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Market insights

What's in store for the markets in 2017?

2016 had a bad start for equity markets, which supposedly sets the tone for the rest of the year, but subsequently, though, it transpired that equity returns were OK in 2016, as both in Australia and internationally, markets had decent returns. The other two potential disrupters were BREXIT and a Trump victory – which contrary to popular opinion by market analysts turned out to be positive for markets.

So what does 2017 hold and can we reliably predict what is going to happen?

Known events or likely events are usually priced into the markets and it is unknown events, ie surprises, X factors and exogenous shocks that impact markets – and by their very nature these events are often hard to predict.

What we can do is look at the balance of probabilities of events occurring and factor in possible upside and downside outcomes. A lot of the analysis is about risk mitigation and asking questions including what are the consequences of getting it wrong?

The first point in trying to predict markets is where you are coming from, that is, the starting point. On this basis most markets and asset classes are at, or close to, historically high levels, after extended runs. This does not mean they cannot continue running – but it does say that maybe we are coming closer to the end game and the balance of risks has become higher. Markets often rally harder and longer than people expect and you usually see the largest up moves in the latter stages of a bull market, just before a major correction.

The second aspect in predicting markets is applying some sort of valuation parameters on markets. On the various valuation metrics be it equities, bonds or property the various asset classes are not cheap – though in most cases they are not wildly expensive either. For instance, while equity valuations are not cheap, if we see top line revenue growth in America for corporates as a result of Trump's economic policies, it would mean their earnings could increase, subsequently reducing their P/E ratio. As a result this makes companies cheaper and in turn, this could potentially justify a whole second leg to the bull market.

One thing to watch in 2017 will be the moves in long bond rates around the world. A gradual increase in rates will not be an issue, in fact there have been a number of equity market rallies associated with increasing interest rates.

The issue is less increasing interest rates (as increasing interest rates often mean higher economic growth which is good for corporates) but rather why they are increasing and the length and magnitude of any changes. We are forecasting between two and three interest rate hikes in the US this year and zero in Australia – all of which could be within market parameters.

That said, any surprise increase in rates will generally tend to be negative for most asset classes. Another factor to watch for will be geopolitical shocks. These are hard to factor in and by their very nature are hard to forecast.

What is necessary in 2017 is flexibility in asset allocation and the ability to move quickly to take advantage of opportunities.

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