Global Market Pullbacks in Perspective

As has been widely reported in the news, global share markets have fallen over the past few days, giving back 6% of recent gains. While this has been quicker than the usual decline, the size of the pullback is actually within the "normal" bounds of market behaviour, even when share markets are generally rising. This is something that tends to be forgotten in the media. (Not to mention that most investors have a diversified portfolio, with other investments such as fixed interest and property that smooth the bumps from share markets.)

Investors had been favoured in 2017 with unusually smooth returns, which has fed its way into general public expectations and newspapers' interpretation of the recent pullback. For 2017, the US share market index (the S&P 500), only had four declines from its peak that were greater than 1%. The largest fall was only 2.8%! This smooth performance, despite a positive economic outlook, is not normal. History suggests that on average, share markets actually have a 5% pullback once per year, and a 10% decline every two years.

Not only is the recent fall well within this "normal" range, but it comes after a strong gain in January, so the S&P 500 index is still up around 1% for the year so far.

How have New Zealand shares reacted?

Closer to home the NZ share market had a quieter start to the new year, and after reopening following the Waitangi Day holiday, fell only a relatively muted 1%. This is quite typical for the local share market in these scenarios, given its more "defensive" nature.

Positive drivers of share markets are still in place

While pullbacks create volatility and fearful newspaper headlines, they often turn out to be buying opportunities when looking back, once clearer thinking prevails. Looking ahead, our assessment of the underlying fundamentals driving global share markets is that they remain very much in place:

- Economic growth remains positive;
- Business and consumer sentiment is upbeat;
- Interest rates are still supportive; and
- Corporate earnings are still growing nicely.

These key pillars are still driving markets, and it's not just in pockets of the global economy, but everywhere from North America, to Europe, to Asia. While wage growth and inflation has been singled out in the recent pullback as areas of concern, they both remain well within the range that is generally positive for share markets.

A growing world economy means higher interest rates, but only gradually

After rising during January, global bond yields have not reacted much to the fall in shares. This means bond markets are suggesting that global economic growth should continue to be solid – in turn providing upwards pressure on overseas central banks to raise interest rates. In early January, before the recent volatility appeared, we reduced portfolios' allocations to global fixed interest investments, given the potential for higher reinvestment rates down the track as economic growth continues. However, as central banks have a well-entrenched history of supporting growth over the past 10 years, they are still likely to act cautiously in moving too fast, if they believe their actions could derail the underlying growth itself!

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