08:33 10 Nov 2017

Strong global economic activity should help investors ride out fluctuating asset valuations

Gold ticked up mid-week as selling in Asia moved overnight into the US and UK markets, although it wasn't nervousness about Donald Trump that was moving the money into safer havens, or at least not directly.

Trump's visit to Asia is so far going quite well. The mood music in Beijing in particular was very positive, no doubt partly because President Xi Jinping now feels secure in his own leadership following the recent Communist Party Congress.

Some commentators are calling President Xi the most powerful leader China has had since Mao Tse-Tung, although given that China itself is exponentially more powerful now than it was in the days of Mao, even that comparison may be putting it mildly.

But even so, China has only two world-class aircraft carriers, and has only built one of its own. The US has three just in Asian waters near North Korea, never mind the rest of its global reach.

So, for the time being, now that Mr Trump has toned down his anti-China rhetoric, it still suits President Xi to flatter Mr Trump on state visits, to roll out the red carpet, and to talk as differences between Great Powers as being understandable and fixable with sensible dialogue.

Why not? After all, Mr Trump was the one who put the final nail in the coffin of the Trans-Pacific Partnership, President Obama's grand plan to isolate and contain China economically and militarily.

In spite of the bluster and tough talk that comes out of the Trump administration, the only conclusion the Chinese were ever likely to draw from that is that the US is now too weak ultimately to pull it all together.

The US is strong, but its influence is declining. Xi can afford to be nice, for a while.

All of which cheered markets and allowed for some support to come in when the jitters swept through.

But it also served to focus traders' minds back on the immediate economic issues. With global conflagration apparently not so near as everyone thought, how do global economies and markets really stack up on a fundamentals basis?

It's the asking of this question that's lead to the wobble. There's no doubt that we are still, as of now, still in the era of low-interest rates. There's been a small rise from the Fed, and there's been one from the Bank of England too, which would have been bigger news before Brexit.

But those rate hikes are just the warm-up. There's plenty more to come. And when they do come investors wonder, and worry, just how exactly other asset classes will end up being priced.

UK readers will know that the property market has already slowed in anticipation. But currencies and equities have been slower on the uptake.

If money becomes more expensive, will other assets be worth correspondingly less?

An imponderable question for an economic theorist, but a very practical one for those with open positions in the market.

Fear that cheap money has led to overinflated equity valuations may sweep through bourses in 2018, but if it does so the narrative will surely be that prices are only being "corrected" rather than decimated.

The risk has already driven some back into gold, but not many. The gold price at just over US$1,280 is still trading below the US$1,300-plus hit just a month ago since with more rate rises looming, the dollar still looks like a useful place to be.

After all, if rates rise, and equities fall, that's arguably a matter of relative valuations. The economic activity that underpins it all is another matter, however.

And here there is reason to be cheerful.

"After years of mostly moderate economic growth in a post-Lehman age of caution, the business cycle has picked up momentum," runs the current analysis from European bank Berenberg.

"Supported by a healthy expansion of world trade, still accommodative monetary policies and a growing readiness of households and businesses to consume and invest, demand is expanding above its trend rate in the US, the Eurozone and Japan. Sentiment indicators project more of the same for 2018. Because the upswing seems to be broad based and well entrenched, it would take a major economic or political shock to derail it."

"Demand" may not be the be all and end all, but without it, there's not much else.