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POINTS OF VIEW

US ELECTION MARKET COMMENTARY

Hands up, who wants to be a pollster? Both the Brexit vote in the UK and the US election produced results which were far from what was expected based on the surveys of public opinion in the run up.

The explanations for this are still being worked on and they probably have something to do with the way the new popularist voter reacts to someone brandishing a microphone and clip board. The clear result is that the world certainly looks very different than it did at the start of 2016. In this commentary we have put together some of our initial thoughts as to what this all means for investors and markets.

Trump will not take power until January 2017. Although we have a Republican president, Senate and House of Congress, this does not necessarily mean Trump will be able to pass legislation that easily. Many in the Republican Party did not support Trump and may provide opposition. And although during the campaign there was some idea as to what may happen e.g. infrastructure spending up, tax cuts and less regulation, the devil will be in the detail.

Hopefully between now and January some of the proposals will be "fleshed out" and a more considered response taken by markets. Also important will be his choice of appointed advisers to various key positions. Who will offer themselves for service in his cabinet? Will they temper some of the campaign rhetoric?

The US election result may well have an impact on other markets. If he is true to the drift of his remarks at the hustings American protectionism may be his approach which would be a negative for emerging markets. The growth of global trade has benefitted emerging markets and provided new markets for developed economies such as the USA. However America has a large population itself and an enormous domestic market, and with "fracking" will likely become energy self-sufficient. The impact of protectionism may be more of a problem for others than in the US itself. In the meantime it is more likely that sentiment will drive US markets rather than clarity on the details of Trump's policies.

And just as Europe was beginning to digest the reality of our Brexit vote, their own elections may now cause surprises. By the end of 2016 we will have had the Italian vote on their constitution, for a slimmer legislature and greater likely stability in government, and the re-run of the Austrian presidential elections, which the right wing Freedom Party won in the first ballot in April. In 2017 there will be French presidential elections in May, followed by Germany in August. If the revolt against established parties takes hold in either France or Germany, in particular if anti EU parties gain in popularity, will the Euro project begin to unravel? Given all of the above, markets are likely to be driven more by sentiment than hard fact.

The impact on portfolios is likely to be seen in volatility in individual asset classes, offset by the breadth of portfolio diversification. As always it is important to feel comfortable with the amount of investment risk in a recommended portfolio. The Parmenion investment solutions allow advisers to recommend to investors one of 10 risk grades each with its own controlled risk characteristics. These will ultimately determine investor's returns in the long run, whatever the short run dramas in the political hot house.

First published on 10th November 2016 by Simon Brett of Parmenion Investment Management.

WORRY ABOUT THE RETURN 'OF' YOUR MONEY, NOT THE RETURN 'ON' YOUR MONEY

The renowned bond investor Bill Gross offered this piece of genuine wisdom in an update shortly after the Brexit result this summer. Was he really suggesting that investors should fear losing their money?

Well, perhaps not, but he was reminding us that capital is always at risk when you invest and that focusing on returns, particularly relative returns, can blind you to that fundamental risk.

The last time there was a real threat to the return 'of' capital was the Global Financial Crisis of 2008-09. Then, coordinated interventions by central banks rescued the financial system. Failure to act would probably have seen debt repayments seriously threatened and many companies' equity wiped out. Thanks to central bank policy, the market didn't reach a point of total capitulation. Nevertheless, US Equity prices fell over 50% from peak to trough, global high yield debt prices fell by 33%, US investment grade corporate debt prices fell by 15%. By contrast, UK Gilts rose 15% from summer 2008 to March 2009. What these price movements tell us is that when the pendulum swung from greed to fear, the question investors asked was "How safe is my capital?" The only assets to comfortably pass the test were government bonds.

There is a certain logic to this. As Donald Trump helpfully pointed out, governments with sovereign power over their currency (unlike members of the Eurozone) never need to default on their debt as they can simply print more money. Whether being repaid in debased currency is better or worse than negotiating to avoid a Zimbabwe-style inflationary spiral is a debate the Western world can hopefully continue to avoid.

The clearest pointer to just how determined investors are to own these "risk-free" assets at any price is that large swathes of European and Japanese government debt are now trading at negative interest rates. Investors who buy or hold those bonds are locking in a hit to capital in exchange for the certainty that the bulk of the nominal amount will be returned to them at maturity.

So, the million, nay billion, dollar question is whether central banks can endlessly swallow the debt issued by their own governments. After all, the Bank of England already owns a quarter of the UK's £1.5 trillion outstanding public debt.

There are some malign effects of this policy. The bank's bond buying has forced down the yields on all assets and distorted the normal functioning of a market where buyers transact with sellers at the price each are happy to agree. The greedy hoovering up of both government and corporate debt by central banks has encouraged borrowers to issue long-dated debt at historically low rates of interest. This has pushed up the duration of bond indices, meaning passive bond funds will now be hit proportionally harder by rising interest rates than they would have been before.

Experienced fund managers are finding it harder than ever to predict how markets will respond to news on the economy. This is because markets have become more interested in how the news will be interpreted by the central bankers, and what policies they will adopt as a consequence. This creates something of an echo chamber, as the policies tend to be shaped based on expectations of how markets will react to the bankers' carefully chosen words.

Through these challenging times, we will continue to invest as we always have, seeking out managers who we believe have the skill and judgement to protect our client's capital when markets are weak and harnessing the power of rebalancing to take advantage of any over-reactions when they occur.

First published on 10th November 2016 by Emily Booth of Parmenion Investment Management.

TAKE THE FIRST NUMBER YOU THOUGHT OF...

2016 has not been a good year for economists trying to delineate the fortunes of the UK economy. 2017 could be worse. It is worth reviewing what was being predicted at various stages of the year.

In January, according to the Treasury's monthly survey of forecasts, City economists were predicting growth of 2.1%. As it turns out, this was a pretty good projection, since it now looks as if the economic activity will have increased by exactly that percentage (although the ONS will almost certainly come to revise the data at a later date). Unfortunately, economists could not restrain themselves from fiddling with their numbers, particularly in the wake of the referendum. Although, even by June, forecasts had become a little more cautious, with anticipated growth for the year reduced to 1.8%, the referendum result sent City soothsayers – and their numbers – into a tailspin. Growth estimates for 2016 were cut to 1.5% (a more appreciable adjustment than it might seem given that we were already almost half way through the year). At the same time, during the two months following the referendum, growth forecasts for 2017 were hammered, falling from 2.1% to just 0.3%.

This was not a glorious moment for the economics profession. The view being promulgated was that the economy would come to an almost immediate grinding halt following the electorate's modest majority decision that the UK's fortunes might not be best pursued by staying in the EU. Indeed, an increase in GDP of 0.3% for 2017 as a whole would have to have been based on falling economic activity in at least two quarters – implying, in all likelihood, that the UK would fall into recession during the year. Since this nadir, and with the benefit of a continuing flow of reasonably positive information, forecasts have been pushed higher and currently stand at 1.0%. In my view, however, they are still too low.

The knee jerk response of the Bank of England to the referendum result was to cut the bank rate to 0.25% and to resume quantitative easing. Interestingly, most commentators seemed to question the validity of these moves; my conclusion was that, even if you did regard downside risks to the economy as being severe, taking monetary policy deeper into unconventional territory could well prove counter-productive. I have discussed in previous columns why I believe that exceptionally low short- and longer-term interest rates induce economic lethargy, and I think that is becoming ever more apparent, not just in the UK, but in other countries that have followed this policy route. Indeed, I now sense a growing realisation (and not before time) that unconventional monetary policy, if ever it was anything more than momentarily successful, has now reached the end of the road.

Back to the real economy, June 23rd did not rock the foundations of the economy. That is not to say that we will not experience a few tremors in the future. But it is evident that households have not curtailed their spending in the face of Brexit uncertainty. It is also evident that companies, while saying that they feared the worst, have not acted as if they were travelling full tilt towards economic Armageddon. Most obviously, household spending has remained on a firmly upward trend. In fact, in more normal times, were the Bank of England to be debating the implications of year-on-year growth in retail sales volumes of over 8% and an expansion in consumer credit of more that 10%, it might have concluded that it was time for a modest tightening in monetary policy (an ever-tightening labour market would also suggest that this policy route was appropriate). But central banks, at least those on this side of the Atlantic, remain convinced that we remain in highly abnormal times and that the merest hint of monetary aggression might cause immediate recession. I remain of the view that central banks are part of the problem – that they are actively hindering a return to normality.

Meanwhile, although key areas of business investment remain very lacklustre, weaker trends were in place well before the referendum. In fact, while it might be supposed that uncertainty over the course that Brexit might take will undermine investment spending, there has been considerable anecdotal evidence suggesting the contrary. In part, this may be due to the depreciation in sterling, which has made the UK considerably more competitive. However, I strongly suspect that it is the UK's better economic momentum and overall vibrancy that have continued to attract the attention of overseas investors.

Of course, the UK is facing a greater degree of uncertainty. But the challenge to UK-based companies from that uncertainty may induce exactly the opposite response to the one widely expected. Rather than encourage them to do nothing, I believe that companies will be provoked into taking positive action to prevent Brexit ambiguities from undermining their longer-term growth prospects.

First published on 12th December 2016 by Richard Jeffrey, Chief Economist at Cazenove Capital Management.

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