Overall, global equity markets have made steady progress over the last quarter. Despite signals that all is not well with the global economy, markets have responded positively to central bank indications towards the end of the quarter that monetary easing is back and interest rate cuts are imminent.

The European Central Bank started the ball rolling with its president, Mario Draghi, highlighting that lingering geopolitical risks are strengthening the case for supportive action. In particular, he commented that further interest rate cuts remain part of their tool kit as well as more quantitative easing, even if it means raising self-imposed limits on renewed asset purchases.

The US Federal Reserve then followed suit by readying the market for a possible interest rate cut of its own in the near future. The rationale is that economic data has generally weakened over the past year and that the US economy could do with some assistance in the face of fading fiscal stimulus and resurgent trade tensions. Nonetheless, there is a sense that this would be more of an “insurance” cut aimed at tiding over a period of uncertainty rather than tackling anything specific. As always, central banks need to tread a fine line – on the one hand they want to provide sufficient stimulus but on the other they do not want to spook markets by being too gloomy on the prospects for the global economy.

“Whilst the pace of growth looks set to fade from 3.3% in 2018, the global economy should nonetheless continue to grow in 2019”

Tariff man

US president Donald Trump continues to use tariffs and the threat of them to pursue his political aims on the global stage.

Having removed the steel and aluminium tariffs on Canada and Mexico in May, it looked like he might be moving forward towards a new NAFTA deal. However, the very next week he imposed a 5% tariff on imports from Mexico to commence from 10 June unless they stopped the flow of immigrants. The tariff was to escalate up to 25% by 1 October if no solution was found. After much panic in Mexico they announced thousands of new border guards would be sent to their southern borders and, to the relief of markets, a deal with the US has now been reached to suspend the tariffs indefinitely.

However, the more significant issue of US-China trade tensions remains unresolved. Following a widely anticipated meeting with Chinese president Xi Jinping at the recently concluded G20 summit, Mr. Trump did ease his confrontational stance somewhat, saying that the talks were “excellent” and that the two countries had agreed to resume the discussions that collapsed in May. This has been welcomed by the business community, but the resumption of trade talks without removing any tariffs was probably no more than in line with expectations. Over the longer-term, markets will want to see the truce translating into a durable trade deal.

UK politics

The UK Conservative party has settled on the final two candidates vying to serve as Prime Minister, with Boris Johnson the current favourite over Jeremy Hunt. Voting closes on 22 July and the winner is set to be announced the next day. Despite most of the participants promoting a renegotiation of the trade deal as their Brexit strategy, the EU are repeatedly saying that the current deal is the only one on offer. As such, Mr. Johnson’s promise to leave on 31 October, whether or not he has managed to strike a new agreement, would seem to increase the possibility of a no-deal Brexit. However, somewhat confusingly, he has since said the chances of a no-deal Brexit are a “million-to-one against”.

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Prospects for the global economy

Despite inevitable cyclical setbacks, we expect global economic growth to continue over the long term on account of rising populations, continuing innovation and productivity improvements. In particular, digitisation (the conversion of physical information into a digital form that enables automation, data analysis and process optimisation) could soon deliver a significant productivity boom following a period of subdued improvement. Having said this, it seems probable that the pace of global economic growth will slow compared to recent history. This is primarily on account of high levels of global debt and geopolitical trends that are challenging global free trade dynamics. However, fears of long term economic stagnation seem too pessimistic – modest growth is still growth.

In the short term, we believe that fears of an imminent global recession are overblown. Whilst the pace of growth looks set to fade from 3.3% in 2018, the global economy should nonetheless continue to grow in 2019 against a supportive backdrop of low inflation and more dovish central banks. Global asset manager Schroders, for example, forecasts global growth of 2.8% in 2019 and 2.6% in 2020. Having said this, we acknowledge that significant economic and geopolitical challenges persist - and that there are scenarios where these could combine to tip some economies into recession.

Conclusion

We remain convinced that equities will deliver the best long term returns compared to cash and fixed return investments. As mentioned above, this is based on the belief that, despite inevitable cyclical setbacks, global growth will continue to be dragged upwards over the long term thanks to rising populations, continuing innovation and productivity improvements. In turn, equities are a relative beneficiary of this growth. In particular, we continue to be attracted to the UK stock market, which remains unloved and undervalued on account of the ongoing political uncertainty.

However, we again highlight two important caveats:

- Equity returns will probably moderate. Global equities have delivered very strong returns since reaching a post Financial Crisis low in March 2009, driven by economic recovery, monetary stimulus and a starting point of cheap valuations. However, it seems unlikely that these outsized returns will be repeated over the next ten years. This is because the starting point is less attractive. Compared to 2009, debt levels are higher, valuations are higher, and monetary policy is more likely to tighten over the next decade.

- Volatility should be expected as short term risks are elevated. There appear to be valuation bubbles in certain parts of the market at a time of heightened geopolitical risk.

We would also like to reiterate how we manage the risk associated with these two caveats. First, we do not advise making financial plans based on extrapolating equity performance since 2009. Second, we manage short term uncertainty for our clients via asset allocation and diversification. For clients that have the financial capacity to stay invested for the long term, have no qualms about volatility and want to maximise long term returns, we are comfortable managing portfolios that are almost entirely invested in equities. This is because short term volatility is largely irrelevant to them. For clients that expect to need to withdraw significant amounts of capital from their portfolios and/or are not so comfortable with volatility, we introduce an ever larger proportion of non-equity assets that are designed to generate a decent income whilst offering relative capital stability during times of equity market weakness. The trick is to get the balance right for each individual’s circumstances over the long term – basically, clients need enough equity exposure to deliver attractive returns and protect them against inflation, but not so much that they are put under financial duress during downturns. The key to equity investment remains the ability to be calm and stay invested during times of stress. We find this is far more effective than attempting to second-guess markets.