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In fundamentals we trust...

Through the mist of headlines about a potential trade war, sanctions and rising geopolitical tensions, hard and quantifiable data suggests that the global macroeconomic backdrop is still in good shape. Indeed, the International Monetary Fund (IMF) recently upgraded its forecasts, predicting that 2018 will be the strongest year for global growth since 2011. In its new assessment of the World Economic Outlook, the IMF foresees growth this year and next of 3.9%.

The US continues to churn out strong economic readings. Business investment, industrial production and consumption are all strong. Core PCE is approaching the Federal Reserve's (Fed) 2% target (it rose 1.9% year-on-year in April). It is expected that the Fed may let it slightly overshoot the 2% level and inflation dynamics continue to build. For example, capacity utilisation, has reached 78%, approaching the 79% level that is deemed inflationary by the Fed. Consumer confidence which dipped in March to 127 rebounded to 128.7 in April.

Confidence is also strong amongst businesses. In the most recent 'Beige Book' - a report released periodically by the Fed which gathers "anecdotal information on current economic conditions" - the overall outlook among businesses "remained positive" – though concerns about further tariffs were highlighted. It was reported that "Markedly stronger growth in loan volumes was seen in commercial and industrial, and commercial real estate," and it is hoped that this could be a precursor to the sort of investment boom that the Fed hoped would result from Trump's tax cuts. US corporations saved billions as a result of the tax cuts and this extra cash is still to be put to work. If companies invest this money to support increased productivity, corporate earnings levels should remain sustainable for longer. As such, company guidance which accompanies earnings data this quarter will be key in that it should give further details about how this cash will be utilised.

In Europe, economic readings have come down from elevated levels but still indicate that the economy is in an expansionary phase. After wavering at the start of 2018, the slowdown in the pace of business activity halted in April with the IHS Markit composite PMI stalling at 55.2 (50 is the marker between economic expansion and contraction). Inflation shows no signs of overheating: it came in at 1.3% in March, versus a 1.4% flash estimate. The European Central Bank (ECB) appears to be cautious about spooking the markets and talk is circulating that the unwinding of the Bank's colossal bond-buying programme may be staggered beyond September into the final quarter of 2018. Markets have pushed expectations for the ECB's first rate hike to June 2019.

All in all, we believe that markets are unlikely to have a sustained move lower without a significant deterioration in this benign growth environment. An expansionary environment coupled with an accommodative policy mix, at this stage, should allow for a continuation of strength in corporate fundamentals and earnings. As such, we maintain an equity overweight throughout our portfolios, keeping faith in fundamentals.

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