MARKET INSIGHT

Nowhere to hide...

There doesn't seem to be any stopping equity markets this year, which continue to climb higher and higher due to a genuine absence of anywhere else to go in order to sustain a reasonable return. As equity markets keep rising, valuations continue to stretch (at this point not excessively), yet investors keep buying in and notching up gains. The scenario is starting to look like a self-fulfilling prophecy and it seems there is nowhere to go to make alternative gains.

What may be concerning is that this scenario has backed investors into a corner where the only option for 'decent' returns is to keep positive and keep owning equities. There are fewer and fewer places to hide in other assets that provide even a solid nominal return.

Current data would lead us to believe that investors continue to be undeterred by the downside risk to equities even given slightly extended valuations, lured by the growth and higher yields available in a world where the variety of sources for real yield continues to narrow. Alternatives available to investors - Government Debt, Corporate Debt, Property, Cash and Absolute Return Funds - are all pretty uninspiring.

Yields are low and the risk-reward profile is rather unattractive given that we have now begun the move into a rising interest rate environment.

Markets, for now, have become seemingly de-sensitised to the geopolitical uncertainty which has dominated the scene this year, such as the saga in North Korea, drama coming out of Washington DC and chaos surrounding Brexit. The laissez faire reaction from stocks continues to surprise us, with global equities marching (albeit struggling) to new all-time highs despite this ambiguous market environment.

Overconfidence? Complacency? Or just plain recklessness?

With this said, the valuations of safe-haven assets such as government bonds and bond proxies would indicate the opposite- investor caution, perhaps? This would go some way to explaining why the more defensive growth stocks have performed so strongly this year. So which is it? With the market's main gauge of risk, namely the VIX index, recently hitting new lows, one could definitely argue that yield hungry investors appear to be unphased by the headlines and key policy risks present in equity markets.

Almost a decade since the Global Financial Crisis, markets have been in a world heavily propped up by the support of governments and central banks which has encouraged risk-taking. Global economic conditions have also remained positive for the recent past and the foreseeable future, with economic growth and inflation seemingly in a state of 'not too hot, not too cold'. As this financial support to markets is withdrawn, it will be a case of assessing where the market truly stands, as it begins to wean itself off years of stimulus, learning to stand on its own two feet once again. In this environment, as always, there will be both winners and losers.

The question is: Who will come out on top and whose flaws will be exposed for all to see? If and when the bull market grinds to a close, will the stocks that climbed up the stairs ultimately come crashing down the elevator shaft?

Why do we say there is nowhere to hide?

Simple - alternative assets to equities are providing very poor, or even the prospect of negative returns. In the current market environment, you simply cannot hide away from equities and make anywhere near equity like returns.

So what are our thoughts?

TAM believe that truly active stock pickers will benefit from the disparity. Our view, for now, is to remain up to weight in equities but we have no intention of getting carried away. Our investment strategy is to keep one foot on the break with a view to capital preservation because when the music stops, we do not want to be the ones without a chair.

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