ATLAS
ASSET MANAGEMENT PTE. LTD.

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Market Outlook

Are you a fishing fan? During my break I was hooked on a newly released video game which had an interesting fishing mini-game embedded into it. In my simulated fishing experience, I spent 80% of my time lying in wait for the fish to bite, in anticipation of the shorter-lived fun of reeling the catch in.

Investing can be like fishing — both activities require patience and there are long periods of inactivity punctuated by a few moments of frenetic action. For example, let's look at the daily returns of the S&P 500 Index for 2016:

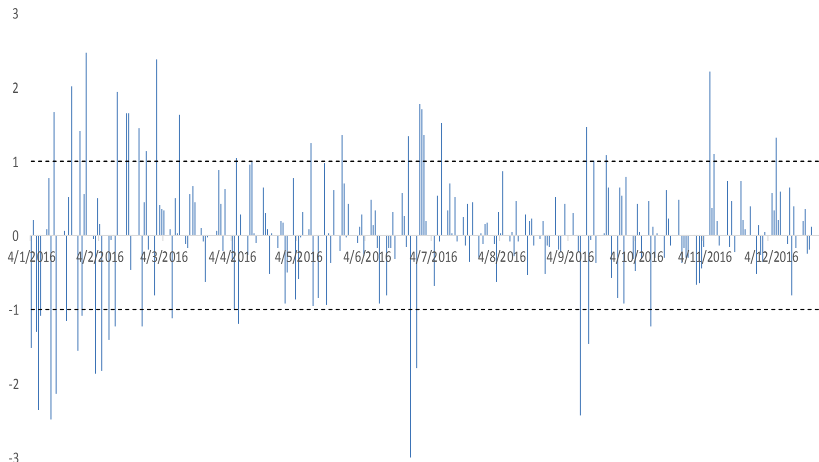

Chart 1: The S&P 500 daily returns for 2016. There were long periods of inactivity punctuated by moments of frenetic action.

Just eyeballing the chart would tell us that there were many days whereby market moves were coma-inducingly small. In fact, 81% of the time, the S&P 500 Index fluctuated between –1% and +1%.

While the S&P 500 was up +9.5% last year (and that excludes dividends), there were 4 days of the year where the S&P 500 was up more than 2%, and these 4 days totaled up to +9.1%. If we have missed any of those 4 days there would be a dent to our returns.

The key then is to stay invested… how much to stay invested is a function of your risk appetite and world view. Markets do not go up in a straight line, and gains for the year can be accumulated in just a few days of a year. If we were trading in and out, we would likely miss out those 4 days.

Can we avoid the down days? The problem is that many investors who avoided the down days also ended up missing the up days too. Besides, how many people actually have time to monitor markets on a minute-by-minute basis when we have other fish to fry? Those who try to time the market by trading in and out tend to miss out on the gains, or worse get whipsawed. Many people have tried to time the market, or take quick profits, and actually ended up with poorer returns. Indeed, Warren Buffet has said that the stock market is a device for transferring money from the impatient to the patient.

To complete the loop, I have included the histogram of the S&P 500 daily returns in 2016. For example, there were 30 days last year whereby the daily returns were between 0.5% to 1.%. This is the nature of our fish — the daily returns look something like a bell curve (but with fatter tails). Most of the time the movement barely causes a ripple; but just be sure to be ready when she makes a big move.

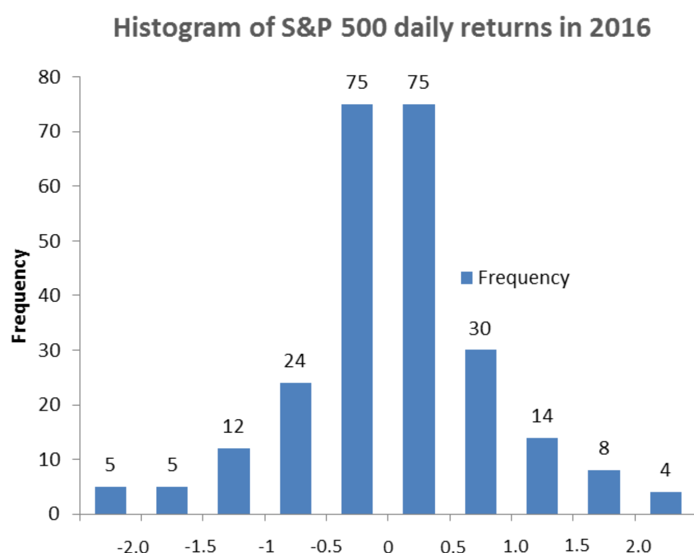

Chart 2: The histogram of S&P 500 daily returns for 2016. 81% of the time the S&P fluctuates between –1% and +1.%.

Marco conditions still kind to equities

The world is probably going to grow a bit faster this year than last year. Particularly, things are looking up in the US, with regulatory reform, tax cuts and infrastructure spending, job growth, etc. In other words, there should be more cash in the average individual's pockets which should drive consumer spending upwards. Meanwhile, Europe and Japan also seem to be in slightly better shape this year but growth will probably stay on trend at its slow rate. China should also grow according to its stated goals, with economic stability a crucial goal for the administration. Thus on a macro level the conditions are positive for equities.

Fixed income and currencies

Similarly, US fundamentals are supportive of the dollar, especially relative to Europe, Japan and emerging market economies. I think we will see volatility if the dollar is overly strong, for example, Trump may tweet to signal his displeasure, which may roil markets temporarily. But no one is bigger than the market, so with US growth expected to be strong, the dollar is expected to hold its own for Q1 .

In fixed income space, literally every investor and his grandmother think that bonds are going to fare poorly. For example, investors pulled a record $3.5 billion from the famous $55.7 billion DoubleLine Total Return Fund last December (the fund invests predominantly in mortgage-backed securities). At this stage where the initial decline has already taken place, I think the truth is probably somewhere in the middle, although the trend looks set for interest rates to rise. Nevertheless, I would say that rate hikes are not a certainty. After hiking rates in December 2016, the Federal Reserve has signaled 3 more hikes in 2017. However if anything goes wrong the Fed will react accordingly. Overall, looking into the first quarter in fixed income space, we would prefer credit risk to interest rate risk, i.e. we would not go for long tenor bonds.

Can things go wrong?

So what can go wrong? Anything and everything can go wrong.

In fact, one of my previous roles required me to dream up all sorts of negative scenarios that might happen to derail the markets. Europe might be in for more volatility post Brexit with a number countries (France and Germany) holding elections, China's economy might implode spectacularly, terror attacks that are catastrophic to market sentiment (for example assassination attempts?). On the political front, the conflict in Asia Pacific over China's military build-up might escalate, while Russia aggression could destabilize the European zone.

The thing is, a LOT of things can go wrong. Every. Single. Year. The point is that at this juncture I do not think that chances of these tail events happening are significantly higher in 2017 as compared to any other year.

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