The 'Wall of Worry' gets built by the IMF

The MSCI All Country World equities index rose by 0.43% over the week, to 512.74, bringing it close to unchanged for the year-to-date, and just 6.83% below the all-time high reached on 26th January. This compares to a fall in the Bloomberg Barclays Global-Aggregate bond index of 0.71% for the week as bond yields rose. The bell-weather S&P500 closed 0.52% higher (at 2,670.14), 7.1% below its all-time high. The NASDAQ Composite fared less well, hit by weakness in Apple and semi-conductors, reflecting bearish channel-checks for smartphone and related component demand from Taiwan Semi and sector analysts. Apple fell 5.2% over the week, but is still only 8.8% below its March high, with its medium-term technical uptrend intact. The STOXX Europe 600 followed Wall Street, rising 0.70%, helped by a slightly lower euro. The Japanese TOPIX did rather better (+1.26%), helped by a weaker yen. The major thread running through markets was that risk-on began to return to equities, and investors showed willingness to go back into the water - helped by a combination of more friendly (or less unfriendly) geopolitical rhetoric, the effect of which was not spoiled by rising interest rates across the curve. The VIX closed at a 'satisfactory', calm level of 16.88, down from the 17.41 of the previous week. In Fixed Income, investors (viewed through swaps) are now approximately 13 basis points less behind the curve than they were at the end of the previous week (now expecting Fed funds to be trading at 2.68% in two years' time, vs. 1.69% in the market today). Accordingly, the US 2-year Treasury yield was just over ten basis points higher over the week (at 2.4573%). The US 10-year yield closed at 2.9602%, a hefty 13 basis points higher, and approaching the technically important 3% level (the exact reference point being the 3.02% reached at end-2013). **If investors perceive the central banks may not have to be so cautious (given less aggressive trade talk than recently - or that 'core' and/or headline inflation expectations are creeping upwards for whatever reasons), they will be more inclined to reduce bond positions.**

"Large shorts are supporting the dollar, and now rates are, too"

Given the move seen in US rates last week mentioned above, in tandem with less *overall* US political concern impacting the dollar, this could be a period during which interest rate differentials once again drive short-term FX rates, and favouring the US dollar. This is distinct from the longer-term arguments regarding twin (fiscal and trade) deficits, the inevitability that central banks will in time diversify more of their dollar holdings into renminbi, and so on - with a number of those arguments being dollar-bearish. For the time being, however, there exists a large bet against the dollar by non-commercial accounts, in reality probably preventing dollar weakness. The dollar index closed 0.57% firmer over the week. In crude oil, the price of Brent closed 2% higher, at $74.06/barrel, with the net-bullish factors of recent weeks only momentarily being affected by Trump's tweeted view that OPEC had rallied the price some way above fair value. **Rising rates hit gold, which was just under $10 lower over the week, at $1,336.36/oz.**

"Last week's IMF update suggested the EM world is developing nicely!"

Last week the IMF updated its forecasts for the global economy. They began by noting that the global economic upswing that began in mid-2016 has "become broader and stronger", and that "advanced economies as a group will continue to expand above their potential growth rates this year and next before decelerating, while growth in emerging market and developing economies will rise before leveling off", adding that, "Global growth seems on track to reach 3.9% this year and next…" (both unchanged from their January report). Their major revisions to real GDP growth since then are as follows: (1) for the **US**, +0.2% for both 2018 and 2019, to 2.9% and 2.7% respectively; (2) for the **Euro-Area**, +0.2% for 2018, making 2.4% for 2018 and 2.0% for 2019; (3) for **Brazil**, +0.4% for both years, making 2.3% for 2018, and 2.5% for 2019; (4) for **South Africa**, +0.6% and +0.8% for 2018 and 2019 respectively, i.e. 1.5%, improving to 1.7%; (5) for the **'ASEAN-5'** (Indonesia, Malaysia, Philippines, Thailand & Vietnam), 2019 is nudged up by 0.1%, making 5.3% for this year and 5.4% for next. **China** was left unchanged at 6.6% for this year, followed by 6.4% for next year. **India was also unchanged, at 7.4% for this year, expected to improve to 7.8% in fiscal 2019.**

"The IMF said financial conditions remain supportive, despite recent equity volatility"

Further viewing the world, the IMF observed that, "Growing trade and investment continue as notable factors powering the global upswing", and that, "…The synchronized expansion will help to dispel some remaining legacies of the crisis by speeding the exit from unconventional monetary policies in advanced economies" - however adding that, "In advanced economies, aging populations and lower projected advances in total factor productivity will make it hard to return to income growth". Also: "An escalating cycle of trade restrictions and retaliation is another risk. The first shots in a potential trade war have now been fired". On a happier note, though, "Financial conditions remain supportive, despite the recent volatility in equity markets and increases in bond yields following signs of firming inflation in advanced economies".

"Prospects remain favorable in emerging Asia and (emerging) Europe, but are challenging in Latin America, the Middle East and sub-Saharan Africa, where - despite some recovery - the medium-term outlook for commodity exporters remains generally subdued, with a need for further economic diversification and adjustment to lower commodity prices".

"The IMF expects EM growth to stabilize close to current levels"

Although the IMF narrative is quite sanguine for the short-to-medium-term, they return to caution looking further out: "…risks beyond the next several quarters are clearly to the downside", and "…financial conditions - which remain easy despite the onset of monetary policy normalization - could tighten sharply and expose vulnerabilities that have accumulated over the years, with adverse repercussions for growth". "Very expansionary fiscal policy in the US, at a time when the current account deficit is already larger than justified by fundamentals, combined with persistent excess current account surpluses in other countries, is projected to widen global imbalances". The eventual slowdown in global growth is "…entirely because of advanced economies, where growth is projected to moderate in line with their modest potential growth; growth across emerging market and developing economies is expected to stabilize close to the current level. The Advanced Economies are projected to grow at 2.5% in 2018 (0.2 of a percentage point higher than in 2017), and by 2.2% in 2019". In the US "the increased fiscal deficit…will require adjustment down the road". **They add, "Medium-term growth in the Euro-Area is projected at 1.4%, held back by low productivity amid weak reform efforts and unfavorable demographics", while "Japan's growth is projected to moderate to 1.2% in 2018 (from "a strong above-trend out-turn of 1.7% in 2017…), before slowing further to 0.9% in 2019".**

"The IMF assumes $58 crude for 2019"

Further commenting on EMs, the IMF continued: "Growth is expected to increase further, from 4.8% in 2017, to 4.9% in 2018, and 5.1% in 2019, and "…the high growth rate reflects primarily continued strong economic performance in emerging Asia". We would especially underline this: "Beyond 2019, growth in emerging market and developing economies is projected to stabilize at about 5% over the medium term"…while "this reflects some modest further strengthening in economic growth in commodity exporters, though to rates much more modest than over the past two decades, a steady decline in China's growth rate to a level that is still well above the emerging market and developing economy average, a gradual increase in India's growth rate as structural reforms raise potential, and continued strong growth in other commodity importers" (essentially China). Also: "Emerging Asia is forecast to continue growing at about 6½% during 2018-19, and remains the most important engine of global growth". Regarding MENA, "Growth in the Middle East, North Africa, Afghanistan, and Pakistan region is expected to pick up in 2018 and 2019, but remains subdued at about 3½%. While stronger oil prices are helping a recovery in domestic demand in oil exporters, including Saudi Arabia, the fiscal adjustment that is still needed is projected to weigh on growth prospects". Specifically on UAE GDP growth, the IMF expects 2.0% this year, rising to 3.0% in 2019, with a longer-term assumption of 3.1% for 2023; inflation in the UAE is expected to be 4.2% this year, falling to 2.5% in 2019 (presumably after VAT falls out). Lastly in this section we would mention the IMF is assuming a simple oil price average (Brent, Dubai Fateh, and WTI) of $62.30 for the current year, and $58.20 in 2019. **While we are not yet oil 'perma-bulls', we would note that reality could be sufficiently different to suggest some different out-turns. i.e. India's growth would be lower, while Saudi Arabia's eventual sale price for its Saudi Aramco stake could be enhanced, funding more complete economic diversification in the long-term.**

"Rising bond yields could steady the progress of the equity bull"

INVESTMENT SUMMARY: Our Asset Allocation Committee met last week, and left 'risk-on' positioning in place, concluding that global equities had more than likely re-found their way after recent volatility. Rising bond yields could well prevent equities from becoming overbought, steadying the bull market. Volatility has fallen across a range of asset classes. Eurozone equities could be dragged higher by other markets (similarly, Japan), possibly leading to opportunities to reduce those classes (via a 'Sell in May' operation, depending on valuations). Elsewhere, the Chinese authorities continue to manage their credit squeeze effectively. **The Committee is seriously examining whether a further break to the upside could be made in commodity prices from current levels.**

When the IMF and others worry about excessive debt, the possibility of trade wars, and so on, they are helping investors by building the 'Wall of Worry' to be scaled by markets. From the perspective of our own asset allocation, we are heartened that the IMF believes that China, India and the 'ASEAN-5' will continue to lead global growth (in 6%+, 7%+ and 5%+ ranges, respectively), and while this alone cannot generate alpha, it helps set the scene for success. **Lastly, there are times in markets when emphasizing sheer investment *quality* (avoiding poor balance sheets, low-quality earnings, and dubious financial structures, etc.) becomes paramount - and with recent rate upside we appear to have arrived at that point.**

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