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## Normalising economies may mean moderate returns

After 10 good years, the markets appear to be finally getting back to pre-crisis norms. Our analysis suggests that this normalisation may result in investment returns becoming much more modest than they have been over the years since the financial crisis, when extraordinarily loose monetary policy has boosted asset prices.

In equities, future returns depend on the economic cycle and corporate revenue and earnings. If you believe the cycle can be extended another few years and corporate earnings will continue to grow, then equities are likely to produce small positive real returns.

So, neither fixed income nor equity markets are likely to generate returns as high as over the years since the financial crisis. While returns are likely to be positive, there will be more volatility. Investors will have to decide what level of volatility they can accept.

If you feel confident you will earn a real return over three to five years then you should be able to stay invested in equities despite the higher volatility.

### Putting volatility in perspective

As volatility rises, it is vital to keep a sense of perspective. We tend to think that today's geopolitical tensions and economic problems are worse than ever, but there have been some equally momentous events in my lifetime. For example, there was the breaking up of the Apartheid regime in South Africa; the breaking up of the Soviet Union. Also, the creation of the euro caused intense anxiety in Europe, while now there are worries about Brexit and the possibility of other countries leaving the EU as well.

All financial markets have some level of volatility. It is a healthy representation of the debate on economics, politics and earnings. Different views cause prices to change. The key is to determine how much is normal. It's just as dangerous to have too little volatility as it is to have too much, because too little lulls people into a false sense of security. This is not normal because there are so many different things going on in the world — whether difficulties in individual companies or things such as trade friction in politics — that you would expect some level of uncertainty, which is what volatility represents.

On the other hand, too much volatility probably means there are huge amounts of uncertainty: the risk of war, the risk of a huge recession. So, there is an ideal balance. But the market should have some level of volatility otherwise there is a danger that it has misunderstood the risks that it is discounting.

The problem with volatility is that it represents uncertainty, which can result in people making some very bad investment decisions. I believe most of the volatility today is just noise caused by the change in monetary policy evident in the United States and Europe.

## **Interest rates return to normal levels**

Today's big debate is whether raising interest rates will harm the economy. After the tremendous financial crisis in the world 10 years ago, the world's central banks set ultra-low interest rates for a very long period of time. But now the economy is beginning to normalize, and the central bankers are rolling back those policies. The US Federal Reserve is leading the way as it begins to raise interest rates again. The European Central Bank is also removing some of the extraordinary measures put in place after the crisis. It is analogous to driving a car. If you are slowing too much you press the accelerator (loose monetary policy) but when you regain an appropriate cruising speed you ease up on the accelerator to maintain speed (normalizing monetary policy). This is different than braking violently to avoid an obstacle.

Generally, investors distrust rising interest rates. They assume the central banks are applying the brakes to avoid an issue like rising inflation. However, if it's really the normalizing of rates after a crisis period, this should instil confidence that growth is now more sustainable than it was a few years ago. If today's higher rates signal a return to normal, it is a good thing.

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