# An outlook on worldwide markets

Standard Life

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# March market review 2018

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**In his latest monthly market review Andrew Milligan, Head of Global Strategy at Standard Life Investments considers whether predicted interest rate increases in the US and UK will affect markets and whether volatility in markets is returning to 'normal' levels. He also discusses one of the big stories dominating headlines in recent weeks – US and China trade tariffs.**

### Signs point to further US interest rate increases

The US Federal Reserve (Fed) raised interest rates at its March meeting and we expect further increases this year.

You may have seen reports that the US economy grew quite slowly in the spring, only about 2% on an annualised basis, but special factors such as poor weather contributed to this. Now all the signs point to the economy rebounding into the summer - this will be helped by the very large tax cuts and spending increases recently agreed by Congress.

Because of these supporting factors we currently expect the Fed to raise interest rates every three months in both 2018 and 2019.

### Will interest rate increases affect markets?

A moderate amount of interest rate moves by the US or UK has already been priced in. This is on the key assumption that inflation remains contained. But is this assumption supported? Yes, wages may be rising but there are still a lot of technological aspects of the modern world - such as online shopping - which are restraining headline inflation.

In general though, stock markets rise during the initial phases of monetary tightening - as banks begin to increase interest rates. After all, a central bank is only acting because economic growth and therefore company profits are strong.

The situation becomes more worrying when a central bank takes a more aggressive stance - but that looks to be some way off.

It's also worth pointing out that financial markets are in unchartered territory as far as the impact of the removal of unconventional monetary policy is concerned. Quantitative easing is a complicated topic! This could add to market volatility over coming months but it helps explain why central banks are trying to be so transparent and forward looking in their statements around policy decisions.

### Volatility verging on normal

Markets have continued to experience volatility over the last month or two despite some positive economic data. So what's next?

It's helpful to compare the levels of market volatility seen so far in 2018 with that in 2017 and the period before. Remember, 2017 was an unusual year; the US stock market index experienced 15 successive positive months, with no decline. Such an outcome was last seen in the early 1950s.

Since February, we think markets are seeing a return to more normal levels of volatility. The important message is that we don't expect volatility to return to abnormal levels, say those seen in the financial crisis or the Eurozone crisis. That would require major changes to some of the deep, underlying drivers of markets. Generally these are low levels of growth and inflation, or marked changes in central bank policy making and market regulation.

### Will tariffs trump markets?

One of the biggest uncertainties investors face over the rest of the year is 'where tariff discussions go'.

So far it's important to remember that there's a world of difference between the economic impact of the tariffs currently proposed by the US and China and the potential impact on financial markets. The sums of money involved are actually quite small and the sectors quite specific; for example only about 2% of US steel imports are from China and US exports equate to less than 2% of China's steel exports.

However, rightly or wrongly, the markets are looking further ahead. Markets fear that these skirmishes are the early stages of a major tussle between China and the US, as well as between the US and a range of other countries. And these skirmishes could grow to include more sectors, such as cars, aircraft and food stuffs.

At the moment, stock markets are relatively expensive and priced for a period of above-trend growth. So an about-turn caused by markets suddenly fearing weak growth would be challenging for investors. Once again, politics is a key driver of markets, trumping other economic fundamentals such as strong profits growth.

**Please talk to your financial adviser for more information.**



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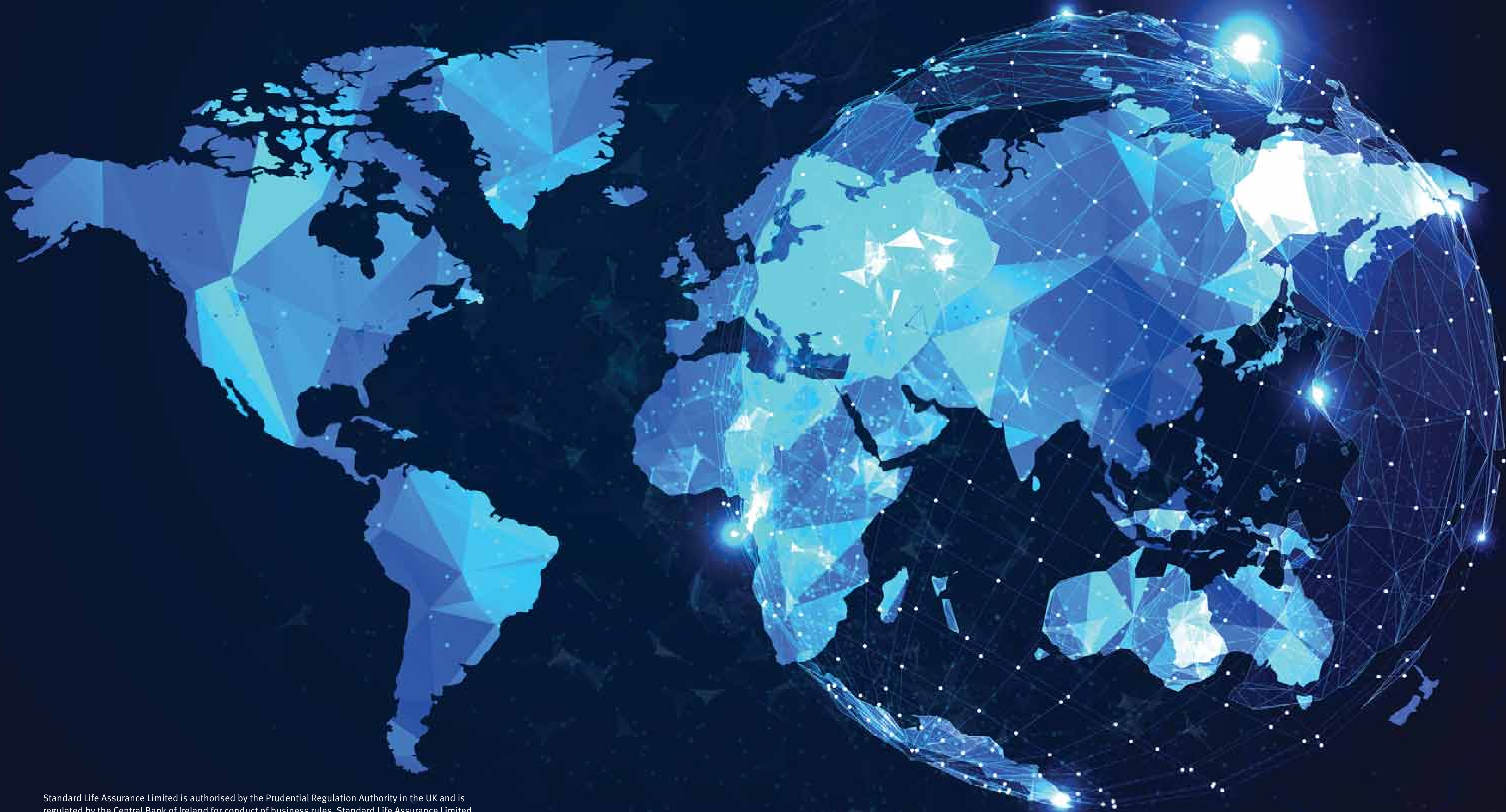



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