Markets Investment banking

Lazard's Temple: The nightmare isn't over for equities

Sarah Turner *Reporter*

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The nightmare of the fourth-quarter for financial markets is not over yet, according to one of Lazard's most senior fund managers, and investors should be scrambling to upgrade the quality of stocks they own in anticipation of another eruption of volatility.

"It's been a bumpy ride for the last 14 months and, unfortunately, I don't think the ride is over," said Lazard Asset Management's Ron Temple at the Portfolio Construction Forum Markets Summit in Sydney on Tuesday.

"When we got to the fourth quarter the market woke up to the protectionism fears and volatility. It was pretty ugly. It was painful for many people [and] we are going to see more of those periods in the next one to two years."

Patient stance a surprise

The fund manager, who oversees US equities, is more positive on the health of the world's biggest economy than he believes most investors are. "Part of my optimism is [due to] the strength of the US labour market. I think that we have six to 12 more months of high levels of job gains with creeping wage growth on the upside," he said.

He was also surprised by the Federal Reserve's move to a patient stance on monetary policy and believes, unlike the market, the Fed may increase rates again.

"What was surprising is the Fed making such a quick pivot from a hiking cycle or tightening cycle to being on hold. I think that the market is over-emphasising patience and assuming the tightening cycle is over when it's actually on pause."

Other risks to his view include protectionism, where escalating tariffs from a trade

"This is the first time in a generation that we are actually pulling liquidity out of the system," said Vimal Gor of Pendal. **Rob Homer**

Last year concluded with the S&P 500's worst December performance since 1931, and about 90 per cent of asset class returns for 2018 were negative.

"When you think about what that means for asset allocation, I believe investors should still be overweight global equities but I think that investors should be very focused on upgrading the quality of what you own."

He urged investors to seek out companies with great franchises, sustainably high return on capital, strong balance sheets and attractive valuations.

Patient stance a surprise

war between the US and China pose a material threat to corporate earnings

growth. "I don't buy GDP, I buy stocks and corporate earnings, so I think this is something to watch as we move through 2019," the fund manager said.

If Apple, for example, gets swept up in the trade wars, then it will face the dilemma of raising prices and losing market share, or protecting profit margins at the expense of volumes, he said.

As for Europe, the fund manager sees better conditions ahead.

Synchronised slowdown

"In the eurozone, the second half was disappointing but I think this year there will be 1 per cent to 1.5 per cent [growth] in real terms as we rebound from a temporary slowdown."

Fixed income manager Vimal Gor of Pendal was unconvinced. "You can make a strong argument that Europe is a derivative of China," he said.

He noted Europe was seeing a synchronised slowdown and that Germany had been slowing faster than the rest of Europe which is "massively problematic" given Germany's role has, in the past, been the engine of European growth.

A rising US dollar in effect tightens monetary policy for the rest of the world, he said. "You get this big sucking sound" of liquidity returning to the US.

"This is the first time in a generation that we are actually pulling liquidity out of the system. I think of money supply as effectively oil in the capital markets engine and if there isn't any oil it makes it really, really hard for that engine to run smoothly."

Potential triggers

There are a range of potential triggers for the next financial crisis, "but the one we think has the most validity is the Italian job" Mr Gor said. Volatility in equities has increased, and it will spread to other asset classes.

Mr Temple replied that volatility was "unnerving for us", but the positive aspect of volatility is "it gives us a chance to upgrade the quality of what we own when great companies sell-off alongside some of their not-so-great peers".

Randal Jenneke, who manages Australian equities at T Rowe Price, acknowledged the tail risks in markets, but chose to highlight the reliability of Australian equities.

"The Australian market typically tends to give you a more stable return than other markets over time because roughly half of your return is dividend yield," he said.

"Earnings are the question marks that are out there. But I think that in a reasonable earnings environment we will still get a pretty good total return. You can see that in terms of dividend yields."

The fund manager believes the correction of 2018 has left markets in a more attractive position.

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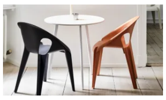

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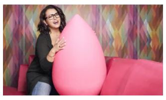

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