We began the year with expectations for improving growth in the U.S. driven by business and consumer spending, coupled with a synchronized upturn in economic prospects around the world. Real GDP growth is running above the averages seen for the last five years in the U.S., Eurozone and Japan. With initial jobless claims hovering at the lowest levels seen since the early 1970’s, wages poised to rise, and the benefits of tax reform increasing the prospects of larger take home pay, the University of Michigan’s consumer sentiment survey results rose to an all-time high in March. Despite recent market turbulence, a review of our 2018 key themes indicates that the underlying global growth story remains on track. Consumers are feeling good, capital spending is increasing, fiscal stimulus is flowing and non-U.S. economies are experiencing above - trend growth.
China, the world’s second largest economy. To date, while there have been some seasonal economic disappointments and increased fears of a global trade war, the fundamental underpinnings for our optimistic growth assessment remains largely intact. Let’s take a look at each of the key themes in more detail.

Theme #1: Increased Capital Spending
With economic momentum building in late 2017, a scarce labor pool requiring additional productivity-enhancing investment, and the added incentive of immediate depreciation under the new tax law, we expected business spending to accelerate into the new year. As depicted on our capital expenditures dashboard (Exhibit #4), the uptrend remains in force. CEO confidence is near a multi-year high, and CapEx plans suggest continued investment in the coming months.

Theme #2: Synchronized Global Growth
Indicators still point to a positive outlook for the global economy. Real GDP growth is running above the averages seen for the last five years in the U.S., Eurozone and Japan. We do acknowledge, however, that early 2018 has brought a slowdown in the rapid acceleration of estimate increases witnessed in 2017. This can be seen in the flatlining of some leading economic indicators in the past few months. We believe this will be a transitory phenomenon consistent with similar seasonal affairs in the post-crisis recovery. It’s a view supported by the most recent Bloomberg consensus estimates for the MSCI All Country World Index (a broad global market index including both developed and emerging countries), which points to strong mid-double digit EPS growth for 2018.

Theme #3: Strong Consumer
With initial jobless claims hovering at the lowest levels seen since the early 1970’s (and don’t forget total U.S. employment has more than doubled since then), wages poised to rise, and the benefits of tax reform increasing the prospects of larger take home pay, it is no surprise that the consumer confidence, according to University of Michigan’s rose to an all-time high in March. In fact, the economic conditions gauge now stands over 60 points above the levels seen during the depth of the financial crisis (Exhibit #5).

Risk #1: Inflation & Rising Rates
In March, the Federal Reserve raised interest rates for the sixth time in this business cycle, marking a seminal milestone in the post-crisis recovery. For the first time since the Bear Stearns collapse in 2008, the federal funds rate is again in line with the core personal consumption expenditure index (Core PCE),
which is the Fed’s preferred inflation gauge (Exhibit #6). While a symbolic milestone, it is also important to note that despite trending up recently, core PCE inflation remains stubbornly below the Fed’s 2% target. Our base case prediction of moderate increases in both inflation and interest rates remains on track so far this year. Despite an early 2018 uptick in inflation pressures, the economy has not had continued negative surprises relating to inflation risk.

Risk #2: Global Trade Frictions
Protectionism is seeing resurgence around the world, and we entered 2018 with concerns for a notable U.S. policy shift under President Trump as well. Despite relatively little trade rhetoric in 2017, two factors supported our view that this year would include a renewed “America First” focus. The first, and perhaps most significant, was a cooling of tensions with North Korea. If President Trump ultimately has his sights set on confronting China over the trade deficit and intellectual property protection, it would be difficult to conceive a scenario where that is accomplished at the same time he is seeking their help applying aggressive sanctions towards a potentially rogue nuclear state. In addition, the midterm elections are looming this fall, and presidential approval ratings suggest the GOP is in for an uphill battle. With this as a backdrop, we expected the president to make efforts to reenergize his base in 2018. Indeed, that is exactly what has happened. We have written several publications on the topic¹, and at this point believe the path of least resistance remains a deal-by-deal approach to negotiation versus an all-out assault on the foundations of the global trade system. We do, however, acknowledge that the potential for a policy mistake is rising as President Trump simultaneously attempts to score political wins while minimizing the collateral economic damage. This remains a notable risk for 2018, at least until the elections this fall.

Risk #3: China
Accounting for an estimated 33% of the IMF global growth forecast for 2018, as China goes, so might the world go this year, or at least the emerging markets. President Xi completed his consolidation of power in 2018, and is now set to continue leading China indefinitely. His mandate is a difficult one as he tries to strike a delicate balance between aggressive structural reform and the maintenance of a steady target growth rate. So far this year we have seen a mixed bag of early economic data from China, which is always complicated by Chinese New Year distortions. Some indicators have pointed to a benign slowdown, while others, such as electricity consumption, suggest improving strength. Add to the mix that Alibaba and Tencent, two of China’s biggest technology companies, had revenue increases greater than 50% in the most recent quarter, and this suggests a protracted downturn is unlikely.

Conclusion
Despite recent market turbulence, a review of our 2018 key themes indicates that the underlying global growth story remains on track. Consumers are feeling good, capital spending is increasing, fiscal stimulus is flowing, and non-U.S. economies are experiencing above-trend growth. Heightened volatility is likely to persist for a while still, but as long as trade tensions gradually cool down there should be limited effect on consumer and business spending. Risks, though they are somewhat elevated, appear contained for now.

¹For more discussion on trade frictions, see Trump & Tariffs: Odds favor skirmishes, not all out trade war (03/08/18), The China IP Investigation: Another bump in the road on the way to November (03/20/18), and Update on Tariffs and Trade with China: Mind the Gap (04/06/2018).

Michael Stritch, CFA
Chief Investment Officer &
National Head of Investments
BMO Wealth Management - U.S.

Yung-Yu Ma, Ph.D.
Chief Investment Strategist
BMO Wealth Management - U.S.
Michael Stritch, CFA
Chief Investment Officer & National Head of Investments
BMO Wealth Management - U.S.

As Chief Investment Officer and National Head of the Investment team, Michael chairs the Personal Asset Management Committee and is responsible for setting investment policy and strategy for our clients throughout the United States. He joined BMO Wealth Management in 2013 as a Managing Director of Investments for our Ultra High Net Worth group, and became National Head of Investments in 2015. In January 2018, Michael took over the role of Chief Investment Officer. With close to two decades of experience in money management, Michael has a deep background in economic analysis, portfolio construction and risk management.

Michael earned a BA in economics from Northwestern University and an MBA with distinction in finance and decision sciences from the J.L. Kellogg Graduate School of Management at Northwestern University in Evanston, Illinois. He is a member of the Beta Gamma Sigma International Honor Society, holds a Chartered Financial Analyst designation, and is a member of the CFA Institute, CFA Society of Chicago, and the Chicago Quantitative Alliance. He is also a graduate of the American Bankers Association – National Trust School.

Yung-Yu Ma, Ph.D.
Chief Investment Strategist
BMO Wealth Management - U.S.

As Chief Investment Strategist, Yung is responsible for performing macroeconomic analysis, valuation modeling and market analysis across asset classes to guide strategic and tactical asset allocations for client portfolios.

Prior to joining BMO Wealth Management, Yung was a finance professor at Lehigh University, where he taught courses in fixed income, equities and derivatives. His academic studies have been cited in the Wall Street Journal, in leading finance journals, top law journals, the Handbook of High Frequency Trading, and in Oxford Handbook of Corporate Governance. During his tenure at Lehigh, he was awarded the Staub Outstanding Teacher Award, awarded to one faculty member by a vote of faculty and students. Prior to his academic career, Yung worked for a global consulting firm performing financial and market analysis for global companies with operations in Hong Kong, Taiwan and Mainland China. Later, he oversaw the operations at a Fortune 500 subsidiary in Taipei and Mainland China.

Dr. Ma earned his Ph.D. in Finance at the University of Utah and his B.A. in Economics and Political Science, magna cum laude, at Williams College.

Yung lives in Portland, Oregon with his wife and two children. He is a basketball fan and enjoys cheering on his sons’ teams.