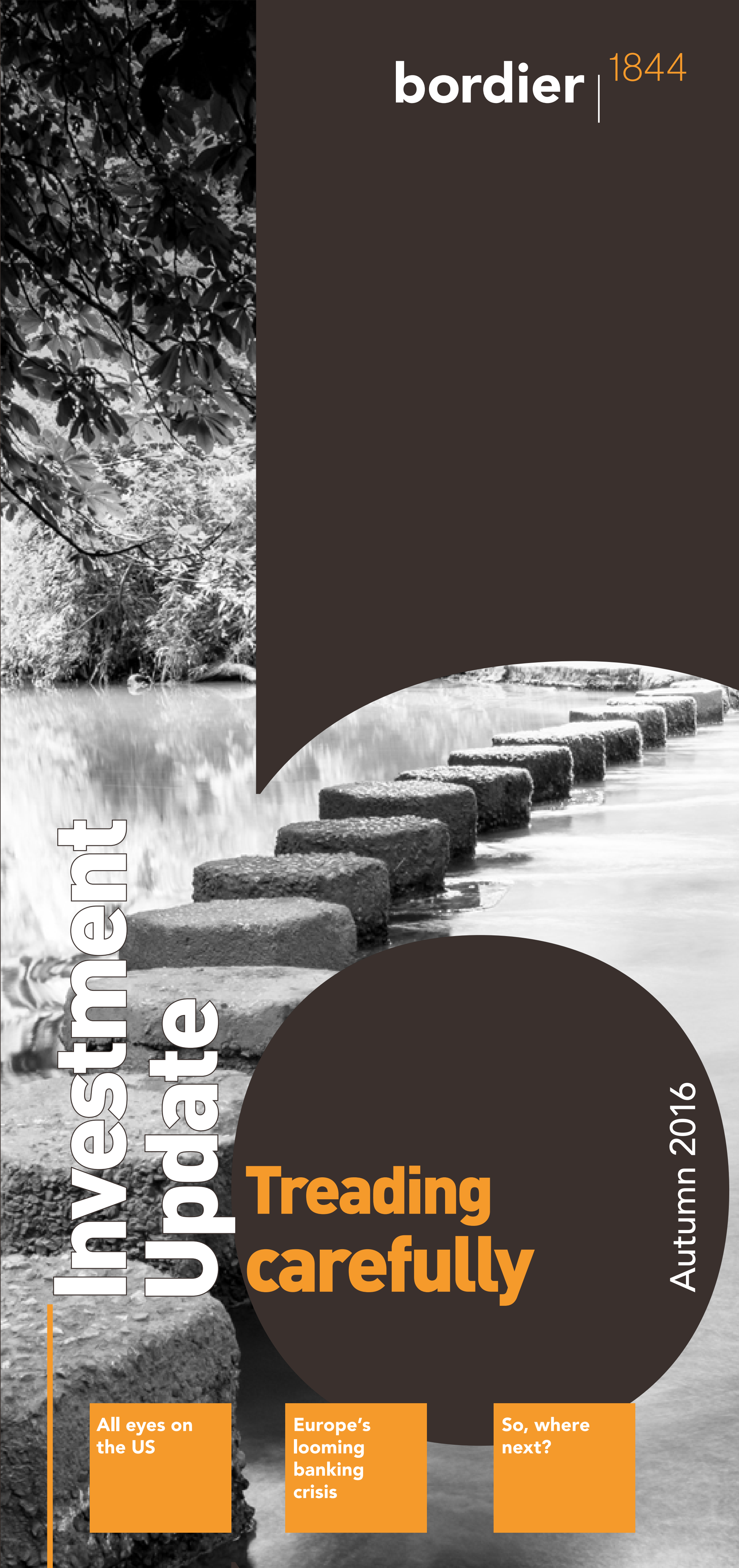
bordier | 1844

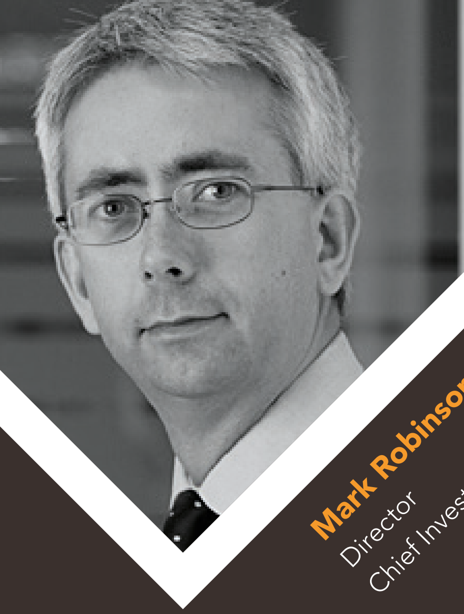


Investment Update

Treading carefully

Autumn 2016

- All eyes on the US
- Europe's looming banking crisis
- So, where next?



Mark Robinson
Director
Chief Investment Officer

Overview

Financial markets have been surprisingly resilient during the third quarter of 2016, recovering their poise after the 'surprise' EU referendum result and generally building on the modest gains that were built up in the first half of the year.

This market reaction was not in the post-Brexit script, but it is welcome nonetheless. However, we should not forget that Article 50 of the Treaty of Lisbon has yet to be invoked and that Brexit is just one piece of a complex global jigsaw, the picture for which is difficult to visualise.

What has got us here, relatively unscathed, is not a more encouraging outlook for economic growth, corporate profitability or reasonable pick-up in inflation, but a continued determination by central banks to feed the financial system with stimulants. If anything, this continued intervention increases our concern about the fundamental health of the global economy, where a number of tripwires are seemingly being ignored, thus causing financial market participants to become increasingly complacent. Continuing to proceed with some caution down this uncertain and bumpy road does therefore seem sensible for the time being, particularly considering the plethora of confusing and conflicting signals and data points.

We would be delighted to report at the end of the year that the increased caution that we have introduced into portfolios over the summer has been somewhat unnecessary. But we have more than a hunch that preparing now for more difficult times ahead is, and will prove to be, the right course of action for our clients based on the information we have at our fingertips today. If some of the current clouds lift, or indeed if we get an over-reaction by markets to some of the negatives around us, then we will be very happy to reassess our positioning. We make no apology for this Update being somewhat gloomy in nature, but would prefer to confront some of the issues head on rather than turning a blind eye to them, as several market participants appear to be doing presently.

3 October 2016

All eyes on the US

It certainly seems that the efficacy of central bank policy around the globe is beginning to wane and there is now a real risk of policy error by the US Federal Reserve, which appears to have become deeply divided on what to do.

Looking back at Janet Yellen's rhetoric from December 2015, by now we should have been limbering up for our fourth rise in US interest rates: the fact that we are still arguing about the second shows that we have not come very far in economic terms, and that traditional methods of monetary policy may be coming close to running their course. Even negative interest rates in Japan and the eurozone seem to be having little effect, so we may see conventional methods of monetary stimulus give way to less common ones, including a shift to more of a fiscal approach involving changes to the level of taxation and government spending. Further stimulus of this nature could 'kick the can' even further down the road for a while longer though, and create another period in which both equities and bonds can continue to enjoy their cosy co-habitation. But it would undoubtedly also increase some of the pressure building in both these asset classes.

Returning to the Fed, it probably will yield to the market pressure to do something on interest rates soon, particularly now that inflation is beginning to pick up moderately. However, if the Fed listens too much to its heart rather than its head, the risk of policy error could be quite real, nudging the economy backwards just at the time when it is finding its feet. To date, the Fed has engineered a relatively smooth path for both equity and bond markets. But the fact that, very broadly speaking, investors have piled into certain equity sectors to find income yield, and into bonds searching for further growth from falling yields, is a worrisome role reversal in itself and something that must unwind at some point.

The US stockmarket's cyclical bull market, defined as a period when there has been no correction of at least 20% from the market's peak, is now the second longest in its history, having begun its general uptrend in March 2009 in the immediate aftermath of the 2008 financial crisis. We are certainly not predicting a crash, but some form of realignment between corporate earnings and the price investors are willing to pay does seem slightly overdue. Added to this is the political event risk, with the prospect of general market and sector-specific volatility, depending on whether Clinton or Trump is installed in the White House.

Europe's looming banking crisis

Back across the Atlantic, financial and political risks in Europe appear to be equally problematic and could also cause some destabilisation of markets in the coming months.

For example, the future of one of Italy's leading lenders, and the world's oldest bank, Monte dei Paschi di Siena, is in some doubt as it tries to reduce its loan book: over a third of this is classified as 'non-performing', where the borrower has not made scheduled payments for at least ninety days. This is just one example of some of the issues faced by several European economies, where youth unemployment ranges from between 25% and 50% in countries such as France, Portugal, Italy, Spain and Greece.

In Germany, meanwhile, and at the institutional end of the banking spectrum, Deutsche Bank has its own issues as it grapples with huge fines imposed for mis-selling practices during the last financial crisis. Although the fine is likely to be scaled back, the matter does bring into focus the bank's massive exposure to the rest of the European banking system and its potential political ramifications. Another banking crisis in Europe, combined with prospect of anti-establishment parties in France and Germany making substantial electoral gains next year, could seriously frustrate the founding members and would undoubtedly also place the EU's future in further doubt. Adding Brexit into the mix clearly also complicates the situation. Despite all the determined intervention and reassurance from the ECB, kick-starting Europe's economy will therefore be a challenge, but that does not mean one should ignore it from an investment standpoint: stockmarket valuations remain reasonably attractive and opportunities for nimble stock-pickers remain.

So, where next?

Whichever way one looks at it, it seems that the global economy is wired up to a number of hazards, any one of which could trigger what we feel would be a well-overdue reality check for markets.

We do not foresee a collapse, but we do believe that complacency has become too acute and that loose and extended central bank policy in particular, and other measures of fiscal relaxation, are giving markets a false sense of security. Sure, the same argument could have been made on a number of occasions over the past few years, and investors would have been 'wrong' to have deserted equity and bond markets too soon, but we believe it would be foolish to press on without some caution – we believe that treading more carefully is more in our clients' best interests than ignoring some of the disguised hazards ahead, many of which have been laid by the very mechanisms that have got us to where we are today: central banks. If they cannot guide us safely from here, and economies cannot grow organically without further external help, then we feel we must do our bit, even if the means with which to find a safer path are becoming increasingly limited.

We believe that treading more carefully is more in our clients' best interests than ignoring some of the disguised hazards ahead.

Contact Us

For further information please visit our website at:
www.bordieruk.com

Bordier & Cie (UK) PLC
23 King Street, St James's, London SW1Y 6QY
T: + 44 (0)20 7667 6600 | F: +44 (0)20 7930 2911
E: enquiries@bordieruk.com

Risk Warning, Disclaimer and Authorisation

This document is issued and approved by Bordier & Cie (UK) PLC. Incorporated in England No: 1583393,registered address 23 King Street St James's, London, SW1Y 6QY. The company is authorised and regulated by the Financial Conduct Authority. Bordier & Cie (UK) PLC was formerly known as Berry Asset Management PLC, and is a specialist investment management company, dedicated to providing portfolio management services. We will advise and make a recommendation for you after we have assessed your needs. We offer Restricted advice as defined by the FCA rules, as we can only offer products from a limited number of companies.

You may ask us for a list of the companies whose products we offer. This document is not intended as an offer to acquire or dispose of any security or interest in any security. Potential investors should take their own independent advice to assess the suitability of investments. Whilst every effort has been made to ensure that the information contained in this presentation is correct, the directors of Bordier & Cie (UK) PLC can take no responsibility for any action taken (or not taken) as a result of the matters discussed within it.