GOING GLOBAL: DISCUSSING MACRO ENVIRONMENT WITH A BMO STRATEGIST

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Last week I spoke with Jeff Weniger, Investment Strategist and Portfolio Manager at BMO Global Asset Management, on his views regarding the Federal Reserve (Fed) and investing in the global marketplace—with a particular focus on Europe, Japan and Korea. Below is a summary of the key points of our discussion. **Enough of the Fed** Many believe that the Fed would be best served by getting uncertainty out of the way and hiking interest rates. Weniger believes the Fed might find itself in a position to hike rates in December if data comes out stronger than expected. This may catch the markets off guard (as it has pushed off expectations as far as the first quarter of next year) and could lend support to the U.S. dollar, which suffered from the market's assumption that the first hike could be delayed. Between now and the December Fed decision, we have two more employment reports, two more inflation reports and more data out of China. Weniger notes that the outcome of these reports is likely to change market expectations heading into December. **Confounding Labor Force Participation** Many economists argue that low labor force participation rates might be indicative of a higher proportion of discouraged workers and broader concerns surrounding the labor markets. Weniger reminds us that a large part of the weak participation rate is due to demographic factors and the rise of the baby boomer generation—the peak of the labor force participation occurred in 2000, well before the great recession of 2008–2009. **Fed Extremely Accommodative Even at 25 Basis Points (bps)** Even if the Fed was to raise rates in December, Weniger thinks it is still amazingly accommodative at 25 bps. For perspective, during the Greenspan era from 1987 to 2006, policy rates of 1% were seen as too accommodative. With no obvious difference in today's market environment, a 25 bps policy rate could still perpetuate an easy monetary policy. **Opportunities Abroad** Weniger's team has been diversifying away from the U.S. markets, given their view that the U.S. market's relative valuations are stretched, compounded by poor earnings growth in 2015. **Europe** Weniger is optimistic about the eurozone and expects confirmation of further monetary policy easing out of the European Central Bank (ECB) over the next few months. Although ECB president Mario Draghi has committed to a €1.1trillion ECB balance sheet expansion before September 2016,[1] Weniger believes that he is likely to expand through greater size and longer duration of policy measures into 2017 and perhaps beyond. He expects the announcement to come before we can blink and potentially even as soon as the next policy meeting on October 22, 2015. **Japan** Weniger has a similarly strong view regarding the Bank of Japan (BOJ) where both quantitative and qualitative easing (QQE) are on the table. He expects a perpetuation of QQE, particularly after the dismal inflation reading out of Japan. The question remains when. There are multiple perspectives on the timing of QQE. One line of thinking is that the BOJ might wait for the Fed to move first in order to obtain the maximum bang for its buck through Fed–BOJ policy divergence. The second school of thought involves the initial public offering of Japan Post, the largest privatization of a Japanese government institution, which is scheduled to take place on November 18. The BOJ might time its policy action to ensure the smooth listing of Japan Post. Weniger's key message regarding Europe and Japan is that he believes there is going to be major stimulus from both economies in the months ahead and he remains attracted to their equity markets. **Korea** South Korea's strong currency has been a major headwind limiting its exports, in particular when viewed against Japan. The country looks particularly interesting to Weniger in light of its relatively low market valuations. From a structural reform standpoint, although slow, Korea is making strides where its corporate culture is concerned—investors need to see a more favorable return of capital in the form of buybacks and dividends before they can be convinced of more upside potential. Weniger believes it is likely that Korea could make a large comeback once the Asia block stabilizes and fears around China subside. He thinks the Bank of Korea needs to play catch-up and ease rates further from the 1.5% level to allow its exporters to better compete on price. **Cautious on the British Pound** Weniger believes the one currency that is particularly vulnerable against the U.S. dollar is the British pound. He thinks the United Kingdom has yet to wash out excesses to the same extent the U.S. did after the 2008 global financial crisis. In particular, housing prices in the UK are stratospheric—nine to ten times average income, which is double that of the U.S. industrial heartland. Further, a current account deficit of 6% of gross domestic product helps make the case against raising rates in the near future, although many believe the Bank of England will hike rates closely with the Fed. Weniger believes this will lead to pound weakness, making the UK an equity market where he would favor using a currency-hedged approach based on relatively low valuations of stocks.

[1]Source: ECB press conference November 2014.

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DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Inflation : Characterized by rising price levels.

Basis point : 1/100th of 1 percent.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

Quantitative and qualitative monetary easing (QQE) : A central bank monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.

Dividend : A portion of corporate profits paid out to shareholders.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Currency hedging : Strategies designed to mitigate the impact of currency performance on investment returns.