bordier 1844

Investment update

Autumn 2018

Shifting the emphasis

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Overview

With the exception of the US, it has been quite a sweat for global stockmarkets to make much headway during our long, hot summer.

Bond markets have also lost some ground against a backdrop of tighter monetary policy and higher inflation. Earlier in the year most developed economies seemed to be gathering some momentum, with the monetary medicine, at last, seemingly providing the impetus needed for several economies to stand on their own two feet again. But in recent months some recoveries appear to have stalled, and in some cases, they have actually reversed. The escalation of trade war tensions and the impact of rising US interest rates has also taken the shine off things, whilst the consequent rise in the US dollar has made life more uncomfortable for many emerging economies. The outcome and impact of Brexit for both the UK and continental European economies remains one of the biggest near-term uncertainties, whilst the threat of Italy's fragile financial position triggering another eurozone crisis never seems too far away.

We are now approaching an important fork in the road: after ten years of post-financial crisis stimulus, the current drivers of global stock and bond markets will soon have to give way and investors will need to navigate a new, and potentially bumpier, route. So far, we seem to be approaching the junction at reasonable speed and without having to hit the monetary brakes too hard, if at all. But some care is still necessary. It will be particularly important to concentrate more on the road ahead than on what is now behind us, since central banks are unlikely to be in a position to hand out similar doses of monetary medicine if the global economy enters another big skid. Looking more through the front windscreen than the rear-view mirror, and moving up and down through the gears, is what active management is all about, so this is where our focus remains. Even if the underlying conditions become a little more uncertain and challenging as we head through the final quarter and into 2019, new opportunities should continue to open up for active asset allocators like us, and active fund managers, to exploit.

30 September 2018

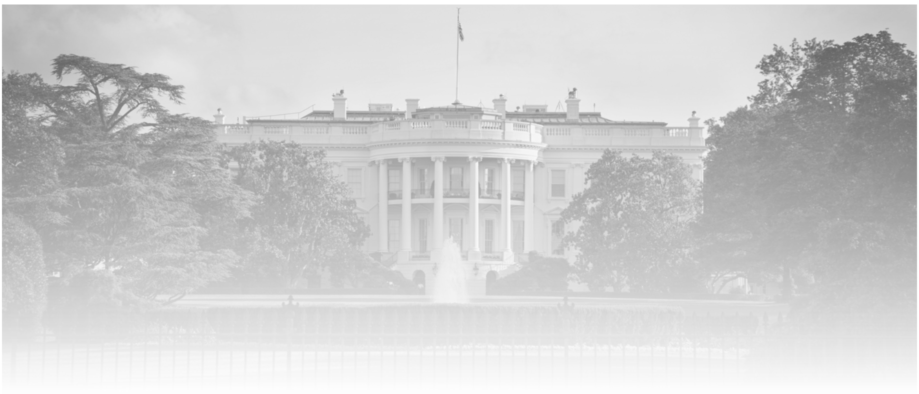
Ten years on

It is now ten years since the height of the global financial crisis. We have come a very long way since then but still need to be alert to the issues that have been created by one of the greatest financial experiments of our lifetimes.

The undercurrent of broad uncertainty has not gone away, so caution is still the watchword, but there are also some brighter spots worthy of exploiting from an investment perspective, most notably those thrown up by the strength of the US economy and its currency. Stockmarket valuations in several areas have generally become a little more acceptable, particularly away from those sectors and companies that have, for some time, been big recipients of capital flows from passive investment approaches; other investment opportunities are also emerging as 'tourist' investors beat a retreat to their natural home. Active management is still alive and well, even if the heat from the post-financial crisis stimulus is beginning to die down somewhat.

The US - onwards and upwards

The chants of U-S-A! U-S-A! from the Ryder Cup galleries were rather more muted this year, but it has been a different story from a US stockmarket and economic perspective.



The boost from President Trump's corporate tax cut now seems to be well-entrenched and is contributing to what looks like a more durable period of improved margins and higher profits growth amongst US companies. So far, the impact of trade reprisals from China also appears to be having less of an adverse impact on growth than at first feared. Overall, the US economy looks to be in quite good health relative to other world economies, although we need to be mindful that inflation is now on the rise and that it may not be too long before the tightening of the monetary screw will precipitate some economic deceleration.

But even if the US economy does begin to slow, we can still expect to find some excellent investment opportunities within what is a vast universe of US corporations, particularly among those that have been somewhat neglected by the huge wave of passive investment into the dominant companies within the leading stockmarket indices like the S&P 500 Index. For example, excluding the five expensive FAANG stocks of Facebook, Apple, Amazon, Netflix and Google (now renamed Alphabet), the US stockmarket is by no means trading on a heady multiple of anticipated profits. The 'S&P 495', plus a whole host of US companies lower down the market capitalisation scale, therefore lies in wait for active managers, and potentially merger and acquisition dealmakers, to discover.

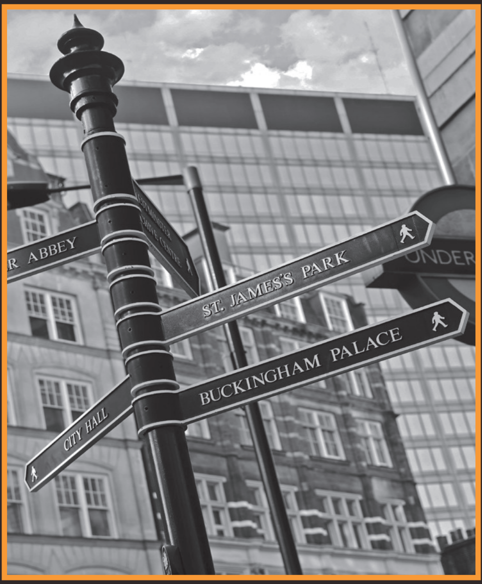
We have active fund managers in the wings ready to take advantage of this opportunity and are therefore reducing cash in favour of an increased US stockmarket allocation. Overall, this move will return us to a neutral position within our strategic stockmarket ranges. This is not a signal that we have become more positive about the global economy and global stockmarkets as a whole - it is more about the obscured opportunities specifically within the US stockmarket, and also our continued confidence in the US dollar.

Lacklustre gold

While the sun has generally been shining on the US stockmarket this year, gold is an alternative dollar-denominated asset that has lost some of its lustre.

To some extent gold's weakness has been offset by the strong upward move in the US dollar, particularly for sterling-based investors, but its historic characteristics as a store of value in times of higher inflation, which is now materialising, have not shone through. Meanwhile, its traditional safe-haven attributes have barely been noticeable during bouts of market volatility, even more recently as uncertainty in emerging economies has gathered pace. Gold's non-income producing characteristics have also become more of a headwind as US interest rate policy, and hence interest from both cash and government bonds, has risen, thereby reducing gold's appeal. We have generally considered gold to be an insurance proxy - there in case we enter times of real trouble - but also an asset that is out of step, or uncorrelated, with most other asset classes and therefore capable of reducing portfolio risk. It has broadly fulfilled these criteria over longer periods, but right now the US dollar's continued ascendancy and the upward shift in US interest rates leans towards a move away from gold.

However, we are keen to retain our commitment to dollar-denominated assets and believe that US government bonds have reached an interesting juncture and are now worthy of an investment allocation. The US Federal Reserve's progressive and well-messaged upward shift in interest rates has caused US government bond yields to rise - in the case of 10-year Treasuries, yields have recently moved close to 3.1%. This is a level they flirted with in the early summer but was last seen more generally over seven years ago as interest rates continued to tumble in the aftermath of the 2008 financial crisis. At these levels, it appears that US government bond yields are now already factoring in most, if not all, of the Federal Reserve's expected shift in monetary policy over the coming year or so. We therefore feel that at current elevated yields, US government bonds, particularly up to 10-year maturities, offer an attractive income-producing, dollar-based investment. Furthermore, if more troubled market conditions do materialise then investors will, more likely than not, retreat to the relative safety of government bonds and the US dollar. We believe this investment can therefore pick-up some of the safe-haven attributes typically afforded, but currently being abandoned, by gold, whilst also providing a reasonable income return.



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