Manulife Asset Management

Monthly Macro View

For retail use, June 2017

Markets in May: 'Mayday' fears have gone away!

Global markets performed well in May despite a moderate dose of, in our view, ill-advised fear and panic (largely political). That isn't to say it's all sunshine and roses – there are real concerns over high yield bond spreads getting crushed and the stalling US small caps.

On balance, the data still points to a relatively favourable environment for global equities – particularly for non-US stocks in Europe and some emerging markets. We, therefore, currently prefer exposure in equities over credit. Read this edition of Monthly Macro View for more insights.

Markets in May: Plenty of action, mostly positive[1]

Global stock markets enjoyed another positive month in May, which means investors who "sold and went away" must now be starting to regret that decision.

- The MSCI AC World index rose 2.3% versus April and is up 3.9% quarter-to-date (QTD) and 11.3% year-to-date (YTD).
- May saw developed market (DM) equity markets gain 2.2%, once more lagging the emerging markets (EM), which added 3.0%.
- Within equities, there were some strong performances last month including Japanese small caps, the FTSE100, Hong Kong, and South Korea.
- US small caps, Australia, Brazil, and Russia, performed negatively.
- In terms of global sectors (MSCI World), energy was the weakest sector in May (-1.3%), with financials almost flat (-0.1%). The defensive sectors telecoms (+3.7%) and utilities (+6.2%) saw the biggest gains.

Can earnings continue to drive stocks higher?

Global equities have managed to climb the proverbial wall of worry and MSCI AC World index gained 11.3% in the first five months of 2017, mainly thanks, it would appear, to strong corporate profits. This raises an important question – can earnings continue to drive stocks higher?

Overall, there's no doubt about how strong earnings have been this quarter[2]:

[1] FactSet, Manulife Asset Management, as of 31 May 2017. Total returns in US dollar.
[2] S&P Capital IQ, FactSet, June 2017.

- Some 72% of S&P 500 companies beat profit forecasts in the first quarter, well above the 66% historical average, according to S&P Capital IQ
- Sales revenues were stronger than expected, with 64% of companies beating consensus top-line growth.
- Overall, S&P 500 earnings in the first quarter of 2017 grew by 14% and revenue growth rate of 7.6% .
- US earnings forecasts YTD have edged slightly lower, but earnings per share are still predicted to grow by around 10% for the 2017 calendar year.

The break with the usual path of downward revisions to earnings projections as the year unfolds reflects analysts pricing in some lofty allowances from President Trump's policies on tax reforms, infrastructure spending, repatriation of overseas profits, and deregulation.

Megan Greene, Manulife Asset Management's Chief Economist warned last November that if these beneficial impacts to earnings do not occur, equity markets could be setting themselves up for disappointment. We took the view in January that there was little chance of major new US policy initiatives being passed this year. Today, at mid-year, that judgement looks more solid than ever.

Investment opportunities in global equities and Asian fixed income

While we share many of the concerns noted above, we still see a relatively favourable environment for global equities based on:

- Continuing evidence of global reflation
- A relatively strong new earnings cycle
- Risk premiums that still favour stocks over bonds

We, therefore, continue to prefer exposure in equities rather than in credit, where positioning appears to be more crowded and thus potentially illiquid, while valuations are less attractive in most developed bond markets.

We do, however, see some good investment opportunities in higher quality US credits and in some emerging market and Asian fixed income markets, where fundamentals are sounder, and government bond markets have not been contaminated by many years of quantitative easing and unconventional monetary policies. The stretch for yield in some Asian bond markets appears to be an acceptable risk in a weaker dollar environment.