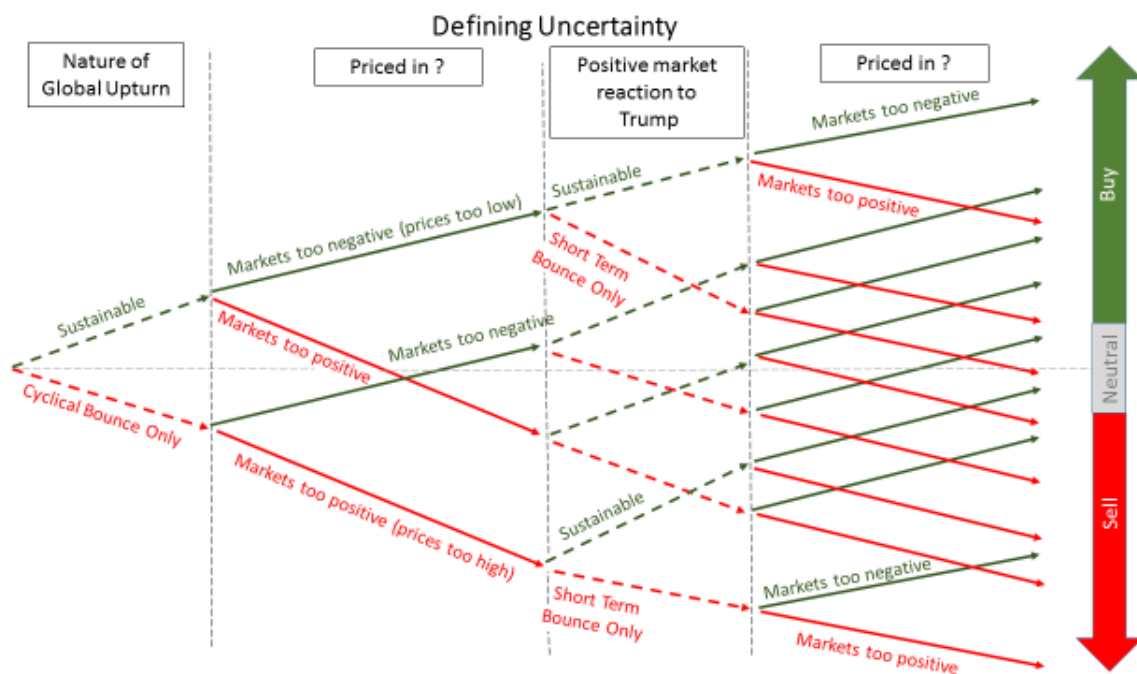
## Uncertainty defined, this is NOT fake news, really ....

Whilst recently presenting on the global economy and markets I was asked what I thought were the biggest risk issues we are facing in today's unpredictable (more so than usual) economic environment. In my view the standout themes are:

1. The recent global upturn based on the positive nature of most of the leading indicators around the globe; and
2. The positive market reaction to Trump.

The two key questions then become; are these two seemingly positive factors *sustainable* or simply a short term bounce AND how much of this good news is already *priced-in* to equity markets.

Although this big picture view may seem overly simplistic the answers to these key questions can produce a range of outcomes in terms of assessing the attractiveness of shares today. The following graphic illustrates this in a simple decision tree.

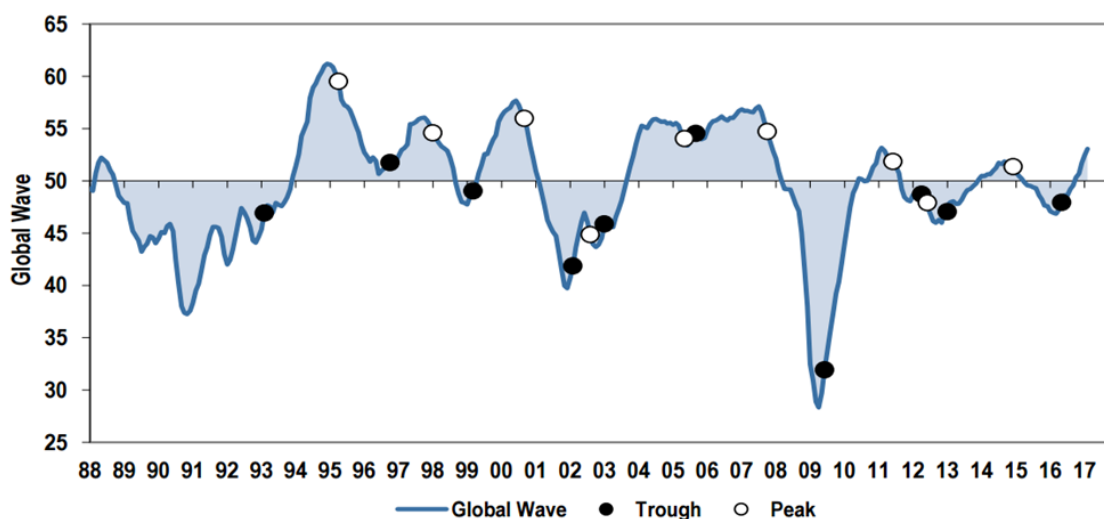


Source: Perennial

### Factor 1 – The current global upturn

The FOMC’s decision on 16 March to increase rates illustrates the confidence the Fed has in the nature of the US upturn. In terms of the global picture Bank of America Merrill Lynch put together a “Global Wave” index that takes into account various factors including Global Industrial Confidence, Global Consumer Confidence, Global Capacity Utilisation, Global Unemployment, Global Producer Prices, Global Credit Spreads, and their Global Earnings Revision Ratio.

From the graph below you can see the recent spike in the Global Wave which is generally a positive signal for share markets.



Source: BofA Merrill Lynch Global Quantitative Strategy, MSCI, IBES, Bloomberg, OECD, IMF

So have the good news been priced in? The table below shows that PE ratios are generally slightly ahead of longer term averages, implying that some of the good news is indeed already priced in. Whilst interest rates have risen somewhat, it appears that not only will we continue to live in a lower interest rate environment for some time, but that this environment can support PE’s that are higher than the average.

Market	Index	Price Earnings Ratio	
		Current Yr Est.	Next Yr Est.
<b>North / Latin America</b>			
US	Dow	17.24	15.58
US	S&P500	18.30	16.30
US	NASDAQ	22.51	19.21
Mexico	Mexico IPC	18.45	15.99
<b>Europe/Africa/Middle East</b>			
Europe	Euro Stoxx 50	14.91	13.53
UK	FTSE 100	14.91	13.84
France	CAC 40	15.03	13.55
Germany	DAX	14.07	12.95
Spain	IBEX	14.77	13.40
Italy	FTSE MIB	14.07	11.88
Netherlands	AEX	16.29	14.49
Switzerland	SMI	17.60	15.84
<b>Asia/Pacific</b>			
Japan	Nikkei 225	18.08	16.51
Hong Kong	Hang Seng	12.13	11.13
China	Shanghai SE Comp.	13.53	11.87
Australia	S&P/ASX 200	16.29	15.73
Singapore	Straits Times Index	14.75	13.74
Source :- Perennial, Bloomberg @ 30/3/17			

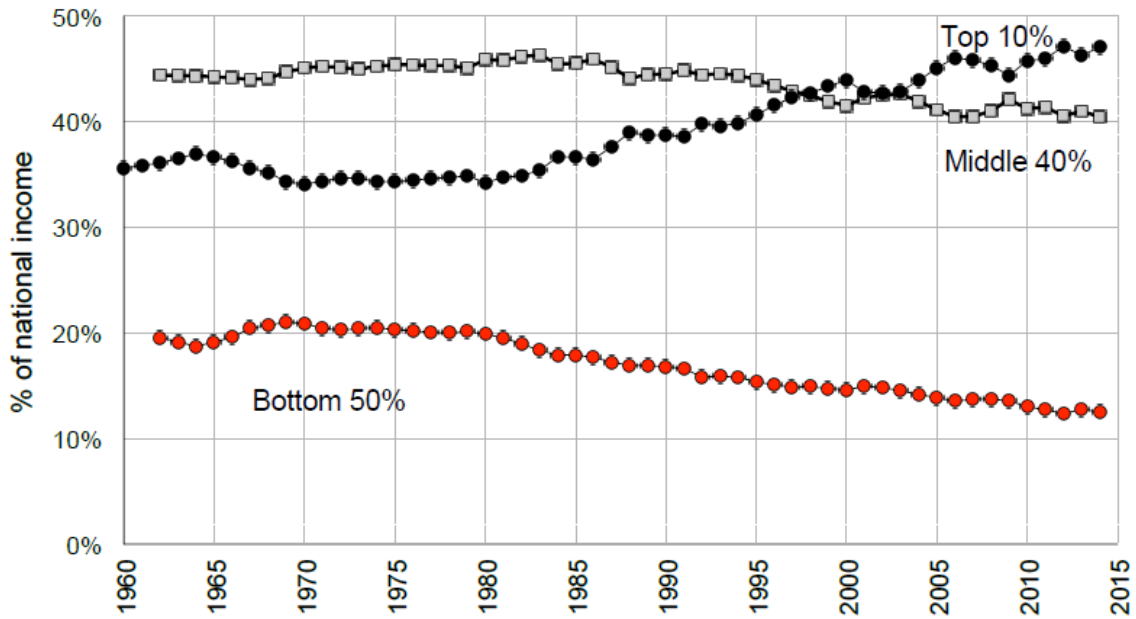
Overall we are optimistic that the current upturn is sustainable however, we continue to monitor key leading indicators, particularly for our stocks that are exposed to global markets.

## **Factor 2 – Trump – just the facts please (no fake news).**

There have been a myriad of opinion pieces on Trump and the Trump-like-figures phenomenon which is sweeping the globe as well as the thorny issue of “populism”. Evidence suggests that populism and its continued rise stems from not only cultural (immigration) discontentment but economic (capitalism has ‘failed’) discontentment as well.

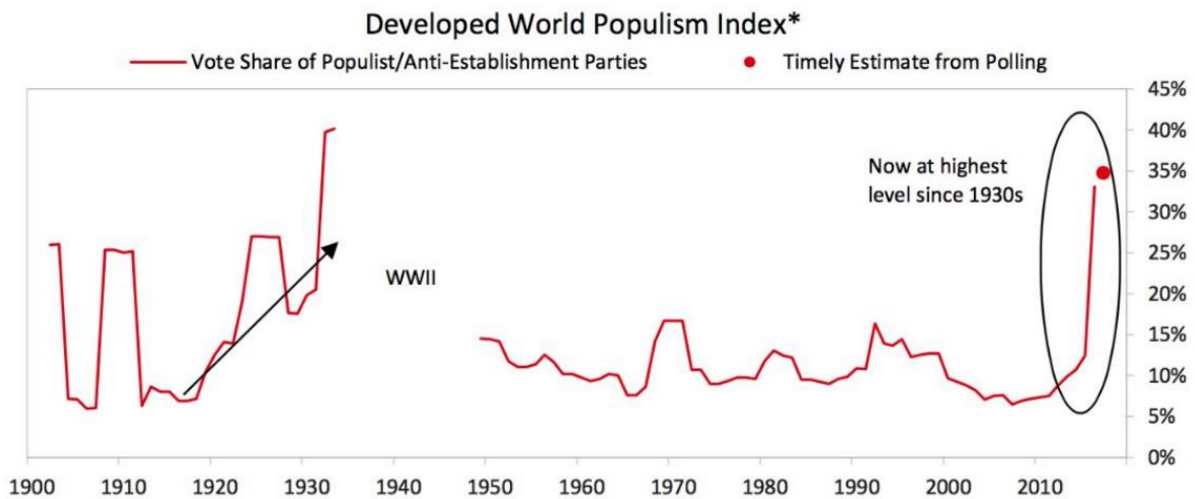
Income inequality is an important factor in the current wave of “populism” in the US and around the world. Income inequality in the US has been difficult to estimate; a recent academic study attempted to extract from the US national accounts the share of income flowing to different socio-economic groups. Surveys suggest that the ‘forgotten bottom 50%’, which comprise Trump’s political base, seemed to feel that the Washington elite have abandoned them. This is reflected in the research (see graph below) which clearly shows their share of income fading since 1980.

### US Share of Pre-Tax Income (equal split individuals)



Source: Distributional National Accounts: Methods and Estimates for the United States; Thomas Piketty (Paris School of Economics); Emmanuel Saez (UC Berkeley and NBER); Gabriel Zucman (UC Berkeley and NBER); December 15, 2016

Bridgewater Associates have produced a brilliant, detailed paper analysing the votes going to populist type parties around the developed world. The chart below quantifies this into an estimated index.



*\*The latest point includes cases like Trump, UKIP in the UK, AfD in Germany, National Front in France, Podemos in Spain, and Five Star Movement in Italy. It doesn't include major emerging country populists, like Erdogan in Turkey or Duterte in the Philippines. In the rest of the study, we look at populists of the past rather than those now in office in order to study the phenomenon because the stories of ones in power or possibly coming to power are still being written. For example, while we consider Donald Trump to be a populist, we have more questions than answers about him and are using these other cases to assess him against by seeing if he follows a more archetypical path or if he deviates from it significantly.*

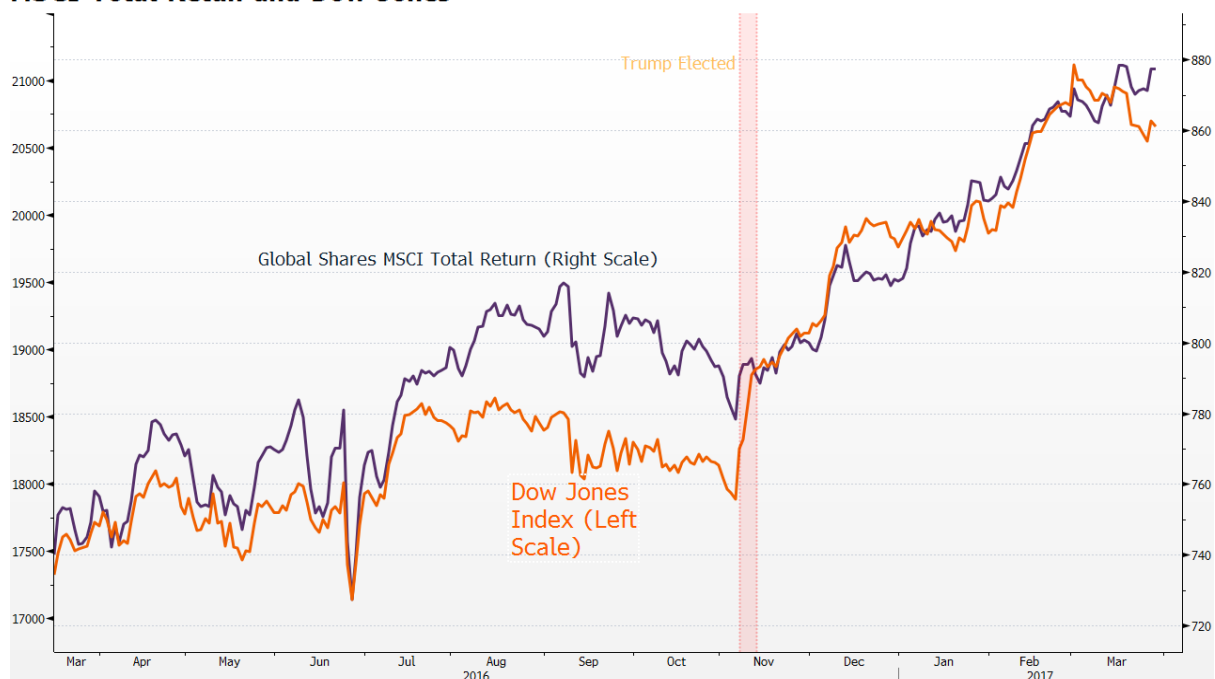
Sourced from Bloomberg <https://www.bloomberg.com/news/articles/2017-03-22/dalio-says-populism-may-be-stronger-than-fiscal-monetary-policy>

Despite the social unrest that populist policies seem to evoke, many populist policies can be positive for markets. The index itself however, is not a market tool but a useful and thoughtful analysis that clearly illustrates that populism is a global and real phenomenon that has the power to influence and shape economic conditions.

The prickly question on how much of the Trump effect is priced in the market is almost impossible to guesstimate given the lack of detail we have around Trump’s actual policies, other than the fact that they appear to be “market friendly”.

Certainly equity markets appear to have responded well to the pro-business, infrastructure and low taxes that have been part of the Trump rhetoric. However, more recently (as shown in the chart below) the US market has pulled back on doubts that the Trump reforms may be harder to enact particularly given the Republican’s push back on the new health model to replace Obamacare.

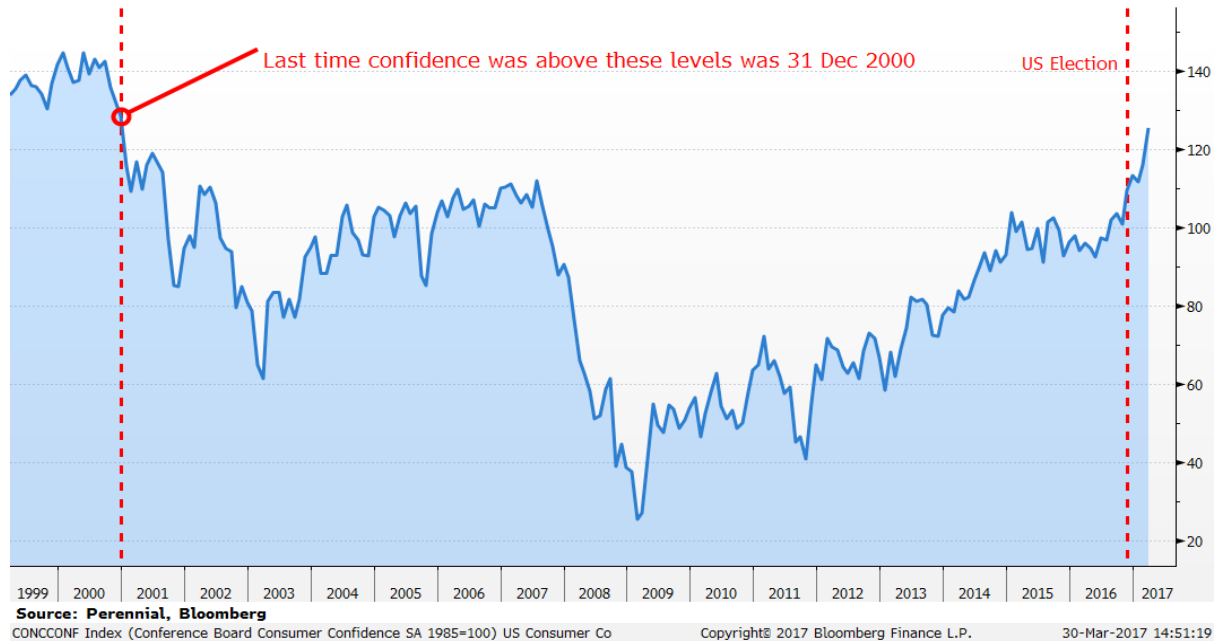
### GLOBAL and US SHAREMARKETS MSCI Total Return and Dow Jones



Source: Perennial, Bloomberg  
GDUACWIF Index (MSCI AC World Daily TR Gross USD) MSCI and Dow Jones Daily 16MA Copyright© 2017 Bloomberg Finance L.P. 30-Mar-2017 15:57:11

The other piece of very interesting recent data is the Consumer Confidence figures for the US which were substantially ahead of most forecasts. Certainly consumers are re-acting positively to the current environment that they are seeing, with consumer confidence figures climbing since Trumps elections to office

## US Consumer Confidence



So what to make of this paradoxical landscape? – It is too early to tell however, I'd be watching these two factors carefully – return to the first chart and follow your own decision tree to start thinking about where your portfolio is positioned for these interesting times.

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*Disclaimer: Please note that these are the views of the writer and not necessarily the views of Perennial Value.*