Insights, Tacit Thought | Weekly Investment Insights

Cyclical upswing, but what of the structural headwinds?

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We held our quarterly investment conference this week where we discuss some of the key economic issues that we believe are driving global markets.

The baseline is reasonably positive in that momentum in the world economy appears to be, if anything, strengthening. Lead indicators, business surveys and institutional research all point to continued expansion. At the same time, some, though by no means all, of the financial imbalances that caused financial mayhem a decade ago have unwound.

Interestingly, China now imports as much, and sometimes more, than it exports and intra-Eurozone current account balances have moved into balance easing some of the financial tensions around the Euro. Even the traditional slower economies of the South are picking up speed.

Major problems remain however:

Debt is still an unresolved problem both for governments and consumers. Wage growth is insufficiently strong to offset any increases in interest rates as and when Central Banks begin the process of normalising interest rates. Central Bank balance sheets remain inflated across the developed world.

Geo-political tensions are elevated principally, but not only, in North Korea. The great irony of the MAD policy of the Cold War – Mutually Assured Destruction – was that it required a distinctly “non-mad” appraisal of the costs of first strike. Our working assumption is that neither Trump or Jong-Un is mad enough to turn a cold war hot.

Brexit. Inevitably there is a growing sense of “Brexit fatigue.” Nevertheless, the economic impact of any kind of Brexit; hard or soft, will have long-lasting effects on financial returns to sterling based assets and therefore on the living standards of our clients. It is a subject that demands a great deal of careful thought.

It is very difficult to make a short-positive case for the economy. Mark Carney’s attempt to talk up the pound last week very obviously highlights his fears of a stagflationary period caused by weak wage growth, higher import prices due a lower pound and deferred investment as businesses simply “wait and see.”

Reasonable people can disagree about the merits and demerits of EU membership in the long-run. Nonetheless, looking from a purely business and investment perspective we know from long experience that “uncertainty” tends to defer investment, it dampens Keynes’ “animal spirits.”

Funds will flow to where international asset allocators perceive the greatest risk-adjusted returns. Will Britain be a destination or a departure point? That is the key question for us and our investors.

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