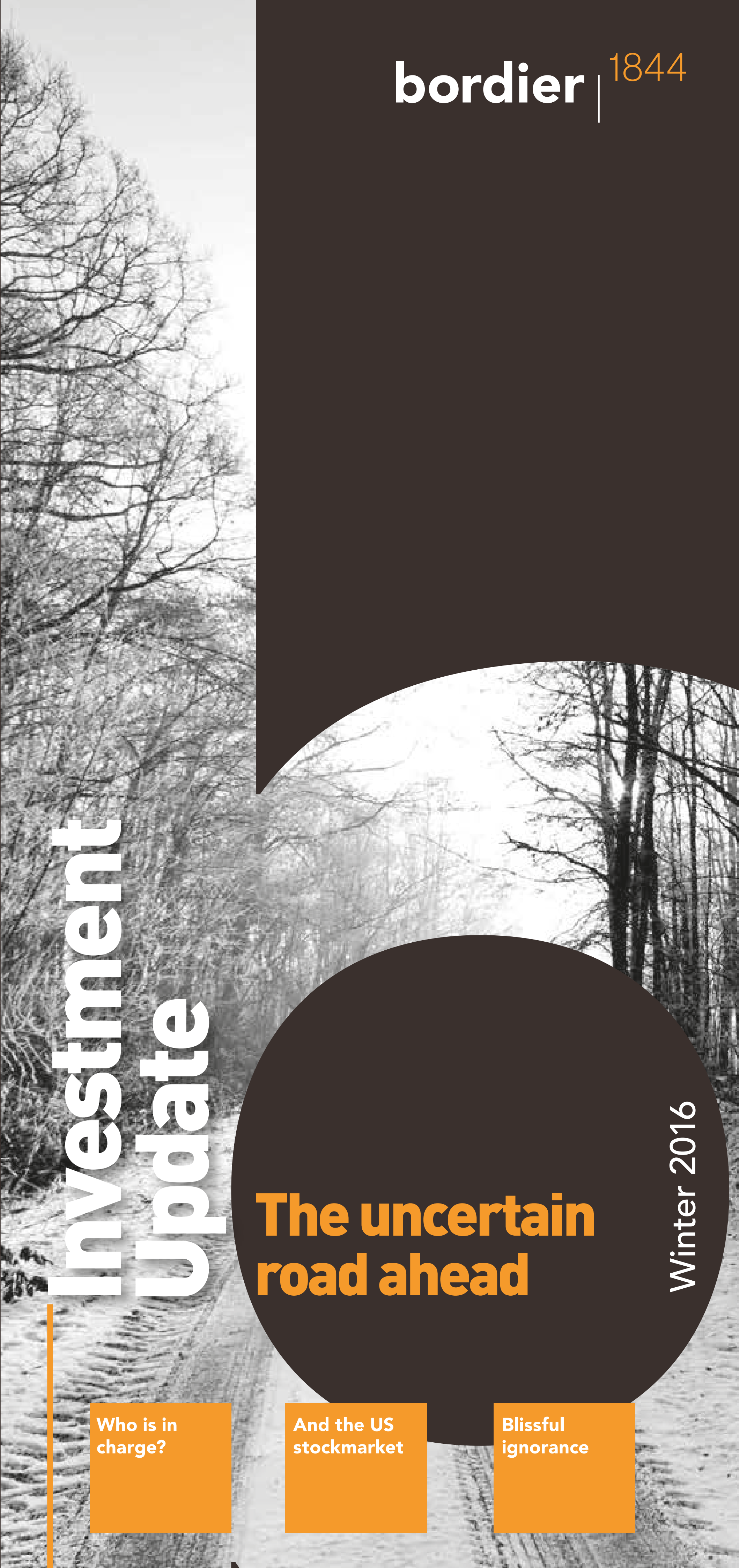
bordier | 1844



Investment Update

Winter 2016

The uncertain road ahead

Who is in charge?

And the US stockmarket

Blissful ignorance

Mark Robinson
Director
Chief Investment Officer

Overview

It is pleasing to report that, despite all the political and economic upsets thrown at them, financial markets have generally carved out another reasonable annual result for investors during 2016.

A continued backdrop of low, zero or negative interest rates, and generally low levels of inflation, have also created opportunities for making modest real, inflation-adjusted, returns without excessive risk. However, it has been a very strange year in which market reactions to key political events in particular have been very different from their anticipated responses. Whether it has been the 'surprise' result surrounding Britain's future in the EU or the election of a demagogic new US president, markets have seemingly defied logic and continued to shrug off the uncertainty posed by these and other events - events that would, under 'normal' circumstances, have been expected to trigger altogether different market, sector or asset class responses. But we do not appear to be living in a 'normal' world. The massive monetary crutch that has provided key market support since the summer of 2008 can explain much of the apparent complacency and seemingly boundless appetite for risk, despite all manner of political and economic uncertainty. That said, we might look back on the final quarter of 2016 as being the approximate turning point when the work of monetary policy truly became exhausted and an altogether different policy response became necessary.

At present, stockmarkets are latching onto the economic positives of massive infrastructure spending, whilst bond markets are reacting relatively responsibly to higher US interest rates and the prospect of higher inflation. However, if this shift in the status quo does not correspond with a durable pick-up in economic growth, then there could be some trouble ahead. We begin 2017 with a genuinely mixed economic and political picture in front of us. Maybe market participants will gradually begin to realise that continuing to view things through rose-tinted spectacles and throwing caution to the wind, as they appear to have done throughout much of 2016, is not such a smart tactic after all.

29 December 2016

Who's in charge?

Before January is out, Donald Trump will have his hands on the political and economic tiller of the USA. Only time will tell as to whether he will be capable of steering the American economy safely through a sea of uncertainty and a climate where several storms could already be brewing.

But one thing is fairly certain: he lacks the experience to navigate single-handedly and will be leaning heavily on the crew of old hands and relative newcomers that he assembles around him. Therein lies a particularly thorny issue, which could, if Trump does not keep a close look-out, set the US economy on a dangerous course. Will he, for example, listen more to the Republican Party policy veterans who favour encouraging business through reduced regulation and lower taxes, or will he take the advice of the political hard-liners who see the elimination of the trade deficit as the key priority, advocating the placing of tariffs on US trading partners and taxes on companies that shift jobs overseas?

On the latter, Trump's recent appointment of Peter Navarro, the author of 'Death by China', as leader of a new National Trade Council is a potentially inflammatory move which will not be greeted with warmth by the Chinese authorities. It seems to be a clear signal that Trump is determined to stand up to China and potentially follow through on some of his turgid pre-election rhetoric in an attempt to readdress what he feels is an imbalance in global trade. Whilst this alone is a concern, so too should be the potential retaliatory measures that China has at its fingertips, most notably the ability to devalue its currency.

Just how far each side will go to maintain or gain an economic advantage is unclear, but we can probably expect this to have greater influence on market sentiment as the year unfolds. Managing the juxtaposition within his own team of advisers will keep Trump busy, but it is the impact of his policies on both the US economy, and other key trading nations, that we need to concern ourselves with most of all.

And the US stockmarket

The US stockmarket's continued strength is somewhat surprising given the backdrop for corporate earnings and the potential impact that the sustained strength in the US dollar might have on US exporters.

Whilst there is likely to be a temporary growth spurt for those business sectors closely linked to Trump's promise of huge infrastructure spending, much of this stimulus appears to have been priced in already and taking the stockmarket as a whole it does appear somewhat overvalued. There is an argument that suggests investors are willing to pay more for a slice of company profits when inflation is low, largely because corporate profits are not flattered so much by inflationary influences. But with inflation now on the move and the potential threat from higher wage growth, a stronger dollar and still relatively weak corporate investment, there is little room for disappointment. Good opportunities for investment still exist in the US stockmarket, but it requires the skill of good stock-pickers to unearth them.

Blissful ignorance

On the whole, markets are still largely ignoring the general level of Brexit and Trump-related uncertainty and their impact on business sentiment and economic activity.

In the case of Trump, markets seem entirely focused on the positives of yet-to-be-confirmed infrastructure spending measures, tax cuts and other fiscal measures, rather than threats posed by a more protectionist stance on international trade, not to mention the general uncertainty posed by Trump's broader agenda and electioneering rhetoric. On Brexit, it is equally still very difficult to determine how the divorce from the EU will take shape and the implications for both the UK economy and the knock-on effects to other economies. In addition, we should be wary of the continuing fragility within Europe's financial sector and uncertainty surrounding various key elections over the coming year, especially given the growing support for populism and euro scepticism. Italy can be singled out as a country at most risk of, ultimately, being the catalyst that destabilises the eurozone to a point beyond repair.

And so, in conclusion

It has been a rather odd and somewhat frustrating year, and yet as noted investors have still generally made some encouraging positive headway. We have perhaps been a little early in positioning client portfolios for greater uncertainty, but since when has it been possible to buy insurance after the event?

Of course, we are hopeful that the key monetary and political authorities will see some of the risks ahead and guide markets through and for this reason we have not battened down the hatches entirely. But equally we should not rely on the authorities being able to navigate safely through what are largely uncharted waters. Whilst we are prepared to alter our cautious stance, in our opinion, and at least in the near term, it will pay to maintain a close look-out in case stormier conditions do materialise. Having some slightly more encouraging news on economic activity is welcome, but market complacency is still running at an elevated level and we believe, based on current evidence, that it is still too soon to be contemplating taking on more risk. We are, however, remaining active and alert to events that will shape 2017.

It has been a rather odd and somewhat frustrating year, and yet as noted investors have still generally made some encouraging positive headway.

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.