Eideard Group
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Market Commentary **Winter 2018**

Running with the Bulls

Surely 2017 will be remembered by all of us as the year that just about everything rose! Buoyed by global economies which strengthened in sync, nearly all world equity markets boasted double digit returns. The MSCI All Country World stock index, which captures just over 85% of the investable opportunities across 23 developed and 24 emerging markets, registered returns in excess of +24%. Notably, there wasn't one month in 2017 that this index didn't post a positive return - a feat not seen since 1988. Furthermore, such pervasive, nosebleed type returns have only been achieved three times in the last 15 years: +22% in 2006, +35% in 2009 and +23% in 2013. You'll recall, however, that 2006 was a banner year before the markets began moderating in 2007 only to fall into the abyss of the Great Crisis in 2008. Notably, that is something to keep in mind. Then, of course, 2009 will be remembered as the first leg of the post crisis comeback years.

Here in the US, the story was much the same - as the broad bull market extended its long run on the back of solid economic news, nominal headline inflation, enhanced corporate profitability, a robust employment picture, and consumer confidence on a remarkable high. The S&P delivered +21.8%, the Dow gained +28.1%, and the tech heavy Nasdaq registered +29.6%. Not surprising to us, we - nor few others - foresaw these lofty highs a year ago, which is precisely why any forecast should be discounted. In fact, while the Dow tirelessly broached 77 record highs, the media's central theme was cautionary since the market was long in the tooth, leading anyone to believe that a "breather" would be coming. We'll never know, but had it not been for the headline news of a promised new tax regime late in the year, the market may have ended 2017 on a much less euphoric note. Instead, the markets enthusiastically anticipated the late year passage of the *Tax Cuts and Job Act*, the most sweeping pro-business and tax reform bill to be enacted since 1986. Its passage spells enhanced profitability for US businesses, a boost in discretionary income for middle and lower income America, and the potential to see some $2 trillion in offshore corporate cash find its way back to American shores at a one- time 15.5% tax hopefully dedicated to sourcing US infrastructure renewal. In fact, as we penned this commentary, Apple announced its intention to repatriate some $250 billion in overseas cash holdings at a tax cost of some $38 billion. Apple's CEO, Tim Cook, revealed that $30 billion of this now free cash flow will be directed to capex over the next 5 years and create some 20,000 new jobs. We think this astounding leadership announcement will motivate other major US companies to follow suit with what has been sheltered overseas cash. How about that for a 2018 bonus present to the US economy!

Turning now to the bond side of things: notwithstanding that for the last couple of years now, so called "experts" have foretold the death of the bond market. Such prognostications have yet to materialize.

Total return for high grade intermediate municipal bonds posted on average +5.8% in 2017, while intermediate high grade corporates registered +3.5%, and high yield corporates delivered +7.5%. At the end of the day, the bellwether benchmark 10 Yr Treasury note traded sideways all year, settling at 2.49% by year's end to continue defying bear forecasts.

While it's noteworthy to remind ourselves that the bond markets are arguably as rich as the equity markets, we think three conditions must come to pass to risk the health of bonds. First, inflation must spike or at least rise meaningfully higher, yet it remains benign. Secondly, global savings would have to recede, but most countries face aging populations which would preclude aggressive spending. And finally, the structural issues borne of long-term global monetary accommodation must fade away. And so while the Federal Reserve is right to remain exceptionally policy vigilant - particularly in light of the expected tailwinds for growth borne of the new tax regime - it's likely to be sometime before rates normalize. Slow and steady should be the moniker to avoid raising havoc within the bond markets - or for that matter the equity markets, both of which would be impacted by anything less.

Turning to energy for a moment: unfortunately this sector failed to participate in 2017's upside. That's a bit puzzling when global growth was on a tear all year. That said, perhaps we are simply witnessing a "lag effect". We know there's been significant fossil fuel inventory overhang since 2014 and that today's shale drilling technologies are increasing US production to levels never before seen. Witness, however, that the price of West Texas crude oil has trended up over the last few months to broach $63/bbl. Hence, we remain optimistic that continued global growth will right the supply-demand imbalance in relatively short order making the sector an attractive opportunity in 2018.

So what should we expect over the next twelve months? Notwithstanding the folly of forecasting as we earlier noted, there seems little doubt that here in the US the new tax regime will be a significant tailwind for GDP growth and all that comes with it. But for the potential of an unbridled rise in inflation, economic conditions of themselves would seem to present little concern over the next year.

For developed international markets, we'd expect to see more muted returns, perhaps coupled with volatility more in line with historical averages particularly if inflation or the Brexit becomes problematic. But again, at this point, systemic risk among developed countries seems nominal.

As to the emerging markets which posted a +37.5% return, year one would suspect that some regression in returns should be in the offing, particularly if the dollar, which weakened by almost 10% last year, found renewed strength - though again, even if that were to occur, systemic risk seems remote. That said, as history recites, emerging economies do have a knack for becoming volatile in short order leading to quick getaways of foreign cash.

Collectively, however, as a global community, we are always subject to the risk of political fallout or geopolitical events that can wreak havoc with world markets at any time. If anything were to short circuit the momentum of this market, it's likely to be just that. Hopefully with cool and deliberate leadership, we will be able to avoid sovereign confrontations in a world that has once again become nuclearly dangerous.