Quarterly Newsletter / Autumn 2017

Lacomp plc is an independent investment management company providing portfolio management services to private investors worldwide.

You may have read press reports relating to something called MiFID II. MiFID is another EU acronym and stands for Markets in Financial Instruments Directive. Financial instruments, in this case, are shares, bonds, units in collective investment schemes and derivatives, and MiFID is the EU legislation for both financial intermediaries as well as the venues (some 300 of them across Europe) where these instruments are traded.

The original MiFID of 2004, officially published in 2006 and becoming effective in 2007, replaced the 1993 Investment Services Directive. However, the financial crisis of 2008 exposed shortcomings in the legislation, and in 2014, the European Parliament approved an updated – and hopefully improved – version of the original MiFID. It was meant to be implemented by January 2017, but the European Council delayed that to January 2018, quoting "legal uncertainty and potential market disruption".

We are less than three months away from that date, but we understand that several national regulators, as well as many asset managers, are struggling to meet the deadline. This is not surprising, seeing that the new legislation is complex, to put it mildly, and contains no fewer than 1.4 *million* paragraphs!

Even at Lacomp, the new regime has meant a massive commitment in terms of management time and associated costs. As a client, you will have become aware of more paperwork – our fact finding, updating of 'Know your Client' documentation, suitability reports (including risk profile and the wonderfully named 'capacity for loss') will probably have caused a wry smile inasmuch as those of you who have known us for decades may find the change in requirements somewhat mystifying. Still, the new regulations ultimately are for your benefit and protection, and we should therefore embrace them rather than find them annoying.

If you think the new order is somewhat cumbersome for *you*, please bear in mind that the majority of the work is being carried out by us at Lacomp, and the FCA have been very helpful in providing us, only three months ago, with a Policy Statement fleshing out what we should do to meet the MiFID II requirements. It's on the internet if you care to read it, but I must warn you: it runs to 1,068 pages!

As another response to the 2007-09 financial crisis, the then US President Barack Obama introduced a number of measures in order to overhaul the US financial regulatory system. Among those was the establishment of the Office of Financial Research, an independent bureau of the US Treasury tasked with providing assistance to the Financial Stability Oversight Council. In their opinion, the collapse of Lehman Brothers highlighted, among other things, the problem of identifying the different market participants and how they were related or connected to each other.

Their answer was to propose what is now known as the Legal Entity Identifier (LEI) system which was endorsed by the G20 leaders at their Mexico meeting in June 2012. In short, every legal entity across the globe, whether it is a company, charity or trust, will each have its own LEI which consists of a 20-digit alphanumeric code. As many of our clients are affected by this new requirement, we will shortly be writing separately to you.

Looking at both MiFID II and LEI and its associated many months or, indeed, years of being works in progress, one can only wonder how long it will take to get the Brexit negotiations over the line. It is now 16 months since the EU referendum, and nothing of substance has happened. We have a split

cabinet, split Tory and Labour parties and, quite possibly, a split country. The other side, i.e. the EU, is not much better when you look below the surface of the veneer of unanimity as presented by the key operators in Brussels. It will be interesting to see whether the 27 heads of state will toe the 'party/Brussels line' at the EU Council summit later this week and present a united front. Chances are that they will, even though many are at loggerheads with Brussels, particularly when it comes to the question of immigration.

Theresa May and David Davis' dinner with Jean-Claude Juncker and Michel Barnier this week resulted in a joint statement that "negotiations would be accelerated" but in reality, the EU still insists on a sequenced agenda, namely that EU citizens in the UK should continue to fall under the jurisdiction of the European Court of Justice after Brexit, and that the question of the Irish border and the 'divorce bill' all have to be agreed on *before* trade talks can start. Anyone who has had the misfortune of going through a divorce in real life will know that the 'divorce bill' would only ever be agreed on when everything else had been settled.

In essence, the EU keep telling us that not enough progress has been made. That is typical of the way the EU handles its negotiations. If you are in any doubt, I suggest you read the book "Adults in the Room" by Yanis Varoufakis, the Marxist economist and academic who taught economics at various universities in many different countries and then became a politician and, for six months in 2015, was Greece's Finance Minister. His book describes the battles he had with the EU, and whilst it does not make pretty reading, it is absolutely fascinating. I actually think it should be compulsory reading for all UK politicians.

Has the Brexit squabbling affected financial markets? Well, the year to date has seen the UK underperform all other major markets, but it is still in positive territory. In fact, the only slight negatives are to be found in the gilt and corporate bond segments.

We have stressed on numerous occasions that it can be an error to conflate political risk with stock market performance which, in view of recent events, is just as well. Given the stresses induced by North Korea's missile testing and President Trump's less than conciliatory responses on Twitter – which Pyongyang has described as tantamount to a declaration of war – you could be forgiven for fearing that catastrophe is nigh. It might well be, in which case 'all bets are off' but, for the present, markets are largely shrugging off this possibility – China's Shanghai Composite index reached an all-time high this year despite being the closest country to North Korea in both diplomatic and economic terms.

We remain positive about the prospects for investment in the region, despite the unfortunate presence of the erratic and dangerous Mr. Kim. It just shows what a couple of years' Swiss education and eating too much cheese can do to you…

Asia accounts for over 20% of global growth yet remains under-represented in global indices, a situation that is likely to change as lower productivity and sluggish growth in the developed world continues to highlight the relative attractions of the region. The recent boost given to Chinese markets following its inclusion in the MSCI index points to the likely direction of travel.

Aside from geopolitics, investors also worry about climatic disasters, for instance the destructive hurricanes Irma, Juan, Maria and the latest one, Ophelia, together with major earthquakes in Mexico, as posing threats. Surely the devastation and disruption must impact not only on confidence levels and global economic activity but also on stock market conditions? Surprisingly perhaps, despite the undoubted human suffering and misery such events have caused, they appear to have had very little lasting market impact, especially as such disasters are followed by the economic stimulus of reconstruction.

The biggest impact on stock markets over the past few months has come from the forex markets where the relative moves of major currencies have affected share prices in most major exchanges. We have spoken of the spectacular collapse of sterling following the referendum last year which has given the

FTSE exporters a major boost and driven the UK indices to new levels. During January the FTSE 100 posted ten consecutive all-time highs, the first time since the index was created in 1984.

This currency effect is important as it has enabled the market to temporarily shrug off the appalling productivity figures – the UK productivity level is now back at pre-crisis levels with Germany producing £1.34 of goods for every pound's worth produced here. This is important as low productivity means low wage growth and falling consumer confidence. Lower consumption then leads to under-investment which further weighs on productivity. It is a vicious cycle, only partially offset by the benefits of a weak currency. This problem will not go away in a hurry and will need to be addressed at some stage soon.

Of equal importance, and often overlooked by UK investors, is the decline in the US dollar, albeit following a significant appreciation over the past five years on the back of a seemingly insatiable demand for US corporate debt. The decline has been gradual, admittedly, driven by frustrated speculations about the likelihood and timing of rate rises by the Federal Reserve and the thwarted ambitions of President Trump in respect of fiscal stimulus and infrastructure spending. Corporate earnings remain strong in the US but, despite the fact that more than 80% of companies posted increases in their bottom line, there was little sign of a corresponding spike in share prices. This is probably an indication that the market is near the top end of what could be considered fair value. Some observers regard it as too expensive, but we retain a more positive approach, keeping our current levels of exposure for the time being without significantly adding to holdings in the region.

Europe started the year with a potential deluge of political headwinds that have largely, if not entirely, dissipated on the back of qualified electoral success for mainstream parties over the threat of a populist wave of protest. The threat has not gone completely. Angela Merkel won her fourth term but the AfD (the nationalist 'Alternative for Germany') managed a sizeable share of the vote. In Austria, on the other hand, 31-year old Sebastian Kurz dragged his conservative People's Party to the right on a largely anti-immigration agenda and looks poised to become the world's youngest leader once he has decided which other party (the Social Democrats or the far-right Freedom Party) will be his coalition partner. That shift to the right was not expected and will have caused consternation in Brussels.

Overall, positive economic developments in the northern part of Europe mean that this is a region where we see some potential for market appreciation. We are selectively adding to European exposure where our clients' investor risk appetite is sufficient to justify such a move.

Much is written of the markets being over-valued and heading for an 'inevitable' fall. Some even argue that the collapse, if and when it comes, will be severe. This might well be the case but, at present, we see nothing obvious in the near future to trigger such an event.

We continue to invest across a broad range of equity markets, avoiding those that are clearly experiencing difficulties or appear over-valued and keeping a lookout for developments that might suddenly become a catalyst for negative change.

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