Quarterly Newsletter / Summer 2017

Lacomp plc

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At the beginning of the year it was quite easy to paint a less than rosy outlook for the global economy. At the risk of repeating the obvious, the Brexit referendum and the prospect of difficult negotiations with our European 'friends', the US election result, forecasts of an impending populist surge in general elections in the Netherlands, Austria and, above all, France all pointed to political uncertainties that would surely upset the markets. Furthermore, there were concerns about geopolitical developments (Middle East and North Korea) and the ever-present threat of terrorist attacks. It looked as though an uneasy time lay ahead.

And that was before Theresa May surprised us all by calling a snap general election. Was it a massive error of judgment on her part, or was the campaign spectacularly badly run? It is almost unbelievable that the Tories managed to fritter away a 20-point lead over Labour. As far as the campaign is concerned, we felt Mrs. May was wrong in not engaging more with the public. Had she participated in debates, she might have been received better than her special advisors Fiona Hill and Nick Timothy thought, even though her manner occasionally comes across as rather stilted and wooden. Hill and Timothy were her trusted advisors ever since she was Home Secretary, and many people felt she had given their views far too much credence. They quickly departed after the election, and not many tears were shed when they left. Members of staff thought them overbearing and unpleasant to deal with.

Labour, on the other hand, ran a breathtakingly successful campaign. Labour under Jeremy Corbyn's leadership previously had been considered unelectable, and the majority of Labour MPs wanted to get rid of him. Only a year ago, just after the Brexit referendum and following the resignations of more than two dozen members from Corbyn's shadow cabinet, a secret 'no confidence' ballot was tabled. Of the 229 Labour MPs, 13 abstained, and of the 95% turnout, 80% voted against him! This triggered a second leadership election, and Corbyn duly won that one as well.

A lot of the credit of Labour's showing in the general election must go to Momentum, the left-wing movement that was founded only two years ago after Corbyn's first leadership triumph. Some commentators say that Momentum are the reincarnation of the Militant tendency of the Seventies, an accusation Momentum refute. Momentum made clever use of technology, particularly in the area of social media. Whether you like them or not, you have got to give them their dues: they insisted that any member of Momentum must also be a signed-up Labour Party member, and that has increased the Labour Party membership to well over half a million.

Some political observers felt that Jeremy Corbyn in reality was not all that interested in winning the keys to Number 10 Downing Street – even he thought that was unattainable – but that his real motive had always been to move the Labour party well to the left. He seems to have succeeded in that, and there are fears of potential deselection of moderate Labour MPs.

Whether Momentum actually has any influence over Labour policy is a moot point. Nevertheless, Labour's anti-austerity stance, the promise of abolishing tuition fees, scrapping the public pay cap and other pledges clearly resonated with the millennials, particularly students and the young unemployed. They probably were not too disturbed by older people worrying about Labour taking the country back to the Seventies when the Labour Party was split down the middle. After all, they will never have heard of British Leyland and Red Robbo, Scargill et al, nor would they know about a decrepit (and state-owned!) railway service, a sugar shortage and the three-day week. They did not experience the winter of discontent, inflation at almost 30% and the humiliating bailout loan from the IMF.

So, although the Conservatives ended up with 318 seats against Labour's 262, it feels as though the Tories were the losers and Labour the winners. A Sunday Times cartoon showing two Lions rugby players leaving the field after their 15:30 loss against the All Blacks had one say to the other: "At least Jeremy Corbyn thinks we have won."

The Conservatives, propped up by the DUP through the so-called 'confidence and supply basis' agreement to ensure a working majority in the Commons, have a difficult time ahead. Theresa May is no longer perceived to be the strong and stable leader, and the rumour mill is working overtime as to how long she may remain at No. 10. Reports of a split cabinet abound, and cabinet discussion seemingly are no longer secret. There appear to be more leaks to the media than you would find in an old garden hose.

The Brexit negotiations now have started in earnest, and the statement in our January Newsletter that Mrs. May's cabinet and her backbenchers were split about which approach to take, still appears to hold true.

With all these events going on – quite apart from the potential worries referred to in our opening paragraph – and bearing in mind financial markets hate uncertainty, you would have reasonably expected the stock markets to have moved lower, but that did not happen. All major indices surprised by remaining in positive territory, with the single exception of the FTSE All Gilt index which fell by 1.1% over the first half of this year.

The FTSE All Share managed a modest 3.3%. With inflation gradually increasing, the Bank of England Monetary Policy Committee has been warning us for several months that interest rates may rise. In March, one member out of nine voted to increase the base rate, and last month three members took that view. However, the latest dip in inflation would suggest that those three monetary hawks may well have to reconsider their stance, and it is likely that the base rate will stay at 0.25% until next year.

You may remember that years ago, when quantitative easing was gathering momentum, the consensus of economists suggested that there would be a nasty inflationary sting in the tail. That clearly has not happened, so maybe the economists got it wrong – nothing new there! – or the central bankers, for once, got it right.

With savers only able to obtain a paltry income from deposit accounts, they are increasingly looking elsewhere for meaningful returns, and investments in shares with decent dividends offer a reasonable, if not risk free, alternative.

It would seem that this long-running bull market is not done yet.

Although we have concentrated on the UK election – please forgive us for boring you if you already are fed up with all media coverage! – America also is dealing with the aftermath of a surprise result.

President Trump's planned tax cuts and infrastructure expenditure had buoyed markets at the beginning of the year – if completed, the planned cut in corporation tax from 35% to 20% was anticipated to have led to a 12% rise in earnings per share on the S&P 500! – but this enthusiasm has stalled as the level of political opposition has become apparent. The expenditure had in part been predicated on the savings to be achieved from the dismantling of his predecessor's Affordable Care Act ('Obamacare') but this has proved a step too far even for many Republicans and the impasse has led many to question whether the planned expenditure will materialise in any meaningful volume. Added to the continued rumblings over the issue of Russian involvement in the election process, the US administration appears to be fire-fighting rather than governing.

A number of agreements/treaties have been revisited as Donald Trump seeks to deliver on his election promises – the Trans Pacific Partnership, the Paris Agreement (on climate change) and even the nuclear deal with Iran have all been targeted. These are all arguably 'foreign news' but the unravelling of NAFTA (the North American Free Trade Agreement) is much closer to home and could have a more immediate impact. An attempt to undo NAFTA ignores the fivefold growth in US exports to Mexico since its inception and threatens a possible trade war with a major trade partner which would be disastrous for US farmers already troubled by falling land values and weak pricing power.

President Trump's approach to economics in which everything is a zero-sum game and success can only be achieved at the expense of a competitor is both outmoded and dangerous. Ironically, if America does turn in on itself, it is likely that, rather than the promised surge in 'American jobs', mechanisation and robotics will be extended in an effort to maintain competitiveness. As history tells us, trade wars are disastrous for growth and protectionism hurts everyone.

The dangers of this have been partially negated by, of all people, President Xi of China, who championed the cause of globalisation at this year's Davos summit whilst his American counterpart talked protectionism. A curious reversal of traditional stereotypes if ever there was one! China will not be slow to step into the vacuum created by America's potential isolation policy, and the new 'silk road' is a clear indication that China has both the will and the means to take on a leading role in the global economy. China already contributed 35.9% of world GDP growth in 2015 and is clearly seeking to extend this further.

The world economy is beginning to diverge, underlining the need for a global approach to investment allocation. The US looks to be at a late stage of the cycle with growth slowing and inflation picking up, whilst here in the UK real wages are in decline and productivity remains a cause for concern. Conversely, emerging markets have seen inflation coming down whilst growth has been rising. India has finally pushed through tax changes which will greatly aid domestic trade and competitiveness. Even Europe is showing positive signs of recovery with production in May showing a 4% increase year-on-year. Whilst US equities look to be a little expensive and UK equities could be susceptible to volatility as the Brexit negotiations throw up uncertainties or problems, we see good long-term prospects in the emerging markets and, selectively, in European stocks.

Bagshot 20th July 2017