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After a stellar first quarter, what's next for financial markets?

The first quarter of 2019 was somewhat of a 'eucatastrophe'[1] on financial markets. J.R.R Tolkien fans will know that this is the opposite of a catastrophe – referring to a sudden turn of events which ensures the tale does not end with some terrible, impending, and very plausible and probable doom... After one of the worst years on record for markets, they roared back in Q1.

Just to give a synopsis, 2018 saw almost every class end in the red. Throughout the year, investors had to contend with extreme volatility. Just to illustrate this: the Dow has swung 1000 points in a single session only 8 times in history: 5 of those were in 2018! What's more is that in the end, market participants weren't rewarded for the stress they endured – equities had their worst year in a decade. The S&P 500 Index missed official bear market status by a whisker, falling 19.8% between September 20th and Christmas Eve. The last month of the year was particularly dreadful – the S&P 500 was down 9% and the Dow was down 8.7% — making it the

worst December since 1931.

On the tails of this, expectations for 2019 were grounded and recession fears were rife. But then, a 'turn of events' helped risk assets make a comeback – the global central bank collective pivoted towards more dovish monetary policy. And now, the first quarter is done and dusted, having produced some of the best quarterly returns for equities since 2012 – highlighting the importance of a longer-term strategic approach when it comes to investing. The value of the MSCI world index has surged some $6 trillion year-to-date. Bloomberg reports that over the quarter, US stocks have gained 13%, European, 12% and Chinese, an incredible 25% - trumped only by Colombia. The Colcap index is up 29% in dollar terms. Oil has gained 30%, and Brent is now flirting with $70 per barrel.

Anticipation has the habit to set you up for disappointment, but Q1 optimism is already spilling into Q2 – especially as reports emerge that the US and China are making headway on trade negotiations. On top of that, upbeat manufacturing data coming out of China recently offered investors a glimpse of hope that the world's second-largest economy was stabilizing. So what do we expect moving forward?

In terms of macro, we expect that the global slowdown will continue, but that central banks will do what they can to prolong the cycle. IMF Managing Director Christine Lagarde this week acknowledged that global growth has lost momentum since the start of the year, though a recession isn't likely in the near term. The IMF's updated global growth forecast will be published tomorrow (April 9th).

We see the US economy 'slowing but still growing'. We are less optimistic on the eurozone and believe that for investors, ECB dovishness is not enough. We need to see macro data find a floor otherwise a negative feedback loop could develop whereby fear makes market participants act in a way that eventually causes recession. We believe that the Chinese government is well-equipped to keep its economy afloat, and Beijing seems to be willing to do 'whatever it takes'.

In these later of the stages, when growth is slowing, historically stocks have had a good run. For this reason, as well as the fact that companies now have a lower hurdle to leap in terms of earnings expectations, we remain exposed to equities, primarily in the US. That said, we believe that the current environment calls for more risk containment. For this reason, we favour Growth, Quality and Momentum styles and also insulate positions with a layer of core Government bonds. The next catalyst for equities could be a truce in terms of trade between the US and China, populists being kept at bay in the European elections, and/or the UK avoiding an 'EU catastrophe' in terms of Brexit.

[1] The prefix borrows the Greek word 'eu', meaning 'good'.

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