

ICI VIEWPOINTS

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Top Investment Strategists Sound Optimistic Notes amid Headwinds

By Rob Elson

Opportunities abound in today's market and macroeconomic environment, and it's up to fund managers to help their investors capitalize on them. That's the outlook from a panel of world-class investment strategists sharing their insights at ICI's 59th annual General Membership Meeting, held earlier this month in Washington, DC.

Heather Miner, global head of strategic advisory solutions at Goldman Sachs Asset Management, moderated the panel, which featured Lisa Shalett, head of investment and portfolio strategies at Morgan Stanley Wealth Management; Darrell Cronk, chief investment officer for wealth and investment management at Wells Fargo & Company; and Gregg S. Fisher, founder and head of quantitative research and portfolio strategy at Gerstein Fisher.

A Sunny Outlook

Miner opened the dialogue with a question on everyone's mind since the new presidential administration took over in January: What will US and global growth look like over the next few years?

"We come out on the bullish side of the equation," Shalett responded. "Over the last seven quarters, we've had a mini macroeconomic recession—catalyzed by a soft landing in China, plummeting oil prices, and a steep appreciation of the dollar. But in the fourth quarter of last year, those headwinds began to abate—and that's what has us quite optimistic that global growth is going to reaccelerate powerfully through 2018."

Cronk agreed that the bull run “still has a couple more years to go,” adding that “telltale indicators”—including accelerating consumer confidence, declining volatility, and tightening monetary policy—show that we’re “closer to the midpoint of the [recovery] cycle than the end of it.”

Helping Investors Take Advantage

Investors have plenty of opportunities to take advantage of this environment. But according to Fisher, they’d be best served by looking outside the United States.

“Investors tend to be comfortable with what has done well lately—and that’s the United States, of course—but I do think it makes sense for investors to rebalance their portfolios globally,” he said. “Emerging markets—along with most developed markets outside the United States—look a lot less expensive than the United States does.”

But the world is not without risks. Even as market volatility has been hovering around all-time lows, Cronk advised attendees not to be “lulled into thinking that volatility is going to stay at this level. There have been 11 post–World War II recoveries, and volatility during this one has been half of what it has been historically.”

He continued: “The VIX curve [a measure of market volatility] is steep right now, telling us that volatility is coming. And there a number of geopolitical risks on the table—like in North Korea, Syria, and Russia—that the markets can’t control or price in.”

Shalett, for her part, cautioned not to “underweight these low-probability events.” Otherwise, she said, “we run the risk of investors not being psychologically prepared for them. These are good times to make sure that all of our investors are comfortable with what the fallout from these events could look like.”

And, Not Or

Turning to investment products, Miner asked the panelists about whether—and when—to favor active or passive management. “It’s not a matter of *or*. It’s a matter of *and*,” Cronk responded. “You need to use all the arrows in the quiver as you put a portfolio together. Active funds, passive funds, smart beta, separately managed accounts, private vehicles—they’re all vitally important.”

In Shalett’s experience, some clients are “piling into ETFs [exchange-traded funds] because they’ve decided that the failure of active management has been proven definitively.” But, she explained, she tries to remind those clients that, by buying large-cap index ETFs right now, “you’re not buying the future growth of earnings of the market. You’re buying yesterday’s winners who’ve appreciated with the highest prices at the highest momentum.”

For Fisher, the debate is less about active and passive than it is about high and low fees. “Investors are more educated about fees than ever,” he said. “No matter their views on markets or securities prices, more and more investors want the low-cost alternative—and I think we should be paying

attention to that.”

Contrasting Views

As the session came to a close, Miner asked the panelists for an out-of-consensus view on the current markets, prompting Cronk and Fisher to take opposing perspectives on small-cap stocks.

“We would fade or underweight small-cap stocks right now,” Cronk said. “We just think they’re incredibly rich. They’re pricing in 20 to 25 percent earnings growth this year, which we think is unsustainable. For them to do well, a number of fiscal and regulatory reforms need to come home to roost over the next 12 to 18 months.”

By contrast, Fisher advised increasing exposure to small-company stocks, especially in small countries. “Small countries over long periods of time have outperformed large countries,” he said. “You don’t necessarily have to buy the largest countries just because they’re the most popular.”

Shalett, eyeing currency markets, forecast that “the US dollar has structurally peaked for the cycle,” and further predicted that the euro and the yen will “strengthen versus the US dollar over the next three to five years.” That, she said with a grin, was her favorite out-of-consensus view—“other than that the S&P500 is going to 2,700.”

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