MONEY

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LIBEL WINS HELPED DAVID NORRIS DELIVER CASES OF CHRISTMAS TREATS
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After a fairy tale year, it's time to get real

Investors have been in fantasy land these past 12 months, but slowing global growth means that 2018 could prove tougher to bear, writes *Eithne Dunne*

A bumper year proved to be a heartwarming 'Goldilocks' story for investors

For Richard Saldanha, Aviva Investors fund manager in global equities, 2017 was a "Goldilocks" year: conditions were just right.

"It was a great year for equity markets, driven by a synchronised recovery in the economy and strong growth across the board," he said. "Inflation was relatively low, and companies delivered good earnings."

Not only that, but political events this year had far less impact on the markets than some feared 12 months ago, when investors may have felt jittery about the prospect of unpredictability from Donald Trump, the beginnings of Brexit and elections in Germany, France and Holland.

"After the Brexit and Trump shocks in 2016 the politics of 2017 were a lot more settled," said Eugene Kiernan, head of investment strategy at Appian Asset Management. "All of the big potential upsets that investors worried about failed to come to pass. They were very much the dogs that didn't bark, and markets took the results of each election in their stride."

Andrew Milligan, head of global strategy at Aberdeen Standard Investments, said 2017 was the first time in several years when all three parts of the world economy – Asia, Europe and America – have been growing.

"There has been a very decent profits growth of about 10%-15%," he said. "That follows a period in 2015-16 when there was a modest profits recession. The contrast with that period, and the return to double-digit profits growth, has encouraged investor confidence. So this year the equity markets benefited from expansion in the global economy and decent profits growth, and at the same time they didn't need to worry about central banks being aggressive on interest rate increases."

Meanwhile, bond yields remained close to historically low levels in 2017.

The ups and the downs

According to Dublin market data firm Longboat Analytics, the best performing sector this year has been emerging market (EM) equities, which gained 18.8%. This is considerably higher growth than the best-performing sector of 2016, US equities at 15.36%. Tech equities came a close second to EMs this year, with a return of 18.56%.

Milligan said the strong performance of EMs was partly down to the upturn in global economic activity, but also related to a depreciated US dollar and – at least for some emerging economies – commodity prices ending the year on a decent note. "Another reason was the rise of the tech sector," he said. "We shouldn't forget that more than 25% of Asian equities are now related to tech. So as tech has done well, it's not just been a US/Nasdaq story but also an EM story."

In terms of individual funds, the best performing was Standard Life's India Equity fund, with a return of 32.53%. Second best was the Standard Life China Equity fund, at 31.6%.

The worst performing sector in 2017 was money markets, with a return of just 0.15%, while aggregate bonds were not far ahead at 1.21%. The worst performing individual fund was the Friends First Pan Euro Insight Property fund, which fell by 16.26%. The next worst performing fund was Irish Life's Indexed Commodities fund, which was down 8.5%.

> **All of the big potential upsets that investors worried about failed to come to pass**

Outlook for 2018

Commentators generally do not expect 2018 to herald any big upsets for the markets, although it is unlikely to hit the sweet spot in quite the way this year did.

Milligan thinks 2018 will again see decent, low double-digit returns, but cites several reasons why it might not reach the heights of 2017.

"First, global growth looks like slowing or rotating, or both, into next year. Second, inflation looks like picking up, not strongly, but enough to allow more central banks to take action. Monetary policy won't be as supportive of risk taking next year."

Friends First chief economist Jim Power said that, from a global economic perspective, 2018 will be similar to 2017.

"The Italian elections always have the potential to throw up a bit of a shock, but generally the global economic backdrop will continue to be positive," he said. "It's also likely that corporate earnings will continue to expand."

Saldanha said the Italian elections and US midterms in November would be the key political events in 2018, but described these as "relatively benign" compared with what was on the calendar for 2017. He added: "With Brexit, markets will react, but that will play out over the longer term. From talking to companies, I don't think it's necessarily influencing them too much. They are optimistic."

Kiernan said the consensus forecast for next year was for earnings growth of about 10%-12%. Meanwhile, with all eyes trained on central banks next year to see what action, if any, they take on interest rates, he said 2018 would be a year when central banks would be conscious of the need to demonstrate credibility.

"They'll want to show that they can manage the transition to an environment of higher rates," said Kiernan. "In the US the Fed is expected to hike three times in 2018. Most people are expecting the Bank of England to increase rates to try to manage some of the implications of Brexit, but the consensus is that the ECB [European Central Bank] won't budge."

Power did not expect the ECB to move in 2018 either, but said it always had to be factored in as a possibility, however slim.

He said what we had at the moment was an artificial investment environment, due to quantitative easing and artificially low interest rates.

"Something has to give; the question is, will it happen in 2018 or 2019? I think it will be later rather than sooner. But the one thing that could change that would be an interest rate shock. So central bankers, particularly in Europe, need to be watched very carefully." Saldanha expects a "gradual normalisation" of interest rates, rather than any dramatic moves.

Volatility has been low for some years, and Kiernan said it was easy to see this starting to pick up.

"But I'd be conscious of the cliché that bull markets don't die of old age. Just because markets have been rising for a long time doesn't automatically mean they'll change direction," he said.

In terms of sectors to watch next year, Saldanha said tech stocks would be a real driver, particularly in America. According to Milligan, the direction of the tech sector as a whole will be important for markets in 2018, but another sector worth watching in 2018 is financials.

"Bond yields were pretty flat this year; we'd expect a steeper yield curve next year and that, by and large, supports the financials," he said. "Within the eurozone, if unemployment continues to decline, some parts of the consumer sector, as well as construction, might be worth looking at also."

The main thing to remember heading into 2018, said Milligan, is that 2017 was the exception rather than the rule in terms of positive returns.

"The sort of equity market performance we saw in 2017 – with so few months where there were negative returns or drawdowns – is very unusual. 2018 could see a return to more normal volatility, and investors will have to expect some down months."

MY INVESTING YEAR
STEPHEN McCARTHY

Stephen McCarthy, owner and founder of Alchemi Financial Services, is gearing up for a flurry of activity from clients in January as they tackle their financial new year resolutions.

First on the list for many will be pensions. McCarthy himself had paused pension contributions for several years during the recession but is firmly back in "catch-up mode" now. The 46-year-old has a defined benefit final salary scheme through AIB, where he worked for 15 years, but also a personal pension with Standard Life.

The latter is invested 100% in equities — primarily in smaller company funds — which tallies with the fact that he has more than 20 years to go to retirement. Currently, 25% of his pension is invested in the Standard Life European Smaller Companies fund, and another 25% in Standard Life's Global Smaller Companies fund.

"Smaller company funds are slightly riskier than normal but have considerable scope for outperformance, and that's what these funds have done," he said. "The European Smaller Companies fund has delivered just short of 12% per annum over the past 10 years, and 18.9% per annum over the past five. The Global Smaller Companies fund has yielded just over 14% per annum since its launch four years ago."

Even for people who are unsure as to where best to invest their pension, it's imperative to know where it is invested now, and whether these investments are broadly suited to your circumstances. McCarthy meets plenty of clients whose pension funds are decidedly out of sync. "We see people who are 20-plus years from retirement and their pension is all in cash funds. Equally we meet people almost at retirement age with 100% of their pension in equities. We do a lot of work trying to make sure people's pensions are invested in appropriate funds, taking account of their risk profile and personal circumstances."

Pensions aside, there are a few other hardy annuals that may need attention come the new year. For example, many people renew their health cover in January. McCarthy's best advice is not to treat this process as a box-ticking exercise.

"People get the renewal letter and have only a short window in which to shop around, so the tendency is to just renew and consider it done. We don't arrange health insurance but we encourage people to shop around or use a broker. Make sure you have the right policy for your needs, and the most competitive policy. What was the best policy last year doesn't always stay the best, and you can save a lot of money."

Simply being organised is a good place to start, said McCarthy. "Have an insurance file, keep the relevant documents, and when your renewal comes up, compare it to what you paid last year. If it's significantly up, get on the phone; then go online or go to a broker."

Also well worth tackling is saving for your children's education. This is a topic McCarthy frequently raises with clients and, much like pensions, the sooner you start on this one, the better. "When people come to us, we'll run projections based on their circumstances, show them how much second or third level is going to cost per child, then come up with a plan for how much they should be saving. Even just saving up the children's allowance goes a long way, whereas a lump sum can be quite scary."

Gary Connolly

Make too many moves and you'll pay the penalty

The call to action in life is strong. Whether it's the doctor who wants to prescribe, the goalkeeper who wants to dive or the investor who wants to trade; it is human nature to believe something must always be done despite evidence that in many cases inaction is better.

Anxious patients that demand a pill make it difficult for doctors to counsel inaction, but often that is the wise course. And as a measure of the benefits to inaction it is a little disconcerting to note that the death rate falls when doctors go on strike, but it is nonetheless the case.

In football penalty kicks, goalkeepers almost always jump right or left but studies show the optimal strategy is to stay in the centre of the goal. Because the norm is to jump, a goal scored yields worse feelings for the goalie who doesn't do anything (stays in the centre) than for the keeper who jumps; leading to a bias for action.

And as far as financial markets go, much of the activity that continually happens is not serving a useful purpose.

Capitalism is about directing capital to its best and most profitable uses. Each year Wall Street directs about $250bn (€211bn) to initial public offerings (IPOs) and secondary offerings. Yet activity on the stock market each year totals $33 trillion; so the vast bulk of activity is not related to the primary function of capital markets. According to John Bogle, founder of Vanguard, 99.2% of what Wall Street is doing must fall under the category of speculation, with the croupier at the table taking a constant rake.

As far as investors and trading is concerned, research from behavioural finance experts Brad Barber and Terrance Odean of more than 66,000 trading accounts found that the average investor turned over 75% of his/her portfolio each year. Transaction costs associated with this excessive trading reduced net performance by 3.7% compared with the market as a whole. Investors who traded most did even worse: these people turned over their portfolios more than twice each year, and as a result suffered a 10.3% reduction in net performance. The idlest investors enjoyed the best performance.

Odean also showed in 1998 that investors had a tendency to sell shares that had risen in value while holding on to losing investments.

Dormant investors not only save on trading costs but also avoid ill-timed trades. A study by Ilia Dichev, The Dark Side of Trading, noted a distinct tendency for retail investors to pile in when everything is rosy and positive and to sell when it's gloomy and bad. An unusual twist to the buy low, sell high advice parroted by the investment industry.

This unholy trinity of behaviour (trading too much, hanging on to losers and poor timing) translates into mediocre returns. The typical investor doesn't do nearly as well as the typical investment. All of this activity adds up to a lot more for the croupier at the table, and to a lot less for the client.

Explanations for what prompts us to want to trade are easy to find. As Financial Times columnist Tim Harford observes, we trade too often because we're too confident in our ability to spot the next best thing. We buy at the top and sell at the bottom because we're influenced by what others are doing.

This may be why the world's most successful investor, Warren Buffett, refers to the appropriate level of activity with your portfolio as being benign neglect bordering on sloth. Impulse is your enemy.

And that impulse appears strongest among men. Much of the performance advantage that female investors enjoy over their male counterparts stems from their willingness to just do nothing. Another Barber and Odean study, Boys will be Boys, found men traded 45% more often than women and earned 1% less annually. Single men were especially guilty, trading 67% more than single women and earning 1.4% less annually. Both sexes are poor at picking stocks, the study found; but the difference in returns is almost entirely due to men's aggressive trading.

Diagnosis may be easy. The cure is less so. According to a Business Insider report, a 2014 internal performance review of Fidelity accounts to determine which type of investors received the best returns between 2003 and 2013, revealed that the best investors were either dead or forgot they had accounts.

For investors and goalkeepers alike, the advice is; don't do something, just stand there.

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