

STILL THE BEST INVESTMENT FOR THE BALANCE OF THE DECADE?



In early July 2015 I wrote an article suggesting that the best investments for the balance of the decade would be US denominated instruments. In the past year the US dollar index and S&P 500 have risen, though modestly. Long US treasuries registered strong gains, with 30-year bonds posting circa 17% total returns over the past year. Will US denominated assets continue to perform well for the balance of the decade?

If US denominated assets are to perform strongly the US dollar must exhibit strength. The chart above suggests the US dollar is poised to move higher in the short term. I believe the greenback will perform strongly over the longer term as well. The United States remains an island of relative economic strength and political stability, despite its challenges. Moreover, the US dollar will benefit from a lack of alternatives available to investors. Brexit has further compromised an already fatally flawed euro as well as the pound sterling. The Chinese are allowing the yuan to devalue at a fairly brisk rate. The market size of currencies such as the Canadian and Australian dollars, the Swiss franc, etc., are too small to play a leading role. The Japanese yen has been the strongest large currency over the past year, somewhat to my surprise. It seems unrealistic to expect the yen to maintain a leading role given Japan’s economic and demographic issues. The US dollar will be the proverbial “last man standing” among currencies in a global economy facing daunting macroeconomic and geopolitical challenges.

The US dollar will ultimately benefit from both a “pull” and “push” of capital. The “pull” will be relatively higher interest rates and the strength of the greenback. The “push” will be lower or negative interest rates in other jurisdictions and weakening economic and political circumstances in Europe, South America and Asia. Brexit will serve as a catalyst to put additional pressure on already fragile economic, social and political fault lines within the European Union. The well documented flow of capital from China is expected to continue, as the Chinese seek to keep ahead of a declining yuan. The fragile state of the global economy, which has produced the current unprecedented prevalence of negative interest rates, will provide ample motivation to “push” capital to US dollar denominated assets.

US treasury bonds have benefited the most from the current environment and they will remain a popular repository of capital for some time. However, I believe that equities in general, and US equities in particular, will begin to outperform bonds for the balance of this decade. It will eventually be recognized that the current era of negative interest cannot continue. This realization, combined with the likelihood of adverse geopolitical developments eroding confidence in foreign sovereign debt, will move large amounts of capital into equities. Equities will be viewed as having the capacity for growth, as well as representing ownership of tangible assets in potentially very turbulent economic times.

The sharp rebound by equity markets following the shock of Brexit is certainly noteworthy. However, the current risk/reward argument for equities is not compelling. I believe a more attractive purchase point will likely present itself this autumn.

In conclusion, it appears that the US dollar is poised to make a sustained advance that will make US denominated assets the favoured asset class for the balance of the decade, with US equities possessing the potential for surprisingly strong returns.

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