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Investment update

Spring 2019

Renewed stimulus

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Overview

From an investment return perspective at least, the first quarter of 2019 has certainly been a more encouraging one than the final quarter of 2018.

Global stockmarkets have regained their composure and the wild volatility witnessed around the year end has subsided. This strong rebound may seem rather odd when the tone from central banks and economic forecasters has been more downbeat about the level of economic activity and the prospects going forward, but the market recovery is nonetheless welcome.

In the near term, several positives have lifted both markets and the sentiment that surrounds them. For the time being, a more conciliatory tone on the US-China trade war has certainly helped. However, the US Federal Reserve's (Fed) volte-face on monetary policy has probably been the most significant influence: the Fed has changed its tune from just a few months ago, signalling two or three interest rate hikes during 2019, to now suggesting no change at all. The prospect of lower-for-even-longer monetary policy has been viewed as a further extension of the huge stimulant that has been injected into the financial system since the global financial crisis, itself extending what has now become a ten-year recovery in a whole host of asset classes. It is not just the Fed that has pressed the pause button on monetary policy – many other central banks are now leaving things on hold or even looking to reduce policy measures to stimulate economic activity and stave off the threat of recession.

The speed of transmission of current monetary policy measures into the broader economy will be the key to how things unfold from here. There is hope that policymakers have caught things in time and that their efforts can reinvigorate a global expansion that has been losing momentum. But we must also be prepared for economic conditions to worsen before they improve. At the moment we are content to remain neutrally positioned as far as stockmarket commitments are concerned. We continue to plot a course that can take advantage of reasonably favourable valuations and the tailwind of extended stimulus, whilst also recognising that the clouds approaching may require more defensive action sometime later this year. For most clients we still have some cash to deploy if increased uncertainty over the pace of the slowdown translates into renewed market jitters, but we will need to fully understand the reasons for any setback, if and when it happens, before changing our general direction.

1 April 2019

Tougher days ahead?

Whilst further intervention by central banks has been greeted with some relief and optimism by investors, there is a darker side to what lies behind the U-turn in policymakers' rhetoric and action.

Economic growth has been revised downwards in almost all the G20 economies, most notably in the eurozone, on the back of a range of uncertainties. These include heightened policy uncertainty itself, persistent trade tensions, concerns over the precise state of the Chinese economy, ongoing declines in business confidence and, closer to home, the continuing Brexit fiasco. Looking ahead, we may be moving into a weaker period of global economic activity, but that does not mean it will grind to a complete standstill or indeed flirt with recessionary conditions everywhere.

There is no doubt that a sharper slowdown in China and a drop in domestic demand would damage global growth and trade prospects, particularly with some of its close neighbours in East Asia and Japan. Fundamentally China is still an economy that sits head and shoulders above the rest of the world in terms of its actual rate of growth and its potential to reach a vast pool of new consumers over the longer term. Meanwhile, the US economy, itself not immune to some of the global growth challenges, still appears to be one of the brighter spots on the economic map. President Trump may not be everyone's cup of tea, but it is difficult to argue that several of his policies have been anything other than stimulative for the US economy.

There are signs that the US economy is becoming more self-sufficient, decoupling from other parts of the world and capable of withstanding some of the broader global economic challenges. At a headline level the US market is still trading at a premium to several other world markets. Some care is required, but it still offers a rich pool of opportunity, innovation and enterprise beneath the surface that can translate into attractive returns for investors. Furthermore, Trump will soon be limbering up to position the economy and himself for the Presidential election in November 2020. A further round of fiscal stimulus is therefore entirely possible which might augment the current assistance being provided by the pause on monetary tightening. Trump could also draw out trade discussions with China, merely to give a shot in the arm to the economy and financial markets closer to the election, particularly if this looks like it might coincide with a more challenging period for economic growth generally. For now, we are content with leaving the US as the dominant overseas stockmarket allocation, but it remains important to steer towards tomorrow's growth stories and not to the winners of yesterday that continue to dominate market indices.

Brexit blues remain

British Summer Time may just have begun, but it feels like the winter is very much still with us as far as Brexit is concerned.

The direct impact of Brexit uncertainty on the UK's economic growth is impossible to quantify precisely. What we can do is make a fairly good guess that it accounts for a significant element of the UK slipping well below the average pace of gross domestic product growth of the US, Germany and France. The Organisation for Economic Co-operation and Development estimate this lag to be in the region of 2.5% since the Referendum. This may be an underestimate: the longer the uncertainty goes on, the deeper the effects are likely to manifest, including the knock-on effects of weaker trade with some of the UK's close trading nations, most notably in the wider European Union itself. It has been bad enough for UK businesses trying to fathom out how they position themselves for the future, but the uncertainty has also clearly been a deterrent for other countries to do business with the UK and also negatively impacted their economic growth.

By the time this update reaches you we may either be closer to knowing the shape of Brexit or still some distance away from it; the political leadership and map may also have altered. We are not holding our breath, expecting the deadlock to have been broken, but like most we believe something needs to shift soon before some more permanent damage is done to the country’s economy and credibility.

With so many unknowns surrounding Brexit, we continue to believe the best strategy is to have more equity capital allocated outside the UK than in it. At present, headline UK stockmarket indices, which are dominated by large international businesses, paint a misleading picture of the trouble being inflicted by Brexit malaise on UK PLC. However, at some point the fog will lift, and it is likely to reveal brighter, longer term investment opportunities that have been adversely caught up for no good reason in the Brexit uncertainty, or are beneficiaries of whatever outcome is delivered. It may therefore be an altogether different part of the UK stockmarket that takes up the reins from the international heavyweights, providing a potentially rich seam of opportunity for active managers to mine in due course.

Interest rates still key

A changed outlook on interest rates has provided a lift for bond markets in recent weeks.

Yields have fallen, and capital values have found some renewed support once again after enduring some tense times during 2018 when concerns about an exodus of capital from this asset class were prominent. Like our stockmarket exposure, commitments to fixed interest markets are also actively managed depending on the outlook for inflation and interest rate policy. With inflation having cooled as a result of slowing economic activity and a lower oil price, and with the threat of higher interest rates consequently having moderated somewhat, our underlying fund managers have begun to adjust their bond portfolios to take advantage of the changed conditions, the aim being to introduce slightly greater opportunity for investment return.

The sea change on interest rates is also having an impact on the outlook for currencies, in particular the US dollar. For sterling-based clients we have already hedged some dollar currency risk to protect US investment gains from a fall in the dollar and/or a rise in the pound emanating from a 'better' Brexit outcome. We have considered doing more, but for the moment are happy with the level of insulation we have introduced. We have also examined a potential allocation to emerging markets, a volatile area we have avoided for some time. Softer US monetary policy and a possibly weaker dollar should remove some of the headwinds that emerging economies have faced in recent times, but we are holding off for now particularly given the uncertainty over Chinese economic activity and China's proximity and close trading links with many emerging economies.

Save the date

Bordier UK Investment Conference 2019
(Exclusive to Bordier UK clients)

Thursday 3 October 2019

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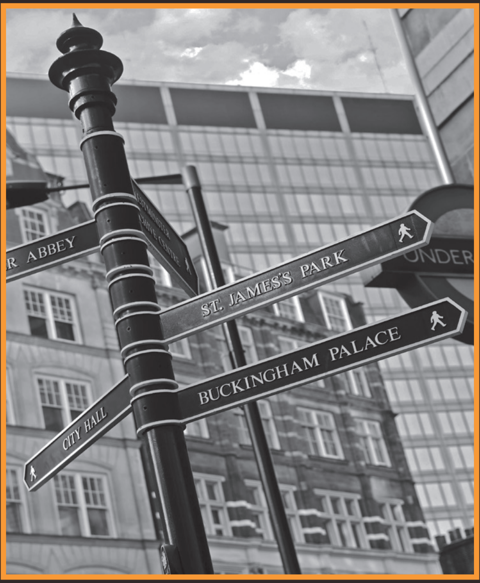

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