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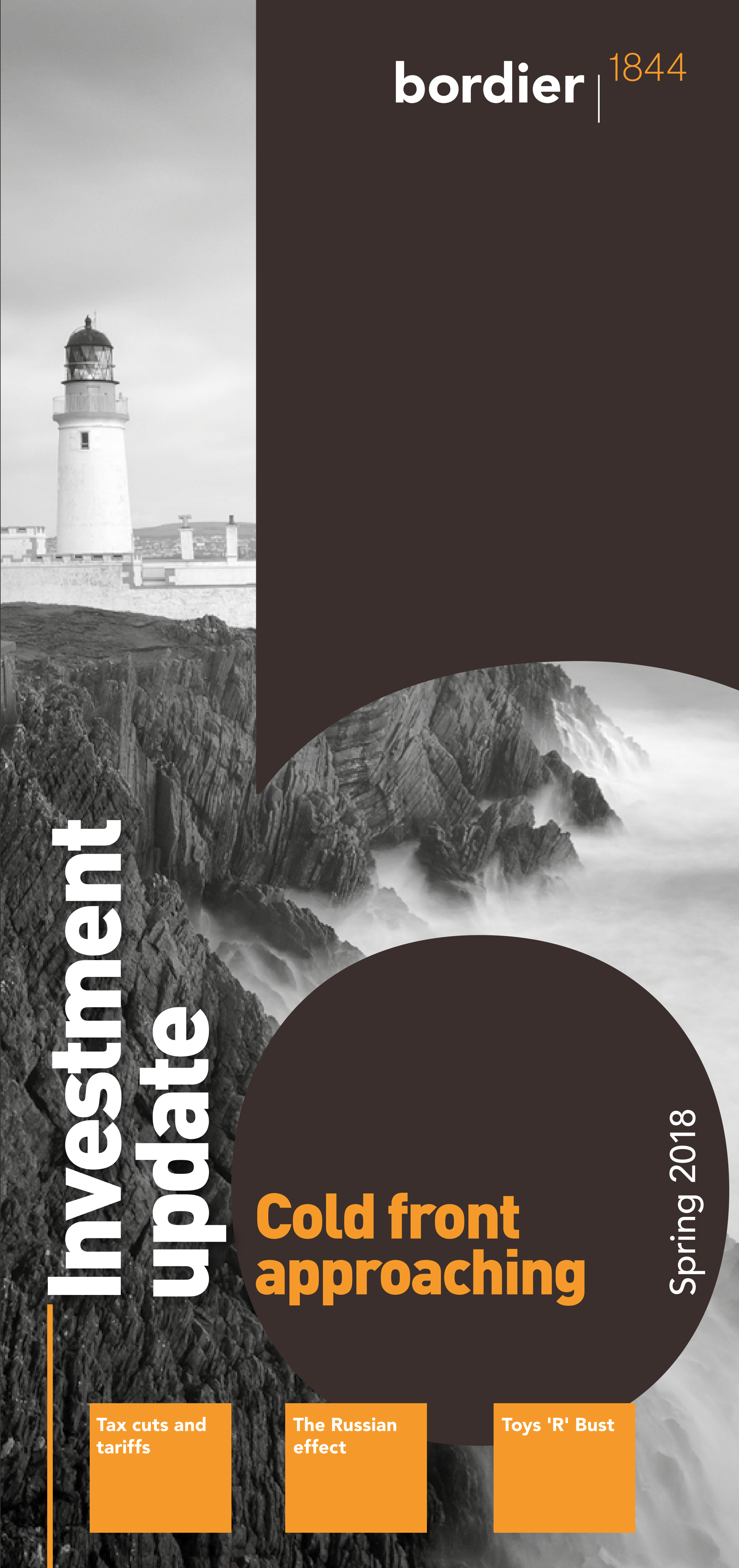

Investment update

Cold front approaching

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Overview

The first quarter of 2018 has seen much more challenging investment conditions than we have seen for a long time, with volatility across asset classes spiking and more notice, at last, being taken of the latent risks that have been accumulating in the post-financial crisis period.

We have written and spoken at length about the need to be wary about the implications for monetary policy change, and as many will know we have trodden a relatively cautious path for some time. We may have been slightly early in making this call, but rarely is it possible to pinpoint in advance the optimal moment to take more defensive action; our priority has been to position as best we can for a more precarious future whilst still participating in the market upside while it has lasted. With this in mind, where risk appetites allowed, we took advantage of February's dip in stockmarkets to increase exposure to Japan and Europe, which remain in receipt of stimulus and we see as being further behind the US economic curve. This has allowed us to move closer to a neutral stockmarket positioning, but we are still very mindful of what lies ahead.

Indeed, in more recent weeks, the list of market risks have grown again to include matters of a more troubling nature, and which may reshape the economic, political and corporate landscape for some time to come. At this stage it is difficult to compute the likely knock-on implications of matters as diverse as a trade war between the US and China, sanctions on Russia, the corporate fallout and mistrust following Facebook's data misdemeanours or how long the 'revolving door' of advisers in the White House can keep turning. But it is difficult to see these varied issues having anything other than a negative impact on market sentiment. The clocks may just have gone forward, but it feels as though we have gone back several years in terms of political and trade relations among and within leading world economies. Rebuilding some market trust and confidence may therefore take some time, particularly if recent issues throw a spanner in the monetary policy works.

3 April 2018

Tax cuts and tariffs

Much newsprint and fanfare has surrounded the passing of President Trump's US tax reforms and the presumption that they will not just fuel-inject US corporate profitability and economic growth, but also bring forward the need to alter monetary policy.

On the back of this fiscal boost, analysts' profit forecasts have been duly raised, and the likes of the Organisation for Economic Co-operation and Development have suggested at least 0.5% might be added to US GDP growth in both 2018 and 2019.

As is becoming very clear, however, President Trump has his own agenda for sustaining and building upon this economic momentum. Instead of working together with its principal trading partners to reduce trade barriers, the US appears to have set itself on a course to do the complete opposite. In yet another instance of engaging mouth before brain, Trump seems to forget that there are never any winners in a trade war: imposing trade tariffs on a whole range of imported goods from China could actually do more harm than good to the US economy, particularly if it contributes to stronger imported inflation and a need to accelerate monetary policy change. This would ultimately knock the current growth momentum off course and shatter the 'America First' dream. But it is quite possible that the market reaction is overdone. For example, according to Capital Economics, the most recent announcement that the US intends to impose a 25% tariff on $50bn of imports from China might actually only cover less than 3% of total US goods imports, a similar amount to those on steel and aluminium. Furthermore, something perhaps to highlight in the above analysis is the word 'intends': we have already seen plenty of instances of Trump's headline-grabbing promises and threats being watered down or withdrawn altogether.

Whatever the ultimate outcome of this current tit-for-tat economic sabre-rattling, it is unlikely to be good for market confidence and sentiment. It also lengthens, once more, the list of uncertainties that surround global markets and exposes the fragilities and vulnerabilities which are still lurking, nine years on, in this post-financial crisis era.

The Russian effect

The use of a Russian nerve agent on the UK's home soil has rightly brought widespread international condemnation.

Quite what the longer-term ramifications and extent of reprisals will be is still very unclear, and suggestions that it could spark a new Cold War may not be far off the mark.

Hopefully, however, a combination of economic sanctions and diplomacy will prevent things spiralling out of control, but at this juncture it is hard to see this situation heading down anything other than a very treacherous path, doing little for investor confidence, and increasing the element of geopolitical risk.

An unintended consequence of this complex matter has at least brought Prime Minister Theresa May, and her UK government, closer to her international allies at a time when support and patience had been dwindling, particularly on the Brexit front. Having now secured some form of a Brexit transition deal - even though it essentially amounts to nothing more than maintaining most of the current commitments to the EU but without any voting rights - means that the UK appears to have retreated from the so-called cliff edge of a 'no deal' situation, although the EU still seems to hold the best cards around the Brexit negotiating table. From an investment standpoint there are some mixed feelings about the transition deal: it has given an unexpected boost to the pound, but in turn has contributed to the recent decline in the UK's mainstream stockmarket indices - these are bloated with companies with significant foreign revenue streams and whose profits are likely to be hit by sterling strength.

Toys 'R' Bust

Pressure is not only being felt by international companies listed on the UK's stockmarket: many domestic companies, particularly those directly focused around consumer spending, are also experiencing tough conditions.

According to the Centre for Retail Research, there have been no less than 29 major retail firms that have disappeared from the UK high street since 2008. These failures have led to nearly 12,000 store closures, claiming around 150,000 jobs. We have lost household names such as Woolworths, HMV, Comet, BHS, MFI, Threshers, Blacks Leisure, Clinton Cards, Stead & Simpson, JJB Sports, Blockbuster and now Maplin and Toys “R” Us. These companies are unlikely to be the last casualties - other well-known brands including Mothercare, Carpetright, Moss Bros, House of Fraser and Prezzo have between them announced a variety pack of refinancing needs or warnings on their trading outlook, so the list of corporate casualties seems set to grow. When viewing this bleak backdrop, in combination with Brexit uncertainties and significantly weaker GDP growth than the rest of the developed world, it is perhaps not surprising to see us continue to retain an emphasis on stockmarket exposures outside the UK.

Active management still rules

Around 20 years after the technology, media and telecom boom of the late 1990s, some of the ideas and growth trends we glean from talking to the managers of funds we select seem equally mind-blowing.

But it is their heavy lifting and sifting, and their constant engagement with company management, that should give them an edge over those investment strategies that are skewed towards yesterday's rather than tomorrow's winners.

Only those companies that are strategically thinking about the challenges and opportunities brought about by disruptive innovation, in whatever sector, and actively doing something about it, deserve to be the survivors through this next phase of what could be quite a tricky economic and market journey. To us, this overwhelmingly suggests that the best investment opportunities will be found by active, rather than passive, managers, as it is the former that have the flexibility to move with the times and identify not just the next wave of disruptors, but also those that will be disrupted.

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Contact us

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