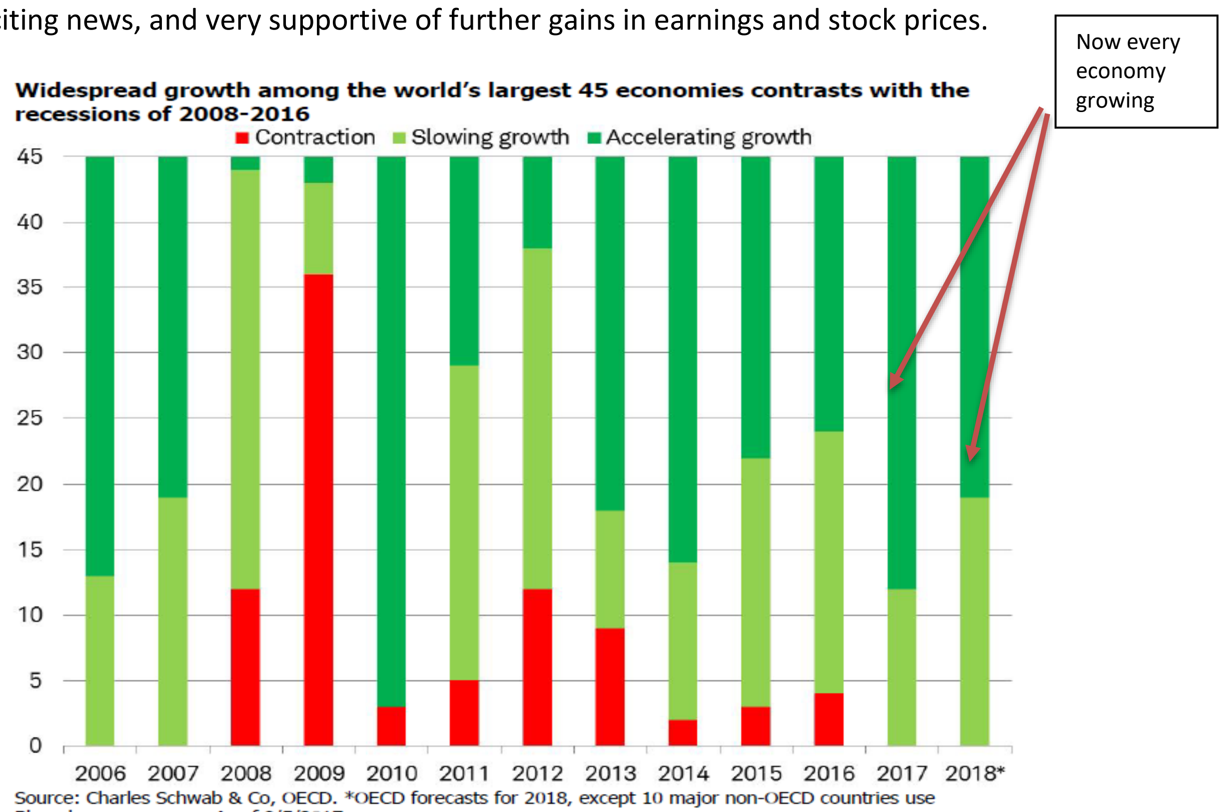
September 27, 2017

Market Insight: Global Growth Story Supports Market Gains

As the month of September comes to a close, global stocks are on track to make an 11th consecutive monthly gain, as measured by the MSCI All Country World Index, and will tie the all-time record for the index set in 2003-04. This steadfast rise flies in the face of many market gurus who have been predicting an impending correction. Sorry to disappoint! Amazingly, despite continued gridlock in Washington, escalating tensions with North Korea, and high stock valuations, the market's rise has not been deterred. This exceptional string of gains begs the question: have investors become too optimistic about growth? Are the markets too expensive? The evidence says no, and in fact, it points to potential further gains. Why? It's all about the global growth story.

Global growth continues to improve and is expected to accelerate in 2018. This will be the first time in 10 years the world's 45 largest economies will post back-to-back growth since 2006-07 period. From 2008-2016 many of these economies experienced recessions, acting as a drag on corporate earnings and stock market performance. But not so now as all economies are in the green.

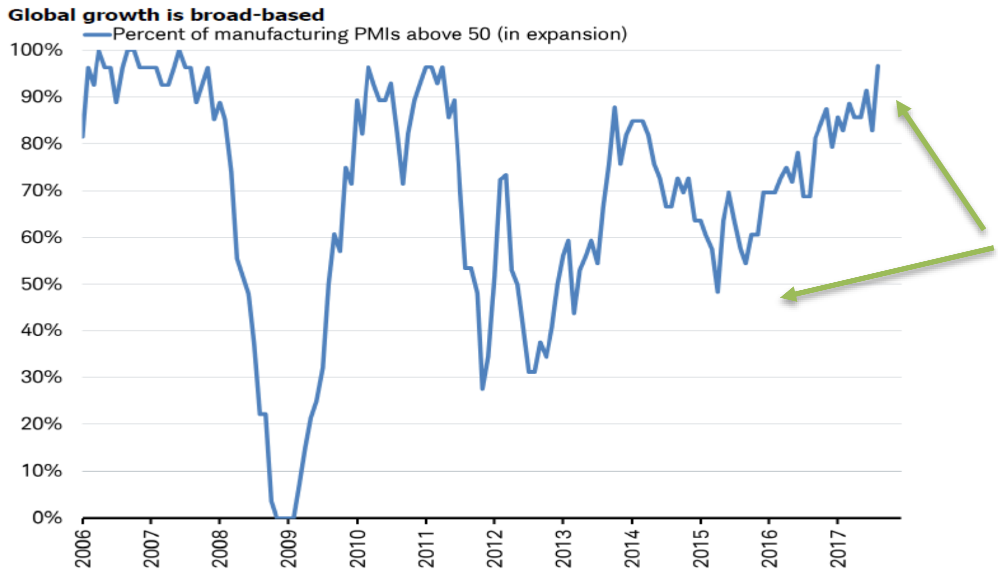
The chart below shows the state of growth (green) or contraction (red) for the world's largest 45 economies over the last 12 years. Notice for 2017, there is no red, which means there is not one economy contracting, and many economies are accelerating (dark green). Additionally, broad base growth is forecasted to continue into 2018. This is exciting news, and very supportive of further gains in earnings and stock prices.



Source: Charles Schwab & Co, OECD. *OECD forecasts for 2018, except 10 major non-OECD countries use Bloomberg consensus. As of 9/5/2017.

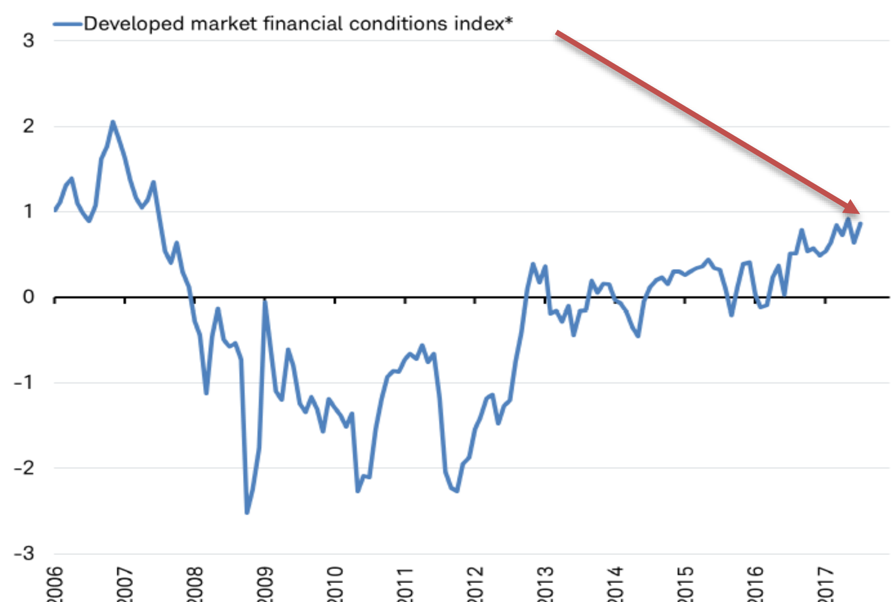
Global Purchasing Managers Index (PMI) is confirming future growth. One of the best indicators of future growth is the PMI new orders component which has now risen to a five-month high. Additionally, the percentage of countries where new orders outpaced inventories rose to 100%, also pointing to future growth.

The chart below shows how the PMI has been steadily rising since 2015, which means more economies have moved from contraction to expansion. Today, 97% of the countries in the Purchasing Managers Index (PMI) are now in expansion territory indicating broad base world growth.



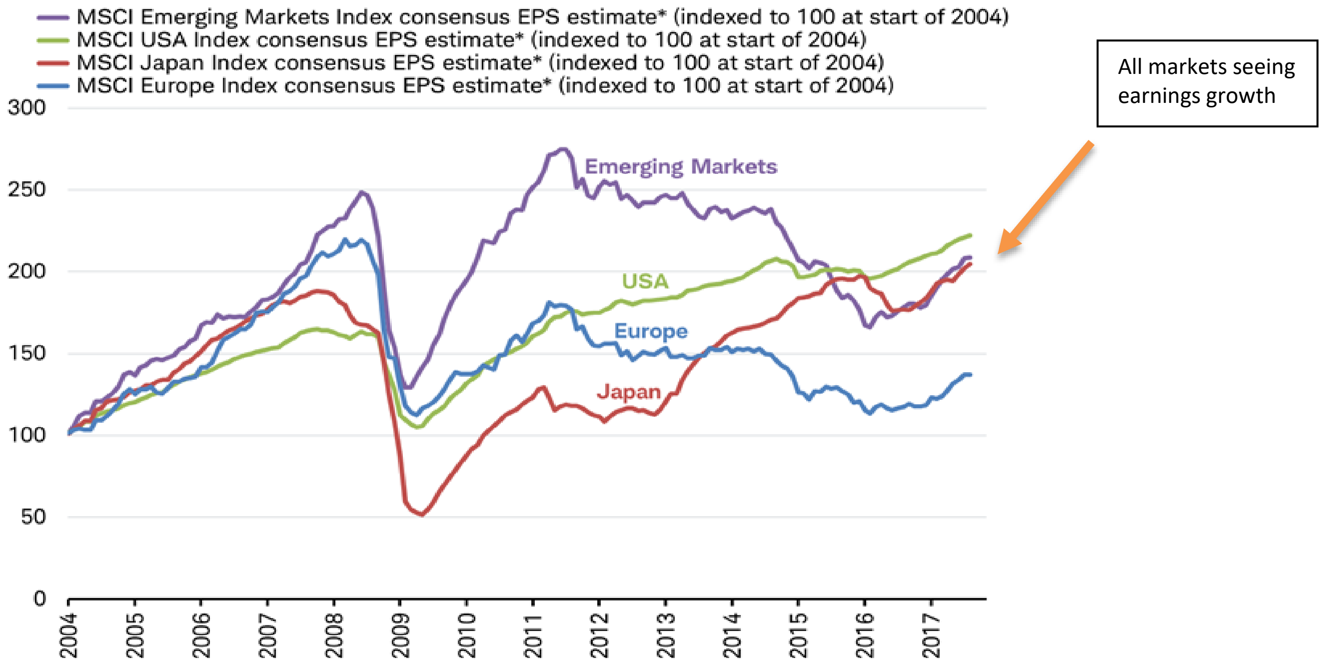
Measures manufacturing purchasing manager indexes from 35 countries.
Source: FactSet, Markit, as of 9/8/2017.

Another measure confirming the stability and prospects of future global growth is the Financial Conditions Index (FCI). This indicator measures the accessibility and affordability of credit which is the life blood for growth. The chart below shows the FCI rose to new post-recession highs in mid-2016, has remained steady despite recent rate increases by the Fed, and indicates future growth is attainable. In contrast to 2007, where despite very strong growth, the FCI began to rapidly decline (when the Fed raised rates) and correctly forecasted an oncoming recession. The <u>net take away here is that the global expansion is quite healthy, on sure footing, and likely to continue well into next year if not beyond</u>.



*Morgan Stanley Developed Market Financial Conditions Index
Source: Charles Schwab, Bloomberg data as of 9/12/2017.

Earnings growth justifies price gains. The global growth story is not just about economies improving but also broad base organic earnings growth, a key support for the stock market. Unlike the past 10yrs where earning growth was spotty, inconsistent, and even divergent; **today, every major market is experiencing earnings growth**. The chart below shows the divergent path of earnings of various markets up until mid-2016 at which time all regions experienced earnings growth. This broad base improvement in earnings means valuation is not overheating and thus the market is less likely to experience big corrections. In other words, there are no 'bubbles'.



In sum, while a decline from recent highs could occur at any time for many different reasons, the solid and improving backdrop of broad base global growth combined with healthy earnings growth, will provide stability and thus limit both the size and length of a pullback in the stock market. At the same time**, continued growth will embolden Central banks to take further steps to neutralize monetary policy which means interest rates should continue to creep higher, albeit slowly.**

Investment Strategy:

Stocks: Equity exposure remains broadly diversified across the global markets with risk at the top end of target levels.

Bonds: Expect interest rates to gradually move higher over the next year; thus, duration is short with credit quality exposure focused on investment grade and high yield corporates, and floating rate bank loans.

These are my thoughts on the current market environment and investment strategy. As always, please contact me with any questions or concerns.

Kind Regards,

Barbara

Barbara HS Huff
CEO & President
New Albany Investment Management
614-216-6139 www.newalbanyinvestment.com