26 October 2018

Heartwood Investment Management

Investment Insight

Weekly Insight

Are doomsday headlines masking underlying resilience?

If we believed everything we read, investors could be under the impression that doomsday was on the doorstep. Certainly, this is a late cycle environment, with market volatility higher than the levels to which we have grown accustomed, but we still see plenty of signs for reassurance.

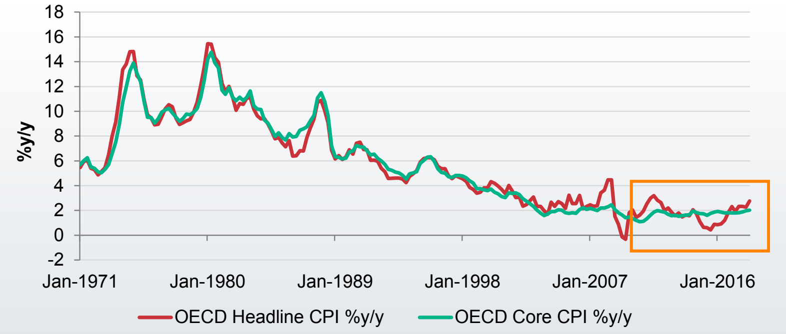
Our analysts monitor a broad range of investment market information, from macroeconomic signals to technical indicators, as well as conducting in-depth asset class research. Below, we assess just three of the factors on our radar.

1) Inflation is under control (for now)

Both headline (total) and core (key consumer goods) inflation are on the rise, but investors must keep these moves in context. While not insignificant, today's levels do not represent a rampant inflationary environment; inflation remains a world away from the double-digit levels last endured in the 1970s.

What's more, inflation over the past few years remains consistent with central bank plans for low and stable levels, aimed at enabling the conditions for robust, sustainable growth.

Today's rising inflation must be kept in context
OECD core and headline CPI



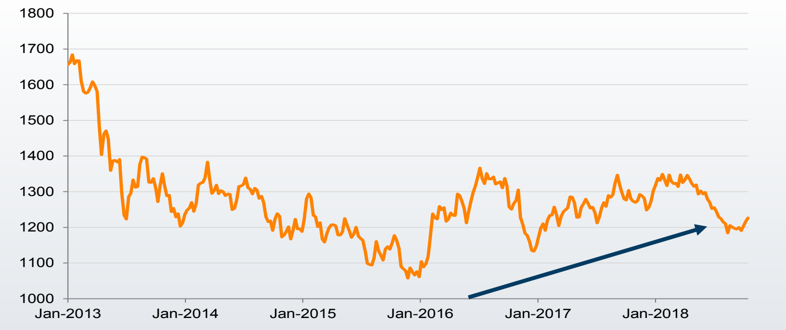
Source: Bloomberg

2) Gold is (finally) acting as a diversifier

In recent years, gold has not performed particularly helpfully in its traditional role as a portfolio diversifier. However, the latest round of market turbulence appears to have kick-started this unique asset into action: despite dollar strength and high real yields (i.e. yields less inflation), gold looks resilient.

In theory, gold should protect against geopolitical and investment market risk, and can even be used as a hedge against inflationary and deflationary environments. The current price premium for its safe haven status demonstrates investor priorities at this stage in the cycle.

Gold's safe haven status commands a premium
Philadelphia Gold and Silver Index price



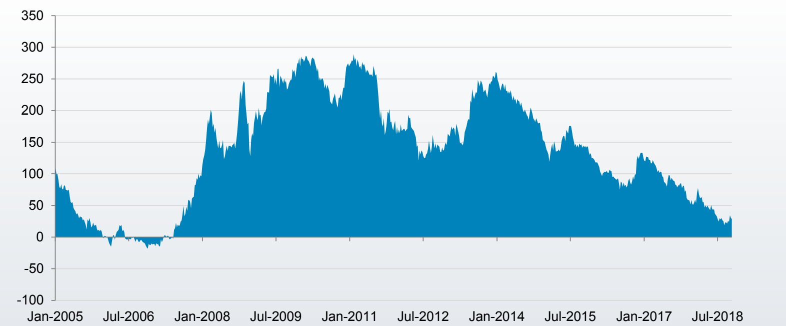
Source: Bloomberg

3) The US government bond yield curve has stopped flattening

The significant convergence of yields for 2-year and 10-year US government bonds can generally be read as an economic red flag. If the gap (or 'spread') between these yields actively inverts, it generally signals recession ahead. Happily, a recent flattening of the yield curve (i.e. a narrowing of the spread between 2-year and 10-year Treasuries) now appears to have eased, with yields beginning to diverge once more.

This is a heartening sign for the economic outlook. It is also important to remember that even an inverted yield curve should not signal an imminent doomsday – this would be a leading indicator pointing to recessionary conditions over the medium term.

The yield curve is not flashing red
2-year and 10-year US Treasury spread



Source: Bloomberg

Graham Bishop
Investment Director

Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

Important Information

Registered Head Office: No.1 Kingsway, London, WC2B 6AN | Registered in England Number: 4132340
020 7045 2600 | heartwoodgroup.co.uk | Part of the Handelsbanken Group