VERMEER NEWSLETTER

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THOUGHTS ON 2019

Déjà Vu

By Simon King
Chief Investment Officer
T: +44 (0)20 7123 5200
E simon.king@vermeerllp.com

Our previous thought piece published in January focussed on the unpredictable environment created by a series of risks and future events with binary outcomes. Unfortunately, very few of these have been resolved. In the meantime, most major markets have rebounded strongly from the travails of late 2018, and we sit broadly in the same position as in the Autumn of last year ie slowing global growth, subdued inflation and interest rates, and most Central Banks scratching their heads on when and how to move from Quantitative Easing to Quantitative Tightening.

Without wishing to sound like a broken record we would reiterate our views that the main challenges to the global economy remain the total absence of real productivity improvements and the willingness of many major governments to run huge budget deficits and run up enormous national debts. Persistently low interest rates mean the running costs of both can be met in the short term, but we maintain that this is simply kicking the can down the road and at some point, the current ruling generation will have to stop robbing the next.

The inconsistencies of the Trump administration continue to cause a mixture of disbelief, despair and amusement. The latest moves in US oil "policy" are a perfect example. The President has a stated aim of trying to keep oil prices low in order to keep a lid on inflation and promote domestic growth. His most recent decision to end the grace period for other countries to stop buying Iranian oil would (if successful) have a meaningful impact on world supply and push up prices. Trump appears to be hoping that Saudi Arabia steps in and increases production, which has given no intimation that it will. In addition, the main buyer of Iranian oil is China, which is unlikely to take much notice of the US ban unless the US chooses to ratchet up the current tariff war. The problem with this example and the numerous others we could mention from walls to health costs and federal shutdowns is the uncertainty it creates in an already difficult period for global economies.

The situation in the US is also being influenced by the trials and tribulations of the Federal Reserve. Its inconsistent policy announcements are leading to uncertainty and market volatility. This is not being helped by the unprecedented public criticism of its stance from the President nor the unusual decision by the Republicans to try and politicise the composition of the Fed's board when the convention is for its members to be as politically neutral as possible. Nonetheless the US is still in growth mode. It rarely pays to underestimate the innate level of optimism that drives the US economy, and presidential elections normally lend a short-term helping hand.

In the UK we see little point in further discussing the machinations of the Brexit process except to reiterate our view that it is having a serious impact on the UK economy. Government has reached a state of paralysis, with every major policy decision now deferred which compounds a previous poor period for active change. At a corporate level, companies are also holding off on investment decisions which means investment in capital will continue to be low. As has become the norm, companies are simply hiring more cheap and expendable labour to paper over the cracks.

The property market is a good example of this. The residential sector is slowly grinding to a halt with a combination of Brexit uncertainty and high levels of transaction costs i.e. Stamp Duty simply strangling the market. House price statistics are becoming irrelevant since a once liquid market has become illiquid. The Government needs to act because in the long-term people must be able to move easily and cheaply. The response so far has been to continue the deeply flawed Help to Buy scheme and to further review the market. As such we continue to review our clients' exposures to the quoted housebuilders which have provided good capital and income performance in recent years. Despite all this the UK market is not without its attractions. Domestic stocks are priced to have no good news which to us appears somewhat pessimistic. There will be a post-Brexit period at some point and then companies will return to making their normal investment decisions. We continue to hunt for UK investments on a selective basis.

We continue to be attracted to emerging markets in general, but India in particular is a market that intrigues us and where we are constantly looking for appropriate investments for our clients. On a global basis, India stands out as one of the few countries whose future growth is not overly dependent on the global economy. Its demographic profile and the point it is at in its economic development mean much of its growth can be internally generated. It does need further radical reform of some of its institutions and systems but if the Modi government is re-elected in the current elections then it can hopefully be somewhat bolder and improve on its previous efforts.

With all these issues washing around it is sometimes easy to lose sight of the bigger picture. As we look back at the decade since the financial crisis the fact is that the world economy has grown and is still growing at a modest pace but with several winners and losers both geographically and by industry. We still have large amounts of fiscal stimulus and debt and we still have low interest rates. It strikes us that we may be in a very similar position in another ten years' time and that we will look back and come to recognise this period as a mini Middle Ages with

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slow but barely discernible progress. In the words of baseball legend Yogi Berra "Its déjà vu all over again".

So, the obvious question given all the uncertainty we have outlined is how will we make money for our clients? The good news is that we continue to identify investments which have the qualities to make progress in all types of economic conditions. These may be large international companies with powerful brands and substantial financial firepower; or smaller companies with excellent market positions in niche areas that are continuing to grow; or vehicles with exposure to areas that are simply not economically sensitive. We seek these out across the globe and in areas where we do not have the specific resource or capacity to do so we will identify other best of breed fund managers who share our core principles of investing.