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Global Markets forecast: Is the rally based on fake news?

Our team of strategists continually assesses economic data and quantitative modeling when researching what we expect for global markets in the coming quarter and beyond.

Let me recap our topline insights from the latest *Global Market Outlook - Q2 Update*:

- Undue pessimism about global growth has given way to excessive optimism
- U.S. equity markets are overbought and a correction in our view should create a buying opportunity
- U.S. Treasuries are now fairly valued at around 2.5%[1], but yields will be under upward pressure from rising inflation and tightening from the U.S. Federal Reserve (the Fed)

Is the equities rally justified?

It's true that global growth has picked up, but not by enough to validate the optimism priced into the S&P 500® Index. We still see plenty of headwinds for the global economy, not least in the form of tightening by the Fed and a slowing Chinese economy.

The optimism may be justified in Europe and, to a lesser extent, Japan. Markets, however, in our view are overestimating the ability of President Trump to boost the U.S. economy. Any Trump stimulus is likely to be offset by more aggressive Fed moves to contain inflationary pressures.

As we said in our *2017 Global Market Outlook* annual report in mid-December, we still believe we are in a "buy the dips and sell the rallies" market environment. We want to sell the current rally and look to buy the next dip.

Global equities: cycle, value, sentiment

Our investment process is based on the building blocks of business cycle, value and sentiment, and they're pointing to a mixed outlook for global equities.

- **Cycle:** While the U.S. cycle score is neutral, tailwinds for equities are strongest in Europe, followed by Japan. Emerging markets cycle scores have improved to neutral, but are still vulnerable to Fed rate hikes and further U.S. dollar strength.
- **Valuation:** The Shiller Price to Earnings (P/E) ratio for U.S. equities, which uses the 10-year average of inflation-adjusted earnings, is the highest it's been outside of 1929 and the late-1990s' Internet bubble. Meaning they are very expensive. European and Japanese equities are around fair value, in our view, while emerging markets are still reasonably cheap.
- **Sentiment:** The U.S. is the most overbought. We're cautious on the near-term outlook for global equities. Europe has an attractive combination of reasonable value and good cycle support. Japan has reasonable value and emerging markets have good value.

Treasuries: the cycle is turning negative

When it comes to Treasuries, there is some difference in the cycle outlook across global markets. The cycle is moderately negative for the U.S., where inflation pressures are picking up and the Fed is lifting short-term rates. The big British sterling devaluation means that inflation pressures are also a cycle headwind for U.K. gilts[2]. By contrast, the Bank of Japan seems likely to maintain its policy of targeting a 10-year bond yield of 0%. And the European Central Bank should continue with negative rates and asset purchases until at least the end of 2017.

Currencies: The U.S. dollar has limited upside

Rising interest rate differentials against other regions are dollar supportive, but this is offset, in our view, by expensive valuations. The euro, Japanese yen (JPY) and British pound (GBP) have attractive valuations, but none seem likely to move significantly higher in the next few months.

Overshooting to the upside

Here's the summary: Our process tells us that U.S. equities are very expensive and are significantly overbought across a range of indicators. The overbought signals drive our near-term caution. Beyond this, we like Europe's cycle outlook and the value in emerging markets.

Read the full report now.

Disclosures:

[1] Source: CNBC.com: http://data.cnbc.com/quotes/US10Y

[2] Gilts are bonds that are issued by the British government, and they are generally considered low-risk investments. Gilts are the U.K. equivalent of U.S. Treasury securities.

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