MARKETS CHEER THE GOOD GLOBAL ENVIRONMENT

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ABOUT **THE AUTHOR**

As Sake Economist of the Year, Rian's insight into and forecasts of how macroeconomic developments impact financial markets inform our top-down views.

September was a very good month for global equity markets. The US S&P 500 Index rose by 1.9% and closed the month at a new record level. The German Dax fared even better, surging by 6.5%, almost fully reversing a cumulative similar-sized decline over the previous two months.

Good equity market performance came in spite of a number of developments that one would normally expect to cause some concerns among investors. These include ongoing concerns over geopolitics, as the tensions between the US and North Korea ratcheted up, warnings by several key central banks of policy normalisation (either interest rate hikes or the start of balance sheet rundowns), and some signs of an economic slowdown in China after the unexpectedly good second quarter growth outcome.

KEY TAKEOUTS:

- WALL STREET ENDS SEPTEMBER ON A NEW HIGH
- WIDESPREAD IMPROVEMENT IN GLOBAL GROWTH
- RENEWED HOPE FOR TRUMP'S TAX REFORM
- INVESTORS FOCUS ON IMPROVING ECONOMY AND PROFITS

IMPROVING GROWTH DRIVES EQUITIES

The fundamental reasons for the strong equity market performance are likely threefold. First is the growing confidence that the global economic recovery not only remains on track, but is spreading around the world. As a result, corporate profitability has remained generally healthy.

The second, almost perverse, reason for the good equity performance is that investors see central banks' willingness to push on with policy normalisation as a sign of policymakers' growing confidence that the global recovery is becoming self-sustaining, thus requiring less monetary support. Put differently, investors view policy normalisation as being for a good reason (that is, firming and spreading growth) and not for a bad reason (i.e. having to curb inflation pressures). Indeed, in recent months inflation surprises have been more on the downside than the upside, giving confidence that central banks are "not behind the curve". In short, the perceived global macroeconomic "Goldilocks" environment (not too hot to cause inflation and not too cold to cause a recession) we described in last month's commentary, has overridden pretty much all other potential concerns for investors over the past month.

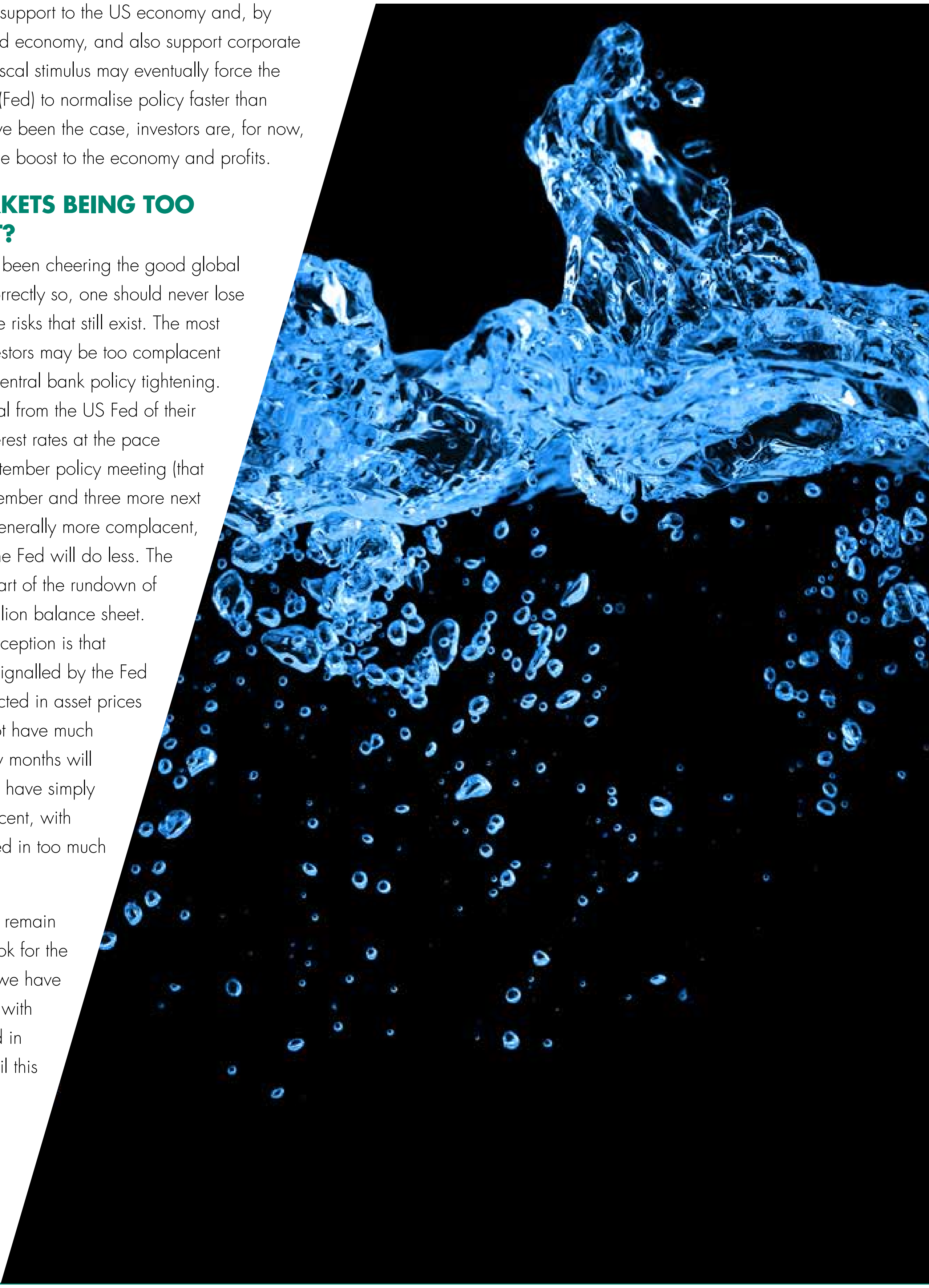
As September drew to a close, the third reason for equity optimism appeared, namely renewed hope that the thus far postponed tax reform and fiscal stimulus in the US is back on the agenda. While the White House's fiscal plan still faces many obstacles and challenges, there is growing optimism that 2018 will indeed see some fiscal stimulus being implemented.

This will lend further support to the US economy and, by implication, the world economy, and also support corporate profitability. While fiscal stimulus may eventually force the US Federal Reserve (Fed) to normalise policy faster than otherwise would have been the case, investors are, for now, happy to focus on the boost to the economy and profits.

ARE THE MARKETS BEING TOO COMPLACENT?

While markets have been cheering the good global environment, and correctly so, one should never lose sight of the inevitable risks that still exist. The most important is that investors may be too complacent about the extent of central bank policy tightening. Despite a clear signal from the US Fed of their intention to raise interest rates at the pace indicated at the September policy meeting (that being a hike in December and three more next year), markets are generally more complacent, seemingly thinking the Fed will do less. The same goes for the start of the rundown of the Fed's US$4.5 trillion balance sheet. Common market perception is that it has been so well signalled by the Fed that it is largely reflected in asset prices and will therefore not have much impact. The next few months will tell whether investors have simply become too complacent, with markets having priced in too much good news.

In the meantime, we remain positive on the outlook for the world economy, as we have been for some time, with no serious headwind in sight that could derail this outlook.



All data sourced from FactSet