August 2017

Market Bulletin

The Orchard Practice

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This update comes to you from Columbia Threadneedle Investments.

Politics are not the only risk on the horizon.

As the tenth anniversary of the Global Financial Crisis passed this month, our thoughts turned to the ongoing muted volatility in financial markets. The 'Goldilocks' conditions of improving growth without price pressures are something of a surprise, yet appear to be increasingly discounted in analysts' and investors' expectations. This situation may appear to be benign, but with valuations across many asset classes appearing full (not to mention negative term premia in bonds) potential risks are mounting.

Among the risks we see on the horizon are geo-politics, changes in central bank leadership, taper tantrums, and the dollar and emerging markets.

Political risk remains elevated in the United States, but had also been rising in Japan with polls indicating Prime Minister Shinzō Abe was falling out of favour with the Japanese electorate. However, improved economic growth data and a less hostile attitude from the public following recent scandals looks to have headed off any political crisis for Abe.

A change in central bank leadership could challenge the easy monetary policy conditions that have underpinned risk assets in recent years, threatening the 'lower for longer' rate environment. In Europe, Mario Draghi's term ends in October 2019, while Janet Yellen's tenure in the US ends in January 19, and Japan governor Haruhiko Kuroda's term ends in April. Their replacements could potentially accelerate central bank normalisation, which could have serious repercussions for global risk assets.

Taper tantrums are possible in Europe as the European Central Bank turns less accommodative, especially as the strengthening and broadening recovery in the euro area signals further tapering of its QE programme. Ditto with the Fed, where term premia in US rates has turned negative. With share buybacks having slowed dramatically, equities may be vulnerable – although they price in greater risk premia than the likes of corporate bonds.

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